

Let nature take its course

By Tom Manning

Thursday, August 16, 2007

HONG KONG:

In the United States, cries of unfair competition are escalating as Chinese goods take over U.S. markets. Accused of manipulating exchange-rate policies to create more dependence on its low-priced products, China believes it is the one under attack. At the worst possible time, the frightening discovery of low-quality pet food, pharmaceuticals and toys from China has fueled the fire. In response, the U.S. Congress intends to pass veto-proof, punitive trade laws this year.

Should Congress pass legislation aimed at the economic policies of other countries? How will the Chinese react? Will they retaliate? Is the yuan really under-valued? If so, why are the Chinese not moving faster?

These issues demand debate before economic engineering precipitates retaliation from China and a trade war that no one wants.

Fundamentally, China believes that its foreign-exchange policy is a sovereign issue, that the country is in compliance with WTO requirements, and that social stability requires economic progress. Any punitive action on the part of the U.S. that questions sovereignty, criticizes performance or disrupts progress would be regarded as an attack that could prompt significant retaliatory measures, which must be anticipated.

China could retaliate in the form of consumer price inflation or credit withdrawal - or both. In fact, China is far less dependent on the United States than everyone assumes - and the United States is far more dependent on China than most people realize. China is not only the leading product supplier to the United States, but also its leading banker. As China expands from manufacturing to services, the ties between China and the United States will only deepen. If a trade war breaks out, the Chinese might be better equipped than the Americans to withstand the resulting difficulties.

A trade war could easily expand beyond economic issues. Today the U.S. and China exist in a multilateral domain; an ill-conceived trade war could affect, for example, the ability to manage threats from North Korea or the need for treaties involving space weaponry.

China could also delay growth opportunities that would benefit the U.S. Over the next decade, the Chinese domestic consumption engine will kick into full gear and begin to drive large portions of industry-wide revenue in the pharmaceutical field, the auto

industry, the electronics industry, and so on. The U.S. could benefit from China's consumption, but with a nasty trade war, this opportunity will collapse.

Against this backdrop, the U.S. should move slowly and cautiously to influence China's policies. There is little doubt that the yuan is undervalued, but sudden changes could bring about a dislocation that could adversely affect the U.S. as well as China. And many economists still disagree about the impact of a large revaluation of the yuan.

Importantly, the Chinese economy might even self-correct, if it does not self-destruct first. Hot as a pistol, the economy has no choice but to cool off soon. With annualized growth now at almost 12 percent, Beijing is deploying a myriad of measures to reign in the pace of expansion. The yuan has already appreciated substantially and could continue to rise. Moreover, in response to Americans' concerns with the quality of Chinese products, new imports from other Asian or Latin American countries could well reduce the over-reliance on China, leading to a voluntary re-pricing of the yuan sooner than expected.

So it is not a question of whether yuan revaluation should or will happen but rather a question of when and how it will be implemented.

Given the impact and potential contagion of wrong-headed global economic policy decisions, particularly from giants like the United States and China, it is imprudent to try to legislate how China should conduct its economic policy. And the U.S. account imbalance might even say less about the yuan than the U.S. reliance on consumption, suggesting that a "buy less and save more" strategy should be put on the U.S. agenda.

Furthermore, such action is clearly not the business of Congress but the province of the president.

The U.S typically wants to "hurry up and act," thinking action will eliminate a problem before it festers further. The Chinese have a different approach, which allows natural forces to correct problems. The U.S. might benefit from further measuring its response before its undue action causes reaction of a predictable kind.

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