Trump's Chinese scapegoat

By Eswar Prasad
December 17, 2016 – *Project Syndicate*

US President-elect Donald Trump has once again managed to turn facts on their head. As part of a broader effort to take China to task for supposedly "raping" the United States economy through unfair trade policy, he has now renewed his accusation that the country manipulates its currency in order to gain an advantage for its exports. Such statements are as dangerous as they are unmoored from reality.

Make no mistake: Trump's accusation of Chinese currency manipulation is not supported by the facts. On the contrary, for the last two and a half years, the People's Bank of China (PBOC) has been intervening in currency markets for the opposite purpose: to prevent the renminbi's value from falling too sharply against the dollar.

China has lately faced a surge in capital outflows, which has created substantial downward pressure on the renminbi's exchange rate. Those outflows are partly a result of the Chinese government's easing of capital-account restrictions – an effort that should allow households, corporations, and institutional investors to diversify their portfolios by increasing their foreign holdings. The outflows also reflect concerns about China's economic prospects, including mounting financial risks, as well as fears among some wealthy Chinese that they may be targeted by President Xi Jinping's anti-corruption drive.

Rather than allow the renminbi's value to decline as fast as markets would dictate, the PBOC has stepped in to limit capital outflows and offset depreciation pressure. And China has incurred substantial costs: the PBOC's efforts to keep the value of the renminbi relatively stable against the dollar has contributed to a nearly $900 billion decline in China's foreign-exchange reserves from its June 2014 peak of about $4 trillion. (The falling value of currencies like the euro and the yen – which account for a share of China's reserves – relative to the US dollar has also contributed to the decline.)

The US benefits from China's approach. Indeed, if Trump demanded, as his predecessors have, that China allow markets to dictate its currency's value, the renminbi would depreciate even faster, boosting China's trade competitiveness *vis-à-vis* the US. In demanding that China stop the renminbi's market-driven depreciation, however, Trump is effectively calling on the country to do exactly what the US has always condemned: intervene directly in currency markets.

Those are the facts. But Trump does not deal in facts. And now that he is no longer just a presidential candidate, his accusations can no longer be dismissed as bluster. With Trump in the White House, what was once viewed in the US as the "nuclear" option – officially charging China with currency manipulation and imposing high across-the-board tariffs on Chinese imports – has become a strong possibility.

Trump knows that fulfilling his promise to revive US manufacturing with domestic policy changes that boost American companies' international competitiveness would be difficult to implement and take a long time to pay off. To him, "getting tough" on China – through both words and action – probably seems like a convenient workaround.

But, far from advancing Trump's goals, such moves would probably elicit an immediate and aggressive Chinese counterstrike. The likely result would be a downward spiral of retaliatory restrictions on bilateral trade and investment flows, which would hurt both economies.

A charitable interpretation is that, as a tough and pragmatic businessman, Trump is simply using threats to stake out a strong bargaining position, and that sense and reason will ultimately prevail. But the longer Trump's incendiary rhetoric continues, the higher the risk that it will produce real-world consequences.

Even the *prospect* of a trade war with China could be enough to damage the US economy. Already, Trump's post-election policy pronouncements – and the uncertainty he has unleashed – have pushed up the dollar's value; after all, the US has long been a relatively safe haven in times of uncertainty (even when it is the cause of it).

While the threat of a trade war with China and the notion of the US abrogating existing trade deals hurts other countries' short-term growth prospects more than those of the US, a rising dollar is bad news for Trump. His promises to increase US exports and bring back manufacturing jobs from countries with cheaper labor would be difficult to fulfill in the best of times. With a stronger dollar undermining US manufacturing's international competitiveness, it would be even more difficult, at least in the short run.

Trump may try to spin these failures, especially as the capital inflows that are helping to push up the dollar's value lower the federal government's financing costs, thereby creating more room for Trump to pursue his fiscal policy goals. But the fact remains that, if Trump's heated protectionist rhetoric continues, the US will face a strong dollar, severely weakened exporters, and a much larger trade deficit – not to mention heightened tensions with a formidable China.

Talking tough may play well at victory rallies, but it doesn't change the facts. If Trump continues down his current path, the US economy will suffer – and so will his standing among the American voters who still, for whatever reason, believe in him.

Eswar Prasad is Professor of Trade Policy at the Dyson School of Applied Economics and Management, Cornell University, and a senior fellow at the Brookings Institution.