

Global: Daily Economic
Comment

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Economic Trends

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Protectionist Tilt

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- Shocked in Washington**
 Protectionist sentiment is reaching a bipartisan boiling point in the US Congress; I witnessed that first while testifying in front of a congressionally-mandated commission on US-China relationships.
- Dark side of the jobless recovery**
 Republicans and Democrats, alike, are up in arms over the steady attrition of employment in this so-called economic recovery; unrelenting layoffs, together with record and ever-widening US trade deficits, are a toxic combination in this highly charged political season.
- China the scapegoat**
 Congressmen are accusing China of relying on the combination of currency manipulation and unfair trading practices to rob American workers of their rightful livelihood; the degree of venom leads me to believe that Congress feels utterly compelled to act.
- Protectionist legislation aimed at China**
 Proposed legislation in both the Senate and the House would result in heavy tariffs — some 27.5% under the Senate version — on all Chinese goods sold in the US; that would take a serious toll on global trade, outsourcing, and world GDP.
- New risks for global rebalancing?**
 Post Dubai, I now find myself doubting the commitment of the US body politic to a non-binding and admittedly vague G-7 communiqué; nor is the reaction on Capitol Hill an outlier — there has also been worrisome post-Dubai pushback from Japan and Europe.
- Set back**
 The G-7's vision of market-determined exchange rates as depicted in the Dubai communiqué fit the script of global rebalancing like a glove; unfortunately, post-Dubai political backlash has been worse than I have feared — shifting the odds away from the benign resolution that I had just started to lean toward.

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Protectionist Tilt

As expressed in Dubai, the G-7's vision of market-determined exchange rates fit the script of global rebalancing like a glove. It promised the one shift in relative prices — a weaker dollar — that a lopsided, US-centric world so desperately needs. For a world beset by massive and unsustainable external imbalances, the G-7 recipe offered the best possible endgame — a balanced global economy. It was the perfect ending to my bad dreams of the past four years.

I should have known better. A day in Washington has seriously dampened my newfound optimism. Cries of protectionism can be heard loud and clear in the hallowed halls of the US Congress. America's jobless recovery has finally reached a breaking point. Republicans and Democrats, alike, are up in arms over the steady attrition of employment in this so-called economic recovery. Job-related distress is bad enough. But unrelenting layoffs, together with record and ever-widening US trade deficits, are a toxic combination in this highly charged political season. For Congress, the agenda is clear: It is now time for action against those deemed responsible for the distress of the American worker. China is the target.

That was the unmistakable message I took away from participating in congressionally-mandated hearings held 25 September on Capitol Hill. The hearings were called by the US-China Economic and Security Review Commission, a permanent arm of the US Congress whose 12 members are selected by the majority and minority leadership of the House and the Senate. This group is charged with the weighty task of assessing the national security implications of the bilateral relationship between the United States and China. Under its charter, the Commission is also given the mandate "...to provide recommendations, where appropriate, to Congress for legislative and administrative action." And so I was summoned as a so-called expert witness for a hearing on "China's Industrial, Investment and Exchange Rate Policies: Impact on the United States." Little did I know of the fireworks that awaited me.

The hearing started with a parade of Senators and Representatives who were unanimous in blaming China for all that ails the American worker. As of a few days ago, there were only two congressmen slated to appear. At least seven actually showed up, with both political parties and all geographic regions of the country well represented. The

degree of venom was extraordinary. It left little doubt in my mind as to where this debate is headed. In the eyes of these politicians, China should be held accountable for the virtual destruction of America's industrial base. Never mind the secular downtrend in US factory sector employment that has been evident for more than 45 years. It is China's emergence that is now billed as the coup de grâce. The consensus of the members of Congress that appeared at this hearing was crystal clear: They are accusing China of relying on the combination of currency manipulation and unfair trading practices to rob American workers of their rightful livelihood.

But this US Congress is not all bluster. America's legislators believe China must now be stopped at all costs. In keeping with this sentiment, protectionist legislation has recently been introduced in both chambers of the Congress that would slap huge tariffs on all Chinese imports into the US. The Senate version (S 1586) sets that tariff at 27.5% — midway between the 15% to 40% estimates the sponsors believe are reasonable approximations of the undervaluation of China's currency. The House version (HR 3058) also imposes across-the-board tariffs on Chinese imports, with the tariff rate to be determined by a computation of the "rate of manipulation" of the RMB. At the hearing, one of the House sponsors implied that the calculated tariff under that formula could easily exceed the 27.5% rate of the Senate bill. For what it's worth, I argued in my own testimony that those estimates of RMB undervaluation are highly dubious for a Chinese economy that ran only an US\$8.9 billion trade surplus in the first eight months of 2003, less than half the pace of a year ago. That observation, as did the rest of my case for the scapegoating of China, rang on deaf ears in this bipartisan onslaught of China-bashing (see my 25 September testimony, *Getting China Right*, available on our website).

Don't get me wrong. I am not jumping to the conclusion that the enactment of these bills should be taken as a given. Hopefully, some semblance of reason will prevail in the end. But after this experience in Washington, I would now assign a lower probability to such hopes. An important shift of Congressional sentiment must be taken seriously. If I'm reading the mood of Congress correctly, America's legislators are dead set on forcing China's hand — one way or another. One of the most seasoned members of the Commission — a 30-year veteran of the Hill — came up to

me after my session ended and said, “Your arguments are solid, but the political train has left the station. I can smell it — something big is coming.” Other veterans present at this hearing came to similar conclusions and cited comparable reactions of shock at the inflammatory rhetoric. Even for the consummate Washington insiders, this hearing was over the top. Sadly, I guess that’s the bottom line: America’s jobless recovery has pushed a bipartisan coalition of US politicians to the brink. Unless there is a spontaneous resurgence of hiring — and quickly — US pressure on China seems set to intensify dramatically further in the months ahead.

The political economy of heightened trade frictions is hardly inconsequential for financial markets. Not only would such tendencies be disruptive to global trade and outsourcing but they would also represent a tax on consumers — ironically, the same workers that politicians are so desperate to protect. All that spells a clear negative for world GDP growth. That’s always been the risk on the dark side of an unbalanced global economy. From the start,

I have maintained that there were two avenues of resolution for a world beset with ever-widening external imbalances — the economics of a US current-account adjustment driven largely by a weaker dollar or the politics of trade frictions and protectionism. At Dubai, the G-7 took an important step in endorsing the economics of global rebalancing — a step that made me more optimistic than I have been in some time. But what I witnessed in Washington was far worse than I had feared. I now find myself doubting the commitment of the US body politic to a non-binding and admittedly vague communiqué. Nor is the post-Dubai reaction on Capitol Hill an outlier. There has also been worrisome pushback from Japan and Europe.

In the end, jobs are the hot-button for any politician. And the heat is now reaching a boiling point in the US Congress. Never before has a modern-day recovery in the US economy been accompanied by such carnage on the job front. The trade deficit is the icing on the cake. Protectionism is in the air, and China is the target. What a let-down.

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