Trump isn’t wrong on China currency manipulation, just late

By Eduardo Porter

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Has the United States mismanaged the ascent of China?

By April 15, the Treasury Department is required to present to Congress a report on the exchange rate policies of the country’s major trading partners, intended to identify manipulators that cheapen their currency to make their exports more attractive and gain market share in the United States, a designation that could eventually lead to retaliation.

It would be hard, these days, to find an economist who feels China fits the bill. Under a trade law passed in 2015, a country must meet three criteria: It would have to have a “material” trade surplus with the rest of the world, have a “significant” surplus with the United States, and intervene persistently in foreign exchange markets to push its currency in one direction.

While China’s surplus with the United States is pretty big — almost $350 billion — its global surplus is modest, at 2.4 percent of its gross domestic product last year. Most significant, it has been pushing its currency up, not down. Since the middle of 2014 it has sold over $1 trillion from its reserves to prop up the renminbi, under pressure from capital flight by Chinese companies and savers.

Even President Trump — who as a candidate promised to label China a currency manipulator on Day 1 and put a 45 percent tariff on imports of Chinese goods — seems to be backing away from broad, immediate retaliation.

And yet the temptation remains. “When you talk about currency manipulation, when you talk about devaluations,” the Chinese “are world champions,” Mr. Trump told The Financial Times, ahead of the state visit of the Chinese leader, Xi Jinping, to the United States last week.

For all Mr. Trump’s random impulsiveness and bluster — and despite his lack of a coherent strategy to engage with what is likely soon to become the world’s biggest economy — he is not entirely alone with his views.

Many learned economists and policy experts ruefully acknowledge that the president’s intuition is broadly right: While labeling China a currency manipulator now would look ridiculous, the United States should have done it a long time ago.

“With the benefit of hindsight, China should have been named,” said Brad Setser, an expert on international economics and finance who worked in the Obama administration and is now at the Council on Foreign Relations.

There were reasonable arguments against putting China on the spot and starting a process that could eventually lead to American retaliation.

Yet by not pushing back against China’s currency manipulation, and allowing China to deploy an arsenal of trade tactics of dubious legality to increase exports to the United States, successive administrations — Republican and Democratic — arguably contributed to the economic dislocations that pummeled so many American workers over more than a decade. Those dislocations helped propel Mr. Trump to power.

From 2000 to 2014 China definitely suppressed the rise of the renminbi to maintain a competitive advantage for its exports, buying dollars hand over fist and adding $4 trillion to its foreign reserves over the period. Until 2005, the Chinese government kept the renminbi pegged to the dollar, following it down as the greenback slid against other major currencies starting in 2003.

American multinationals were flocking into China, taking advantage of its entry into the World Trade Organization in December 2001, which guaranteed access to the American and other world markets for its exports. By 2007, China's broad trade surplus hit 10 percent of its gross domestic product — an unheard-of imbalance for an economy this large. And its surplus with the United States amounted to a full third of the American deficit with the world.

Though the requirement that the Treasury identify currency manipulators "gaining unfair competitive advantage in international trade" dates back to the Omnibus Trade and Competitiveness Act of 1988, China was never called out.

There were good reasons. Or at least they seemed so at the time. For one, China hands in the administration of George W. Bush argued that putting China on the spot would make negotiations more difficult, because even Chinese leaders who understood the need to allow their currency to rise could not be seen to bow to American pressure.

Labeling China a manipulator could have severely hindered progress in other areas of a complex bilateral economic relationship. And the United States had bigger fish to fry.

"There were other dimensions of China's economic policies that were seen as more important to U.S. economic and business interests," Eswar Prasad, who headed the China desk at the International Monetary Fund and is now a professor at Cornell, told me. These included "greater market access, better intellectual property rights protection, easier access to investment opportunities, etc."

At the end of the day, economists argued at the time, Chinese exchange rate policies didn't cost the United States much. After all, in 2007 the United States was operating at full employment. The trade deficit was because of Americans' dismal savings rate and supercharged consumption, not a cheap renminbi. After all, if Americans wanted to consume more than they created, they had to get it somewhere.

And the United States had a stake in China's rise. A crucial strategic goal of American foreign policy since Mao's death had been how to peacefully incorporate China into the existing order of free-market economies, bound by international law into the fabric of the postwar multilateral institutions.

And the strategy even worked — a little bit. China did allow its currency to rise a little from 2005 to 2008. And when the financial crisis hit, it took the foot off the export pedal and deployed a giant fiscal stimulus, which bolstered internal demand.

Yet though these arguments may all be true, they omitted an important consideration: The overhaul of the world economy imposed by China's global rise also created losers.

In a set of influential papers that have come to inform the thinking about the United States' relations with China, David Autor, Daron Acemoglu and Brendan Price from the Massachusetts Institute of Technology; Gordon Hanson from the University of California, San Diego; and David Dorn from the University of Zurich concluded that lots of American workers, in many communities, suffered a blow from which they never recovered.

Rising Chinese imports from 1999 to 2011 cost up to 2.4 million American jobs, one paper estimated. Another found that sagging wages in local labor markets exposed to Chinese competition reduced earnings by $213 per adult per year.

Economic theory posited that a developed country like the United States would adjust to import competition by moving workers into more advanced industries that competed successfully in global markets. In the real world of American workers exposed to the rush of imports after China erupted onto world markets, the adjustment didn't happen.

If mediocre job prospects and low wages didn't stop American families from consuming, it was because the American financial system was flush with Chinese cash and willing to lend, financing their homes and refinancing them to buy the furniture. But that equilibrium didn't end well either, did it?

What it left was a lot of betrayed anger floating around among many Americans on the wrong end of these dynamics. "By not following the law, the administration sent a political signal that the U.S. wouldn't stand up to Chinese cheating," said Edward Alden, a senior fellow at the Council on Foreign Relations. "As we can see now, that hurt in terms of maintaining political support for open trade."

If there was a winner from this dynamic, it was Mr. Trump.

Will Mr. Trump really go after China? In addition to an expected executive order to retaliate against the dumping of Chinese steel, he has promised more. He could tinker with the definitions of "material" and "significant" trade surpluses to justify a manipulation charge.

And yet a charge of manipulation would add irony upon irony. "It would be incredibly ironic not to have named China a manipulator when it was manipulating, and name it when it is not," Mr. Setser told me. And Mr. Trump would be retaliating against the economic dynamic that handed him the presidency.