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SINO-US TRADE WAR

Playing the Blame Game

Wang Yong

The prospect of a trade war, or even worse, a currency war, between two of the largest economies in the world—USA and China—has cast a shadow over the still unstable global economy.

The United States threatens economic sanctions on China, which makes the exchange rate issue even more complicated.

A serious, cool-headed calculation of the risks must first be thoroughly considered, for if such an economically detrimental situation comes, both China and the United States will lose, leaving the global economy severely damaged.

Why does the United States continue to pressure China to appreciate its currency-the *yuan*? And what are the chances of this pressure turning into action? US domestic politics and recent diplomatic frictions between the two countries can help answer these questions.

As the US mid-term elections approach, weakening political support for the Democratic party and President Barack Obama is beginning to show. It has become a grim challenge to maintain its current majority after the upcoming election. In order to gain political credit, advisors are obviously turning to a recent political practice in times of crisis, which is to blame China. Toughening the stance against China is conducive to divert popular dissatisfaction about Obama's economic policies; and taking actions on the yuan will boost the hopes of those voters who are complaining about high unemployment.

Fear is proliferating across the United States due to China's rapid economic growth, making it ideal for American politicians to implement policies that "take on" China. To reap immediate benefits, pressuring China's exchange rate was meant to win the support of "swing states" and their representatives in the Congress during the healthcare debate.

The threat of sanctions on Chinese goods could be useful to saving "face" following the recent bilateral diplomatic squabble over the US arms sales to Taiwan and Obama's meeting with the Dalai Lama.

The US Government tends to follow precedents of the past, with Chinese actions labeled "arrogant" or "tough." This friction is related to changes in the relative power position between the two countries in the wake of the global financial crisis, as the United States tries to let China know it is still the No.l.

Since July 2005, China's currency, also known as renminbi (yuan), has appreciated up to 21 percent. But against American expectations it has not helped to improve the US trade deficit. And China's trade surplus has not reduced.

Clearly, the shaping forces of today's exchange rate have gone far beyond bilateral trade. Doubts persist surrounding the effects the yuan appreciation will have on China's status as the "workshop of the world" or the boost it is expected to give American exports.

The Chinese economy will without doubt suffer damage from forced economic actions. First of all, 20 percent or more of the surcharge tariff will drive a large share of Chinese exports out of the US market and will significantly reduce external demands.

Second, a large number of workers in China's export processing zones will lose jobs, resulting in a slowdown of economic growth and social unrest.

Third, as more speculative capital enters China betting on the yuan appreciation, the asset bubble problem in China's economy will deteriorate and possibly spiral out of control.

A possible Sino-US trade and currency war will strike a severe blow to East Asia's economy as a whole. The so-called "Made-in-China" miracle has actually been a collective of division of labor across the region. In the past 15 years, East Asian economies including Japan, South Korea, Singapore, China's Taiwan and Hong Kong moved their assembly lines to China's mainland to take advantage of its cheap labor costs, and continue to target their exports on the US market.

These economies greatly reduced their trade surpluses with the United States. But it is China who takes the blame for creating the surplus. US can easily imagine the panic and damage that will ensue in East Asia regarding even the slightest possibility of a trade and currency war between these two giants.

A major setback will be caused to the faltering recovery of the global economy, too. Leading the world out of the recession, China has replaced the United States as the greatest engine of the economic growth. But the outbreak of a Sino-US economic war will only lead to global economic turmoil.

The panic from a Sino-US trade and currency war could drive capital holders to dump dollars to buy euros. And a substantial appreciation of the euro is definitely not what Europe wants to see right now.

When Obama took office in early 2009, his team proposed a series of ideas to strengthen the cooperation with China based on common interests over issues including North Korea, Afghanistan, Iran, antiterrorism, climate change and global governance reforms such as with the IMF and G20.

Despite frictions over American arms sales to Taiwan and Obama's meeting with the Dalai Lama, the basic pattern of common interests and attractive prospects of strategic cooperation between the two countries is still there. And the United States needs China's cooperation as much as it did before.

If Washington unilaterally triggers a trade and currency war, its relationship with Beijing will be severely damaged, and deteriorated domestic politics will make these and future collaborations more difficult. □□□

[courtesy : Beijing Review]