It is essential that the U.S. capitalize on vehicles such as the U.S. China Strategic Economic Dialogue (SED) to hold China to its intentions for further appreciation. With successful dialogue and engagement, the SED will allow the U.S. to address fully the threats that are apparent as a result of China’s currency valuation and its expectations for China’s continued commitment to appreciation. Moreover, as Japan’s case has identified, hasty appreciation in practice may not be the solution to reducing a trade deficit to a sufficient level.

In conclusion, while Japan has relaxed some of its protectionist polices of the 1980s, this case study has shown that the U.S. still maintains one of the largest trade deficits with this country that has a proven record of currency appreciations. This case study also provided evidence to substantiate the fact that reducing the U.S.-China trade deficit will require a multifaceted approach that involves constant engagement between all parties affected. Moreover, while unilateral action should never be taken off the table, it should take a back seat to a multilateral approach that could be mutually beneficial. In the end, the U.S. could have the potential to not only reach its goal of a more balanced bilateral exchange with China but also maintain a stable ally in the process.

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96 The SED was established by Presidents Bush and Hu as a framework for addressing issues of mutual concern and a mechanism for managing the U.S.-China economic relationship on a strategic basis.
5.1 INTRODUCTION

The preceding chapters discussed the various policy implications and respective positions as to how an undervalued RMB affects the U.S. economy. The remainder of this thesis will focus on the assortment of policy options proposed by a number of policy makers, each in an attempt to compel a reluctant Chinese government to accelerate appreciation of the RMB.

In 2007, the value of the RMB against the dollar increased 6.9 percent and some analyst expect an appreciation of at least 7-10 percent by the end of 2008. This revaluation along with many others corroborate the fact that China is staying to its commitment to gradually appreciate the RMB. However, for many policymakers in Washington, appreciation at a snails pace is not fast enough.

To reiterate a point from the case study in Chapter four, agitation and scrutiny over China’s currency valuation is at an all time high, and it will take an appreciation of Japanese proportions in order to settle many American critics. Furthermore, the numerous concerned Americans placing tremendous pressure on Congress and the Bush Administration to implement aggressive measures that reconcile the disparities an undervalued RMB presents to the U.S. economy, outnumber those who favor a laissez faire approach. To this, many Americans may regard a subtle approach to addressing this issue as the equivalent to inaction. Therefore, as pressure builds, a response from the U.S. can be expected. The real question is what type of response will the U.S. ultimately

undertake. This question is the focus of chapter five as the leading policy options are considered and discussed in detail.

Congress has introduced a variety of bills specifically aimed at addressing China’s currency value, many of which have gained significant support in both the House and Senate. Particularly, four pieces of legislation out of the seven introduced during the 110th Congress have achieved broad approval and gained the attention from many economists and interest groups who agree that unilateral action is necessary. This chapter takes a deeper look into these bills introduced in Congress, and the idea behind their concept.

The Bush Administration on the other hand, as have previous administrations, has shown more reluctance toward an overly aggressive and unilateral approach. Indeed, the growing support in Congress for revaluation has gotten the attention of the administration, but the Executive Branch has so far been successful in preventing the passage of any major currency legislation. However, it should not go unnoticed that the administration has also been successful in maintaining pressure on the Chinese government in ensuring the continuation of strategic dialogue and engagement. Further examination of the administrations policies toward this issue will be examined.

The scope of this chapter focuses on how the proposed policies will affect China’s currency policy. However, trade is also discussed at length given the nexus between currency and trade. In addition, the approach that many pieces of legislation take is directed at Chinese imports to recompense for the costs to the U.S. economy as a result of an undervalued RMB. Furthermore, the reader will not only be provided a thorough
analysis of the policy proposals but also the variety of angles from which currency disputes can be addressed.

5.2 LEGISLATIVE BRANCH

Since 2003 Members of Congress have introduced legislation specifically targeted toward forcing China to revalue the RMB. Many pieces of legislation range in their approach to addressing this issue but all have a similar objective as the end goal. Democrats and Republicans have largely begun to work together as the issue of China’s currency valuation continues to become a difficult issue for many policymakers. Given that, not many high profile bills in Congress get broad bipartisan support, the fact that China currency legislation is attracting wide-ranging support demonstrates the increasing importance of this topic.

During the 109th Congress, legislative action was taken on one measure in the House and another in the Senate, both of which served as a subsequent display of the true support for currency legislation in Congress. The first legislation considered was amendment S. Amdt. 309, in the Senate offered by Senator Schumie, a Democrat from New York and 14 cosponsors. The amendment was offered to S. 600 the Foreign Affairs Authorization Act for Fiscal Years (FY) 2006 and 2007. This amendment required China to appreciate the RMB to market levels or face a 27.5 percent tariff on Chinese goods imported in the U.S. A motion was offered to table this particular amendment, an action that would have essentially killed consideration of the measure. With a vote of 33 to 67, the motion failed with an unforeseen display of support for consideration of legislation.

aimed at China’s currency value. Senator Schumer, as the sponsor of the amendment admitted, never expected the large pool of support for such a measure in the Senate, but he later removed consideration of the amendment and similar stand-alone legislation after consulting with the administration.

Senator Schumer was the first member of Congress to introduce legislation specifically aimed at addressing the value of the RMB.99 S. 1586 or as it is commonly referred to, “Schumer-Graham bill,” came on the back of a mounting U.S. trade deficit with China and was intended to address the disparities created as a direct result of China’s undervalued currency. Similar to S.Amdt.309, this bill would have imposed high tariffs on Chinese imports to the U.S. and required the Administration to negotiate with the Chinese government to ensure a process that leads to a market-based system of currency valuation.100

The second piece of legislation considered in Congress, The United States Trade Rights Enforcement Act (H.R. 3283), was taken up in the House of Representatives. Introduced by Congressman Phil English, a Republican from Pennsylvania and 14 cosponsors, this legislation first came to the House floor for consideration on July 26, 2005. In an attempt to pass this legislation under suspension of the House rules, which limits debate and requires a 2/3 majority vote for passage, the bill failed by a vote of 240 to 186. However, after considering the bill under normal rules of the House and allowing proper deliberation, the legislation passed the House the next day by a vote of 255-168.

This legislation was directly aimed at the effect that China’s undervalued currency had on the U.S. trade deficit by primarily doing the following:101

- Authorizing the application of U.S. countervailing duty law to exports from China.
- Requiring the Department Treasury to submit a report to Congress defining currency manipulation, describing actions of foreign countries that would be considered currency manipulation, and describing how statutory provisions addressing currency manipulation can be better clarified administratively to provide for improved and more predictable evaluation.
- Authorizing funds for the International Trade Commission (ITC) and requiring an ITC report on the sensitivity of U.S. trade and jobs to currency policies.

The legislation differed from Senator Schumer’s legislation by including a variety of measures in one bill to address China’s currency value. The first measure was similar to the Schumer bill by focusing on U.S. imports from China. Essentially, the bill would require countervailing (CVD) duties to be applied to certain merchandise exported from China. The second measure aimed to alter the definitions of which the Department of Treasury could determine manipulation of currency by another country as outlined in the 1988 Omnibus Trade and Competitiveness Act. This move would, for all intents and purposes, tie the hands of the Secretary of Treasury by forcing him to define China’s currency practices as manipulative, which would subsequently force the administration to take action to reconcile this matter. The final measure in this bill aimed directly at China,

would require the ITC to provide an official report to Congress that displays the
connection between China’s currency practices and the affect on domestic jobs in the
U.S. While these measures gained wide support and subsequently passed the House, the
legislation was referred to the Senate Committee on Finance where it was stalled and
never brought to the Senate floor for consideration.

Currently in the 110th Congress there are four bills in particular that have gained
wide attention and considered as likely measures that could be brought to the floor in
both the House and Senate. While all four bills are similar in their fundamental
approach, they each take unique issue with certain aspects of the U.S regulatory authority
over various Chinese economic polices that relate to the U.S. For example, each bill
takes issue with the way the Department of Treasury identifies currency manipulation.
Two of the bills pursue action via U.S. countervailing laws while two others pursue
retribution byway of U.S. anti-dumping (AD) laws, and all four bills attempt to take
action in the WTO and IMF. Lastly, the official title of each bill overtly exhibits their
intention for currency reform, their indiscriminate way of not including China in the title
notwithstanding. These four pieces of legislation include:

* H.R. 782, the Fair Currency Act of 2007, introduced by Congressmen Tim Ryan
  and Duncan Hunter

* H.R. 2942, the Currency Reform for Fair Trade Act of 2007, also introduced by
  Congressmen Tim Ryan and Duncan Hunter

* S. 1607, the Currency Exchange Rate Oversight Reform Act of 2007, introduced
  by Senator Spencer Baucus

* S.1677, the Currency Reform and Financial Markets Access Act of 2007,
  introduced by Senator Chris Dodd
The first Ryan-Hunter bill was introduced during the 109th Congress as H.R. 1498, the Chinese Currency Act of 2005. The legislation was cosponsored by 178 members, which included a number of Democrats and Republicans. However, the bill never made it out of committee before the end of the 109th Congress.\footnote{All bills introduced during a congressional cycle of two years, if not passed and sign into law before the end of the cycle, are no longer valid and for future consideration, they must be reintroduced during subsequent congressional cycles.} They later introduced H.R. 782, the Fair Currency Act of 2007, which maintained the commonly referred to name, the Ryan-Hunter bill.

It is clear that in their second attempt to pass legislation that addressed China’s undervalued currency, they decided to broaden their focus of currency manipulation. This new approach is apparent in the name of the bill, the Fair Currency Act of 2007, which signifies a considerable shift in addressing China specifically as did preceding legislation. Moreover, H.R. 782 also goes a step further by directing the measures in the bill toward non-market economy countries.\footnote{Non-market economy country means a country that does not operate on market principles of cost and pricing structures so that sales of merchandise in such country reflect the fair value of the merchandise.}

Reps. Ryan and Hunter, in a letter soliciting support from colleagues in Congress highlighted the point in their bill that Congress must act to address currency manipulations and not depend on the Department of Commerce or Treasury for that matter. The letter displays a cartoon of Lucy duping Charlie Brown from the famous cartoon “Peanuts,” by yanking a football just as Charlie Brown is kicking it, causing him to fall to the ground.\footnote{See appendix 5.1} The cartoon is accompanied with the questions, “Did H.R. 782 just get “Lucy’d” by the Department of Commerce.” The letter essentially addresses the
point that if Congress were to act on H.R. 782, Congressional intent of resolving misaligned currencies and inequitable trading practices would be addressed.

Three parts of this very diverse legislation appear to be directly targeted toward China’s currency practices. The first, and one of the most important measures in the bill, seeks to classify China’s currency undervaluation as the equivalent of a government subsidy. The argument that China’s undervalued currency is in essence a subsidy is one of the more contemporary arguments of many economists, labor unions, and U.S. manufacturers.\(^{105}\) At issue in their argument, is the notion that Chinese authorities artificially maintain an undervalued RMB at a calculating level in an effort to boost exports, a sector which its economy heavily depends on.

H.R. 782 amends the Tariff Act of 1930 by expanding the authority in the law to impose CVD to non-market economy countries that are proven to be providing unlawful subsidies.\(^{106}\) The authority is expanded in this bill by clarifying the definitions by which currency manipulation could be considered a subsidy. Furthermore, H.R. 782, includes a definition that is consistent with Articles 1, 2, and 3 of the Subsidies and Countervailing Measures Agreement (SCM) in the WTO. The SCM list the following three principle factors as constituting a prohibited countervailable export subsidy: a financial contribution by the exporter’s government, a benefit conferred on the exporters, and export contingency.\(^{107}\)

With this new clarification of a government-prolonged employment of a misaligned currency as an export subsidy, H.R. 782 would then apply these new terms to

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107 See World Trade Organization, Coverage of the Agreement
countries who employ a “dirty float” exchange rate regime.\textsuperscript{108} Forbes defines a dirty float as a system of floating exchange rates in which the government occasionally intervenes to change the direction of the value of the country’s currency. Therefore, this is essentially a measure aimed directly at China’s managed float of its currency via its currency basket exchange rate regime. Under this bill, as long as China continues to maintain this policy, their imports to the U.S. would face the imposition of CVD laws. Since China’s economy hinges on its export market, if it was not able to sustain sharp decreases in exports to the U.S. due to stiff tariffs, it would then be forced to acquiesce to U.S. pressure to appreciate the RMB.

The third measure, would adjust the criterion in the 1988 Omnibus Trade and Competitiveness Act from which the Department of Treasury determines whether a country is manipulating its currency. However, H.R. 782 broadens the responsibility of Treasury to report countries whose currency is fundamentally misaligned\textsuperscript{109} and seek out measures to resolve the issue with those countries who are reported.\textsuperscript{110} This provision augments the possibility that Treasury could report China as a currency manipulator, thus forcing it to appreciate to some level.

H.R. 782 has not come to the House floor for consideration, however, it has been referred to the Committee on Ways and Means, Financial Services, Foreign Affairs, and Armed Services. To date, this legislation has wide support with 119 cosponsors that include Democrats and Republicans.

\textsuperscript{109} The bill has a specific definition of a misaligned currency that is stated as a material sustained disparity between the observed levels of an effective exchange rate for a currency and the corresponding levels of an effective exchange rate for that currency that would be consistent with fundamental macroeconomic conditions based on a generally accepted economic rationale.
The second Ryan-Hunter legislation, H.R. 2942 the Currency Reform for Fair Trade Act of 2007, is an updated version of H.R. 782. It was introduced on June 28, 2007 and has a total of 70 cosponsors. This legislation has broad support in Congress and in the manufacturing sectors faced with increased competition due to an undervalued RMB.

Similar to H.R. 782, this legislation aims to expand the criterion for an unlawful subsidy by including an undervalued currency. However, this legislation, in response to the new definitions of a subsidy, would allow unfair currency practices or currency misalignment to be taken into consideration in AD cases. In a letter to their colleagues in Congress, Reps. Ryan and Hunter stated that this new measure would provide a trade remedy for injured U.S. companies faced with a competitive disadvantage due to unfair currency undervaluation.\(^{111}\) If passed, this legislation is expected to induce appreciation of the RMB through punitive measures as a direct result of the damage caused to U.S. industries affected by China’s undervalued currency.

Aside from China currency legislation in the House, two similar measures have been introduced in the Senate. The first, introduced by Senators Max Baucus a Democrat from Montana, and Charles Grassley, a Republican from Iowa. Both Senators serve on the Senate Committee on Finance, which has jurisdiction over trade policy, in the prominent positions of Chairman and Ranking Member. Given their influence on the committee, they were not only able to successfully introduce the bill with 13 cosponsors, but also able to pass S.1607 through the committee by a vote of 20 to 1. This all but unanimous vote in the Senate Committee on Finance may serve as a harbinger for what could come if brought to the floor for full consideration.

\(^{111}\) See appendix 5.2

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This legislation takes on many of the provisions that are included in both Ryan-Hunter bills in the House. It would create new definitions for currency misalignment from which the Secretary could report to Congress on currencies that are significantly misaligned. The bill would also include methods of reprisal consisting of tariffs to impose in the event that a country fails to reconcile currency disputes with the Secretary of Treasury, in addition to allowing the U.S. to file AD cases against a country who prolongs use of a currency regime considered to be misaligned. However, this legislation includes two unique provisions that are worth highlighting in this section.

The first provision would give the country identified as having a currency that is misaligned, 90 days to work in consultation with the U.S. Treasury to reconcile the discrepancies with its currency. If the country fails to do so within the specified period, the U.S. government would prohibit federal procurement of products from that country. The second punitive measure would include suspending all Overseas Private Investment Corporation (OPIC) financing in addition to directing other multilateral development banks to oppose financing in that country. In the case of China, these measures are intended to take direct aim at its financing capabilities in an attempt to force immediate appreciation of the RMB.

The second currency bill in the Senate is H.R. 1677, the Currency Reform and Financial Markets Access Act of 2007. Senators Chris Dodd a Democrat from Connecticut, and Richard Shelby a Republican from Alabama, also the Chairman and Ranking Member on the Senate Committee on Banking, Housing, and Urban Affairs, introduced this legislation. This bill differs from the other three in that it only sets requirements for the Department of Treasury in how to deal with currency manipulation.

Specifically, it would no longer allow the Treasury Department to skirt on the issue of currency manipulation without officially naming questionable countries. As in the case with China, it has fallen short of being labeled a currency manipulator since 1994. However, the Secretary of Treasury, in his bi-annual report to Congress, has identified China’s progress and its intent to continue appreciation. S. 1677 would require a report from the Department of Treasury that identifies all culpable countries regardless of their intent. In addition, the report would also be required to include timelines, benchmarks, and other identifiable plans of action that aim to resolve the currency disputes with the country in question.

The fact that both bills in the Senate are supported by the Chairman and Ranking Member of the respective Committees of Jurisdiction, yields a strong signal that enactment of currency legislation may not be far away, providing that China doesn’t revalue its currency. In fact, Senator Schumer, the first author of legislation aimed at China’s currency practice, stated in February 2008 that the Senate is not far away from passing legislation that forces China to revalue. However, out of all of the bills mentioned in this chapter, it is important to know what bill out of the four would most likely get passed in both bodies of Congress and sent to the President’s desk for approval. In an interview with Pat Malloy, Commissioner at the U.S. China Economic and Security Review Commission, I got a chance to ask this question.

According to the Commissioner, it is his opinion from following the various pieces of legislation introduced in Congress that the Ryan-Hunter bill, H.R. 2942, has the

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best chance of passing in Congress. He supports the Ryan-Hunter legislation because it is an all-encompassing bill that will not only address properly China’s misaligned currency but also the trade disputes that are exacerbated as a result of its undervalued currency.

Addressing the issue of the bi-annual reports to Congress from the Department of Treasury, the Commissioner mentioned that he served on the Senate Banking Committee during the time that the 1988 Omnibus Trade and Competitiveness Act was formulated. As a result, he is very familiar with the purpose of the bill and its original intent. However, the Department of Treasury, he believes, has abdicated its responsibility in making China responsible for the economic damage caused to the U.S. economy as a direct result of its undervalued currency. He further outlined the fact that the Ryan-Hunter bill would properly define China’s currency as misaligned and therefore, it would be incumbent upon the Department of Treasury to take responsibility and address this issue.

He also believes that the CVDs that would potentially be imposed, on China would make up for the so-called “subsidy” of a misaligned currency. Further, he included the fact that if China had not been given Most Favored Nation (MFN) status, tariffs would be around 42 percent. However, because of its MFN status, China enjoys low tariffs around 2.5 percent. Before it was admitted into the WTO, businesses were reluctant to make long-term commitments and investments due to the fact that its MFN status had to be renewed annually. That has changed now that it is a member of the WTO, and businesses have made record profits with the guarantee of low tariffs despite the fact that China is not holding up its end of the bargain with regards to a number of
trade commitments and laws. According to the Commissioner, American companies have been captured by China’s economic policies. Furthermore, many companies who are considered “Friends of China,” get special benefits made possible by low tariffs and an undervalued currency.

Commissioner Malloy believes that the Ryan-Hunter will address many of these issues but, it will do so within a legal framework. He reiterated this point by stating the fact that the U.S. must focus on the laws of the WTO and IMF when holding China accountable. In doing so, the issue of China’s currency can be addressed in a fair and transparent manner. However, there are economists who have a different opinion.116

Stephen Roach, Chairman at Morgan Stanley Asia, disputes the claims that China’s undervalued currency equates to that of a subsidy. He makes mention of the fact that China does acquire a massive level of U.S. securities in order to maintain the level that the RMB appreciates against the dollar. However, Roach argues that this has kept interest rates artificially low and maintained the value of the dollar, to some extent, at a higher level than it would be without China’s interference. As a result, he makes the striking rebuttal to the critics of China’s currency policy that, China is in fact subsidizing U.S. interest rates.

Gary Hufbauer, a Senior Fellow at the Peterson Institute for International Economics, also provides a different opinion about currency legislation in Congress.117 He outlines two points against assertions that legislation, which includes CVDs and brings forth cases of to the WTO and IMF, will be successful in addressing China’s Currency issue.

The first point he makes is that protectionist measures implemented by Congress such as imposing stiff tariffs on goods from a country expected of undervaluing its currency, runs the risk of initiating “mirror legislation” abroad. In effect, what is well intended policy in the U.S., could be seen as threatening to other countries who trade and engage in a bilateral exchange with the U.S. A subsequent trade war could be the result causing an economic slowdown similar to levels experienced in reaction to the Smoot-Hawley Tariff Act of 1930. Many economists during that timed, warned of the effects that were possible as a result of Congress unilaterally interfering with foreign commerce. He argues that Congress must not overlook this possibility and other unintended consequences that may arise as a direct result of the passage of aggressive currency legislation.

His second point makes the case that provisions in the Ryan-Hunter and Baucus-Grassley bills, which send currency disputes in the form of subsidies to the WTO and IMF, may not be successful for two reasons. First, even though U.S. law would identify a misaligned currency implemented over a prolonged period as a subsidy, the narrowly defined laws within the WTO do not correspond accordingly with U.S. law. Moreover, if subsidy cases are brought before the WTO, they must be specific as defined in SCM Article 2. The next problem the U.S. would run into is the fact that exchange rates or currency disputes are under the jurisdiction of the IMF, and trade concerns are taken up in the WTO. Therefore, attempting to argue the point that an undervalued currency

118 See Hufbauer, Gary & Brunel, Claire (2007) pgs 16-17
119 The Smoot-Hawley Tariff Act of 1930 imposed excessive taxes on U.S. imports and is attributed to hindering international economic development and cooperation during the period of the Great Depression. Many countries in response, dramatically increased their tariffs on U.S. exports which hurt the U.S. economy and exacerbated the effects of the Great Depression.
120 See Hufbauer, Gary & Brunel, Claire (2007) pg 11
constitutes a defacto subsidy would create a jurisdictional conflict. Given that, there is no precedent for this matter, Hufbauer argues the fact that both bodies would be reluctant to over step the authority of the other, in addition to the fact that both bodies would also be reluctant to cede authority from their respective jurisdiction.\textsuperscript{121} Therefore, this issue would not likely be handled by either the WTO or IMF.

In view of the fact that all four pieces of legislation must still get the approval from the President before they are enacted into law, it is also essential to understand what type of angle the Executive Branch is taking to ensure China appreciates the RMB. The remainder of this Chapter will focus on some of the policy options considered by the Executive Branch and its view of accelerating appreciation of the RMB.

5.3 EXECUTIVE BRANCH

Amid increasing pressure from Congress, U.S. manufacturers, and labor groups, the Bush Administration is hard-pressed in finding remedies that address China’s undervalued currency. In March of 2008, the administration released a report naming 62 trading partners as having unfair trading practices against the U.S. However, with 66 pages dedicated to China alone, more than any other country, and 24 pages more than the member nations of the European Union, it was a known fact that China was the prime culprit.\textsuperscript{122} Nonetheless, with a $256.3 billion trade deficit with China, this announcement by the administration only fueled more calls for currency appreciation from critics of China’s currency valuation.

\textsuperscript{121} See Hufbauer, Gary & Brumel, Claire (2007) pg 8
Treasury Secretary and chief U.S. negotiator for China economic policy, Hank Paulson has stated that neither naming China as a currency manipulator as Congress would prefer, nor making the Chinese currency more flexible would immediately reduce China’s enormous trade surplus. However, he has given notice to the Chinese authorities that moving too slowly toward appreciation will not be helpful to its economy. From these two statements alone, it is easy to see how the Secretary is stuck in a quandary as he represents the administration in dealing with China currency reform. First, he has the task of providing Congress the assurances that the administration is making headway with pressuring China to continue appreciation of the RMB in an effort to prevent them from passing legislative remedies, which the administration opposes. He also has to maintain sufficient pressure on China to revalue its currency while simultaneously attempting to preserve a stable U.S.-Sino relationship.

Even though many in Congress believe that the administration has not done enough to redress the massive U.S.-China imbalance, it is important however, to analyze the action and promising developments that have taken place thus far. This section will focus specifically on two of the most recent developments by the administration that, while not directly addressing China’s undervalued currency, does augment the level of pressure placed on China for reform.

The first policy option that this thesis focuses on does not directly deal with China’s currency, however, it displays the administrations apparent willingness to intensify pressure on China as concerns regarding the U.S. economy worsen. Specifically, the administration has stepped up efforts to target specific subsidies that China appear to be providing to certain industries that compete against U.S. companies.

123 See Zwaniecki, Andrzej (2007) Treasury’s Paulson Pledges to Keep Pressing China on Currency
In addition, recent announcements from the Department of Commerce signals the administration is becoming increasingly inclined to apply CVD laws to China despite the fact that it is a non-market economy. These recent actions exhibit a shift from past decisions where the administration refrained from investigating some trade petitions despite strong calls for action.

In February of 2007, the President requested that the United States Trade Representative (USTR) pursue a case in the WTO against China regarding a variety of subsidies that they suspected China of providing to domestic companies. The following two statements made by administration officials, Susan Schwab the U.S. Trade Representative and Commerce Secretary Carlos Gutierrez reiterated the administrations commitment to take more aggressive action against China byway of the WTO.

**U.S. Trade Representative Susan Schwab**

"[The administration is] committed to challenging China’s WTO-inconsistent practices that harm American workers and businesses. China’s use of market-distorting subsidies creates an uneven playing field and subverts China’s own efforts to foster consumption-led growth."

**Secretary of Commerce Carlos Gutierrez**

"China is using prohibited subsidies to compete unfairly. American workers, consumers, farmers and businesses benefit greatly from being able to buy and sell in the world marketplace, but others must follow the rules. China has not. The Bush Administration will continue to use every tool at our disposal to enforce U.S. trade laws and to make sure others compete fairly."

The case filed by the administration was directed at nine subsidies that benefited many industries such as steel, paper, and other manufacturing goods, all of which are having a tough time coping with increased competition from China. Moreover, the

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124 A federal court decision in 1986 determined that CDV laws should not be applied to non-market economy countries.

125 See U.S. Trade Representative press release (2007) United States Files WTO Case Against China Over Prohibited Subsidies
subsidies at issue, included exemptions from tariffs, preferential lending terms, value added tax breaks and other financial support intended to benefit Chinese exporters.\textsuperscript{126}

Another case by the administration was the Department of Commerce’s announcement on March 30, 2007 that the department decided to apply U.S. CVD laws to coated free sheet paper imported from China. After dramatic increases in coated free sheet paper were imported into the U.S. from China between 2005 and 2006, the department decided to move forward with filing CVD laws against China. The chart below displays the enormous increase of imports in just over three years.

<table>
<thead>
<tr>
<th>Import Statistics for Coated Free Sheet Paper</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
</tr>
<tr>
<td>2004</td>
</tr>
<tr>
<td>Volume (kg)</td>
</tr>
<tr>
<td>Value (U.S.)</td>
</tr>
</tbody>
</table>

Table 5.1 Source: U.S. Department of Commerce

According to table 5.1, between 2004 and 2006, imports of coated free sheet paper from China more than tripled. This chart only serves as a snapshot of what many other U.S. industries face as they compete with an increasing number of cheap imports from China.

While both these cases filed from the administration focus on trade, the fact that China maintains an undervalued currency makes these products and services cheaper than similar products manufactured in the U.S. The administration understands that, as

\textsuperscript{126} See U.S.-Business Council (June 2007) China’s Trade Relations
China’s currency value appreciates, the competition between both countries could become more equitable.

In September of 2006, the administration agreed to commence a semiannual “Strategic Economic Dialogue (SED)” with high-level officials in both the U.S. and China’s executive cabinets. The purpose of establishing the SED was to allow both countries to examine their long-term strategic issues. In addition, it provides a setting from which challenging issues such as currency appreciation can be discussed in detail and in an amenable environment. Most importantly, it brings both parties to the table, which enables everyone to gain a deeper understanding of the unique differences between the two countries.

To date, the U.S. and China have engaged in three SEDs with each yielding reasonable results. However, while there has been success in many areas such as financial services, import safety, and civil aviation, minimal gains have been made that deal with China’s currency. During the most recent SED in December of 2007, both countries committed to making attempts to address the U.S.-China economic imbalance through the U.S. Joint Economic Committee. In addition, China agreed to continue cooperative consultations to assist the country in achieving market economy status. In doing so, its currency would float freely and adjust according to market pressures. Yet, despite how promising it is for China to move toward a market economy, if solid results are not produced in the interim, many policymakers may push for increased reform.

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In order to maintain the legitimacy of the SED, the administration will need to continue to pressure China to make noticeable reform with its currency. During the second meeting, which was held in Washington, D.C., the RMB appreciated to a record high of 7.65 to the dollar.\textsuperscript{129} While this was not representative of the 20 to 40 percent appreciation that many critics believe the RMB to be undervalued, it provided the view that China was reacting to the SED. Many policymakers and economists are giving the administration the benefit of doubt in hopes that the SED will produce significant results. Even some major critics such as Nicolas Lardy extol the prospects for progress that the SED present.\textsuperscript{130} Therefore, confidence in the SED may hinge on the noticeable moves toward greater appreciation that ensue as a result.

5.3 CONCLUSION

Both the Executive and Legislative branch are clearly charting very different paths with regards to resolving concerns over the value of China’s currency. Given the overwhelming bipartisan votes on China currency legislation, Congress appears to favor a more aggressive approach. The administration on the other hand appears intent on taking a more cautious role.

However, despite the clear difference in views between both branches, it may inadvertently present an ideal arrangement from which to address the complexity of an issue such as China’s undervalued currency. Essentially, the dichotomy of views create a “good cop/bad cop” scenario, where Congress maintains the threat and intention to impose stiff tariffs and the administration continues to affably engage China on the issue.

\textsuperscript{129} See U.S.-Business Council (2007) China’s Trade Relations
\textsuperscript{130} See Bureau of International Information Programs, U.S. Department of State (2007) Broad U.S.-China Dialogue Advances Toward Long-Term Goals
Whether this arrangement is coincidental or done somewhat wittingly, it sends the message to China that it must continue on the path toward reform or run the risk of damaging an important sector of its economy, exports.

To this, it would be extremely disadvantageous for Congress to follow through immaturely with unilateral action before exhausting all other alternatives. Indeed, it is within the authority of Congress to regulate foreign commerce, but it must give full consideration to the unintended consequences that may result from passage of such legislation. Passage of retaliatory legislation would be short sighted as China has shown its willingness to work with the U.S. through avenues such as the S.E.D. and other joint bilateral agreements. Immature and retaliatory measures may stymie progress made from the economic diplomacy and strategic engagements taken thus far by the U.S. Ultimately, currency legislation should always be left on the table, however, it should be used primarily as leverage to compel China to follow through on its commitment to appreciate its currency.

Secretary Paulson has expressed to China that continuing appreciation is in its best interest.\textsuperscript{131} However, the administration must continue to engage China on this important issue. In addition, it is essential that the case be made that if China slips on its commitment to appreciation, Congress will indubitably move forward with aggressive legislative action. Therefore, it could be duly noted that China has been warned and it would be incumbent on the country to follow through with its commitment.

\textsuperscript{131} See Zwaniecki, Andrzej (2007) Treasury's Paulson Pledges to Keep Pressing China on Currency

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A STUDY ON WHY THE UNITED STATES MUST BE CAUTIOUS IN ATTEMPTS TO ACCELERATE APPRECIATION OF THE RMB

CHAPTER SIX

6.1 CONCLUSION

This thesis has demonstrated why hastening appreciation of the RMB is not the immediate solution that will address thoroughly the U.S.-China economic imbalance. Furthermore, the results that may ensue from a failed policy to address this issue could prove detrimental to China's budding economy in addition to the ripple effects that would be felt in the U.S. and the global economy.

It was almost 30 years ago when Deng Xiaoping placed China on an economical trajectory that promised future prosperity. China is awakening and its economy has evolved from one of the smallest economies to now one of the largest. As this thesis has demonstrated, China's growth has been beneficial for some, and provided a great deal of frustration for others. However, the implementation of hasty and premature policy at a time when growth is steady will prove to be shortsighted and could stifle growth at a time when the global economy is benefiting from a growing Chinese economy.

China's economic evolution illustrates the fact that it is on a path toward a market economy and one that will hopefully ensure more of an economic balance with the U.S. This thesis displayed the evolution of China's currency regime and while it has been slow in the eyes of some critics, the progress has been steady. Each decade beginning in 1980, China made significant reforms in its currency regime and the value of the RMB has increased. China employed a dual exchange rate regime during a period when it was critical for the country to expand its exports and open its economy to new markets.
During the 1990s, the country responded to U.S. criticism by unifying its currency and pegging the yuan to the dollar. China again modified its currency regime amid U.S. objections, to the current basket exchange rate system. Today, China has made good on its commitment to continue gradual appreciation of its currency in addition to moving toward a more liberal economy.\textsuperscript{132}

It is important that the U.S. continue to work with China in an effort to continue the progress that has been made thus far. Retaliatory measures such as stiff tariffs intended to compel China to appreciate immediately may only damage U.S.-China relations. Japan’s example during the 1990s demonstrated how quickly tensions can rise when retaliatory measures are undertaken. To prevent a similar event with China, the U.S. must take full advantage of the SED that brings both countries together twice a year to address freely any concerns and frustration. Moreover, the economic relationship between the U.S. and China may prove to be one of the most important collaborations in the near future and it is incumbent upon both countries to ensure continued cooperation.

If China is intent on being a leading economy within the global community, it must do its part in furthering the reforms necessary to become a market economy. Indeed, its evolution has been gradual and rightfully so, but as Secretary Paulson recently mentioned, appropriate appreciation is in China’s best interest as its economy continues to grow.\textsuperscript{133}

To some extent, China’s economy could be compared to a grown adult still living at home and depending on its parent’s resources. At some point in your adulthood, you are expected to move out of your parent’s home, make your own living, and not depend

\textsuperscript{133} See Zwaniecki, Andrzej (2007) Treasury’s Paulson Pledges to Keep Pressing China on Currency
on someone telling you what to do. A great deal of frustration builds when China appears to employ a currency regime not intended for a mature economy. In addition, the currency basket makes China appear dependent on other countries currency, some of whom, China has surpassed in growth. If China intends to be a major economic power, it must lead by example, beginning with revaluing its currency and allowing it to float freely in a market economy. As China’s economy matures, necessary changes and reform should not come as a result of U.S. pressure.

The case study in Chapter four yielded strong inferences that contributed significantly to the final conclusion of this thesis. Admittedly, the positions and arguments of this thesis changed many times. This is because the issue of China’s currency reform is a difficult topic from which to study. However, the insight provided from the historical evaluation of Japan’s experience provided very convincing evidence that steady and gradual appreciation is in the best interest of an economy that experienced similar growth.

The most convincing evidence presented in the case study placed into question the primary and fundamental argument made by advocates for accelerated appreciation. The trade deficit is always elaborated upon by many critics who believe immediate appreciation will result in a simultaneous decrease in the U.S trade deficit with China. However, as figures 4.2 and 4.3 in chapter four illustrated, as the U.S. trade deficit with Japan slightly decreased following Japan’s dramatic appreciation, it never reduced to a complete level. In fact, Japan still runs one of the largest surpluses’ with the U.S.

It is a fair and general assumption that the appreciation of the Japanese yen following the “Nixon Shock” and Plaza Accord agreement were intended to bring long-
term balance to the U.S.-Japanese economies. Nevertheless, following the Nixon Shock in the 1970s, the U.S. trade deficit later increased rather exponentially during the 1980s.\textsuperscript{134} Moreover, as the U.S. faced another increased trade deficit, the plan was again to increase the value of the yen against the dollar. While this of course lowered the trade deficit, it did so only temporarily.

Further examination of the case study also illustrated how the U.S. trade deficit not only increased with China, but it also expanded with the rest of the world. As mentioned earlier, this represented an increase in U.S. domestic consumption. Therefore, as Japan's currency appreciated, the cheap goods of China and other countries with similarly lower valued currencies fed American consumption. This provided sufficient evidence to the case that if China were to appreciate dramatically the RMB, it could be expected that the trade deficit will be redistributed to other countries with cheaper currencies.

Why not work with China toward gradual appreciation that enables stable economic growth on its part. It has over one billion consumers who, as their lifestyles and standards increase, would have the potential to afford many goods made in America. If U.S. policymakers are thinking long term, a continual economic alliance and bilateral exchange would almost certainly provide a sizable return.

At the present time, concern about the U.S. economy is rightly addressed and very much legitimate. The U.S. is in uncharted waters with such a massive trade deficit with China. In addition, the economic outlook, as mentioned earlier, is not where many would prefer. While a sizable portion of the deficit has a lot to do with increased consumption, China’s undervalued currency also plays just as important of a role. To this, just as this

\textsuperscript{134} See Solarz, Stephen (1982-83) A Search for Balance pg 76.
thesis advocates for U.S. policy that gives consideration to China’s economy, it also has a responsibility to work with the U.S. in an effort to address this issue.

First and foremost, China must continue to tackle the issue of its undervalued currency by appreciating the RMB at a steady rate. In addition, it must also increase the band from which the yuan floats against the dollar to allow more of an increase in value. These two efforts, while they will not have an immediate effect on the U.S. trade deficit, they would ensure a gradual expansion of the Chinese economy that should yield future returns for the U.S.

China must also work collaboratively with the U.S. to increase its domestic consumption levels. While this is one of the long-term goals of the SED, aggressive measures should be taken as their economy expands.\textsuperscript{135} With an increased value of the RMB, American goods would become more affordable in China. If efforts are made to increase consumption at a much greater rate as the RMB appreciates, both economies would benefit as increased trade and further collaboration would be the result.

Lastly, there are a number of other topics that while not directly tied to the issue of currency valuation, do play a significant role within the U.S.-China bilateral exchange. More specifically, issues such as sovereign wealth funds, WTO and IMF agreements, and China’s lack of transparency for example, must be addressed along with China’s currency reform. This thesis did not include much about either topic solely due to an effort to provide proper attention to the effects of an undervalued RMB. In addition, while this thesis argues for patience with regards to currency reform, it does not dismiss the fact that there are a number of legitimate concerns that pose significant threats to the U.S.

economy. That is why continued dialogue and engagement through the SED is so

\textsuperscript{135} See Department of Treasury (2006) Fact Sheet Creation of the U.S.-China Strategic Economic Dialogue
critically important. It is essential that both countries come to the table in order to gain a better understanding of the challenges that both economies face.

Unilateral action such as aggressive legislation from Congress could hinder the continual progress being made from engaging China directly on the issues that we find challenging in the U.S. China has the potential to be a long-lasting ally with whom we currently have the ability to search for remedies to challenging issues through diplomatic means. The possibility of damaging this relationship through unilateral action may not be in the long-term interests of the U.S.

It is also important to stress the fact that the issue of China's undervalued currency is not just a problem for the U.S. As the value of the Euro increases, concerns in Europe are growing accordingly. Therefore, gaining the support of other economies that face similar challenges in an effort to address this issue in a multilateral approach would prove beneficial. Above all else, China would at least get the point that the U.S. is not the only country concerned, and other trading partners are willing to take action if it does not appreciate its currency.

To close, if the end result is to lower the U.S. trade deficit with China indefinitely, then hasty appreciation is not answer. While hasty appreciation may be attractive in the short term, Japan has showed that it is not effective as a long-term measure. The U.S must take a multifaceted approach that includes constant engagement with China and the inclusion of other major trading partners. China desires to expand its economy and most importantly would eventually like to become a market economy. It is important and in the best interest of the U.S. to work with China in achieving this goal. In the end, the

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136 See Bergsten, Fred (2007) Europe Must Look East to Deal with the Euro
137 Former Trade representative piece on China wanting to become a market economy.
improvement of China’s economy and the millions of Chinese people subsequently lifted from poverty as a result would be a global achievement.
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States Affected by trade imbalance

Net job loss due to growing trade deficits with China ranked by total jobs lost, 2001-06 State Net jobs lost

<table>
<thead>
<tr>
<th>State</th>
<th>Jobs Lost</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>269,300</td>
</tr>
<tr>
<td>New York</td>
<td>105,900</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>78,200</td>
</tr>
<tr>
<td>Florida</td>
<td>71,900</td>
</tr>
<tr>
<td>Georgia</td>
<td>60,400</td>
</tr>
<tr>
<td>Michigan</td>
<td>54,900</td>
</tr>
<tr>
<td>Indiana</td>
<td>45,200</td>
</tr>
<tr>
<td>Tennessee</td>
<td>38,000</td>
</tr>
<tr>
<td>Virginia</td>
<td>37,800</td>
</tr>
<tr>
<td>Colorado</td>
<td>30,700</td>
</tr>
<tr>
<td>Alabama</td>
<td>27,900</td>
</tr>
<tr>
<td>Washington</td>
<td>27,000</td>
</tr>
<tr>
<td>Maryland</td>
<td>22,900</td>
</tr>
<tr>
<td>Connecticut</td>
<td>19,000</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>16,200</td>
</tr>
<tr>
<td>Mississippi</td>
<td>14,300</td>
</tr>
<tr>
<td>New Hampshire</td>
<td>13,000</td>
</tr>
<tr>
<td>Kansas</td>
<td>10,600</td>
</tr>
<tr>
<td>Idaho</td>
<td>8,500</td>
</tr>
<tr>
<td>West Virginia</td>
<td>8,400</td>
</tr>
<tr>
<td>Nebraska</td>
<td>6,200</td>
</tr>
<tr>
<td>Vermont</td>
<td>4,900</td>
</tr>
<tr>
<td>Delaware</td>
<td>3,400</td>
</tr>
<tr>
<td>Montana</td>
<td>2,500</td>
</tr>
<tr>
<td>District of Columbia</td>
<td>2,100</td>
</tr>
<tr>
<td>Wyoming</td>
<td>1,700</td>
</tr>
</tbody>
</table>

**National total** 1,763,000

* Totals do not add due to rounding error.

Source: EPI analysis of Census Bureau and BLS data.
Appendix 4.1 pg.54

1986 Times Article

Monday, Aug. 11, 1986

A Baffling Trade Imbalance

By Barbara Rudolph

When the value of the dollar began falling early last year, American manufacturers were confident that their competitive powers would be rejuvenated. As the currency weakened, they reasoned, U.S. exports would become cheaper, while foreign imports would grow more expensive for American consumers. The trade deficit would begin its long-awaited decline. Economists cautioned that it would take time—twelve months, a year and a half at the most. But it would happen. This was no idle daydream, after all, but a proven tenet of modern economic policy.

Things have not turned out that way. Since March 1985 the dollar has fallen in value by about 30% against an average of major currencies, and yet the trade gap—economic theory be damned—keeps right on growing. Last week the Government reported that the trade deficit hit a record six-month level of $83.9 billion. June’s trade imbalance was almost identical to the one posted in May. If the deficit keeps expanding at the current pace, it will total $168 billion by year’s end, a 13% increase over 1985’s record level. Plainly, the widely expected turnaround in the balance of trade is now overdue. Says Walter Heller, chief economic adviser to Presidents Kennedy and Johnson and one of many economists who had predicted that the trade deficit would surely be shrinking by now: “This is a staggering surprise. We have to admit we were off base on timing.”

If the trade deficit does not soon diminish, some economists fear, its effects could help push the U.S. into a recession. In testimony before the House Banking Committee, Federal Reserve Chairman Paul Volcker said that the trade deficit had placed the economy in “difficult and dangerous” circumstances. It has undoubtedly caused much of the recent slowdown in growth: the economy expanded at a 1.1% annual rate between April and June, down from a 3.8% rate the previous quarter. The Commerce Department reported last week that the index of leading economic indicators, a barometer of future growth, increased by a modest 1.3% in June. The unemployment picture, though, improved somewhat. The number of jobless Americans fell from 7.1% to 6.9% of the population.

The seemingly intractable trade deficit is reviving pleas for protectionism. This week the House of Representatives will reconsider legislation to assist the ailing textile industry by drastically reducing imports. President Reagan has vetoed this bill, but the House will now vote on a proposal to override that veto. Supporting textile protection has become a cause celebre for critics of Reagan’s free-trade policies. Said
House Speaker Tip O'Neill at a Washington rally for textile workers: "It is time, Mr. President . . . to take off your STAY THE COURSE button and start wearing a MADE IN THE U.S.A. button."

The President last week reaffirmed his opposition to the bill. Said he: "This protectionist legislation would impose tremendous costs on consumers . . . and U.S. business. It must not become law." He met with 35 Congressmen to ask for support to sustain his veto. One danger of such a bill is that American import restrictions would provoke its trading partners to take similar actions, hurting U.S. exports. The Administration is not ignoring the industry, however. Last week the U.S. Government agreed to renew for five years an important international pact that governs trade in textiles. The so-called Multi-Fiber Agreement expands import controls to popular fibers such as linen and silk blends. The pact, said a White House statement, stands "in sharp contrast to the sledgehammer approach" of the congressional bill.

Many American businessmen argue that the U.S. trade gap could be narrowed if foreign countries were to dismantle barriers to trade, such as quotas and stringent customs regulations, which effectively block sales of American products. The Administration has tried, not too successfully, to combat these practices through trade negotiations. But last week the U.S. could claim that real progress had been made. After a year of often heated talks about the semiconductor trade, Japan finally agreed to boost prices of the computer chips it sells in the U.S. The Commerce Department had charged that Japan was "dumping" chips at money-losing prices to gain market share. Japan also promised to open its semiconductor market to U.S. companies, although no precise sales goals were set. Said President Reagan: "This agreement represents an important step toward freer and more equitable world trade."

The Administration, though, is prepared to offer some extra protection to the beleaguered American farmer. Last week President Reagan authorized the sale of Government-subsidized wheat to the Soviet Union. The Soviets have been buying little of the costly American grain, but the federal subsidies will bring the price down. Senate Majority Leader Robert Dole of Kansas, along with several Midwestern Republican Senators who are up for re-election this year, had lobbied the President to take the action.

No one expected that the trade deficit would vanish the moment the dollar began its descent. To begin with, the greenback fell only modestly at first, down about 9% between February and July of last year. During the next eight months, however, it fell a more dramatic 19%. Indeed, it is still falling. Last week the dollar bought only 153.6 yen at one point, the greenback's lowest level since the late 1940s. The dollar has fallen some 39% against the yen since early 1985.

But, economists point out, the dollar is in some ways stronger than it appears. While it has fallen against major currencies, when it is valued against a broader measure of 25 currencies, it has hardly dropped at all. It has decreased less than 4% against the Taiwan yuan since March 1985 and actually risen nearly 4% against the South Korean won.

The unexpectedly high level of imports is another reason that the trade deficit has not yet shrunk. A sharp fall in the dollar normally sparks a comparable increase in the price of foreign goods sold in the U.S. Foreign manufacturers usually raise their prices because the money they pocket from American consumers is worth less when converted into their own currencies. So far, though, imports have remained a relative bargain for American consumers and businesses. The average price of Japanese automobiles, for example, has climbed
no more than 14% since last September, less than half the appreciation of the yen. The Japanese manufacturer Komatsu has raised the prices of its construction equipment in the U.S. by just 18% since last October. Japanese manufacturers are pocketing lower profits to avoid huge price hikes. Says Nissan's Yukihiro Eguchi: "We have to maintain our competitive edge on exports to the U.S. from such countries as Yugoslavia and South Korea. It's as simple as that."

Finally, the deficit continues to swell because the economies of Japan and Western Europe are not expanding rapidly enough to absorb as many U.S. exports as American manufacturers would like to sell. For the first quarter of this year, Japan's gross national product fell 1.5%, while GNP in West Germany was off 1.5% from the previous three months.

The U.S. has been running trade deficits for all but two of the past 14 years, but the levels rose dramatically just after the dollar temporarily surged in value beginning in 1980. The trade gap widened by 311% between 1980 and 1985. Exports fell by 3%, but imports increased by 41% as American demand was fanned by the huge federal budget deficit.

For the past ten years, the U.S. has been running its steepest trade deficit with Japan (1985 total: $49.7 billion). In June, for the first time ever, Western Europe had a higher surplus with the U.S. than Japan did: $3.8 billion vs. $3.7 billion. But that was only because June's U.S. exports to Japan were bolstered by a sale of $2 billion worth of old. Japan will use the bullion to manufacture commemorative coins to celebrate the 60th year of Emperor Hirohito's reign. Without that unusual sale, the U.S. deficit with Japan would have reached a record high in June.

Japan's neighbors in the Pacific Rim are also responsible for much of the U.S. trade problem. For the first six months of this year, South Korea's trade surplus with the U.S. increased by 20%, to an annual rate of $5 billion, while Taiwan's surplus grew by 5%, to a rate of $14 billion.

Latin American nations have traditionally been eager customers for American products, but since 1982 they have been so burdened by foreign debt that they have had little spare money for imports. U.S. trade with Latin America deteriorated from a surplus of $1.9 billion in 1981 to a deficit of $17.2 billion in 1985. When they splurge on imports, Latin American consumers are increasingly choosing products from other sources besides the U.S. In Colombia, for example, U.S. goods accounted for 44% of all imports in 1981. Four years later, that ratio had fallen to 32%. One reason: the growing popularity of Japanese products. The share of imports from Japanese firms jumped from 5% to 13%. Says Oscar Bradford, head of the Colombian-American Chamber of Commerce: "The Japanese came in here with marketing studies and plenty of capital."

As the U.S. trade deficit has grown, some American industries have been all but destroyed by low-cost foreign producers. Imports of leather shoes rose from 33% of the market in 1981 to 58% in 1985. Machine-tool imports have nearly doubled since 1981. Even within industries that are still dominated by American firms, foreign manufacturers have made significant gains. Example: computer imports claim 18% of the U.S. market.

Still, no recent change in American trade has been more alarming than the withering of U.S. farm exports. During May and June, for the first time since 1971, the U.S. was a net importer of agricultural products, with
a deficit of $348 million in May and $71 million in June. The U.S. is importing coffee, fish and fruits, among other foods. "Think of it!" exclaimed Senate Minority Leader Robert Byrd last week. "The greatest food basket in the world is running an agricultural deficit." The Government expects the U.S. will post a $5 billion agricultural surplus by the end of fiscal 1986. Reason: beginning this year, the U.S. will lower prices supports, forcing farmers to sell their crops for less. To compensate for the loss in income, Washington will increase cash subsidies to farmers. The lower crop prices, the Administration hopes, will make American agricultural products more competitive in world markets. The U.S. would again be a net agricultural exporter, but the cost to taxpayers is high. The Government will spend more than $25 billion on farm-support programs this fiscal year, a 42% increase over 1985.

Reducing the overall trade deficit will not come any easier. U.S. Treasury officials have repeatedly pressured America's major trading partners, especially Japan and Germany, to stimulate their economies. This would bolster demand for American products and thus reduce the U.S. trade gap. But both nations are wary of taking this step. One reason is their leaders' reluctance to fuel growth for fear of igniting inflation.

Some businessmen and economists argue that American companies must assume considerable blame for their failure to sell more of their products abroad. Says Charles Nevil, president of the Meridian Group, a Los Angeles-based export-management firm: "American firms have a basic indifference to exports. The hard dollar wasn't the cancer, and the soft dollar isn't the cure" for the deficit. If American exports are to grow, companies must become more adept at satisfying the needs and tastes of foreign consumers.

How much the dollar's fall will do for U.S. trade remains to be seen. Lester Thurow, a professor of economics at M.I.T., cautions that the weakened currency is no panacea. Says he: "The dollar is nowhere near a low enough level to solve the trade-deficit problem." Allan Meltzer, a professor of political economy at Carnegie-Mellon University, is more sanguine. He comments, "I have no problem believing that the export surge is coming." Not surprisingly, neither Meltzer nor anyone else is willing to predict the precise timetable for a turnaround in the balance of trade.

CHART: TEXT NOT AVAILABLE

With reporting by Gisela Bolte and Barrett Seaman/Washington, with other bureaus
Economics and politics often make strange bedfellows. Such is the case with America's increasingly contentious relationship with China, which has taken a sudden turn for the worse on the trade front. This poses a major risk for the global economy.

Politicians in Washington are getting nervous because of two pernicious problems facing the U.S. economy: a lackluster job market, and America's massive foreign-trade deficit. Despite a modest improvement in job creation over the past year, the U.S. remains mired in the weakest hiring cycle on record. At the same time, salaries have barely kept up with inflation astonishing in an era of rapid productivity growth, which is normally thought to boost real wages. As a result, there is a palpable discontent in the U.S. work force that politicians do not take lightly.

To complicate matters, America's foreign-trade deficit is veering out of control. The trade gap surged to $666 billion in 2004, a record 5.7% of U.S. gross domestic product. China accounted for the largest chunk of the shortfall U.S. imports of Chinese goods exceeded exports to China by $162 billion, accounting for about a quarter of the total trade gap.

In political circles, this is ironclad evidence of cause and effect and China is being blamed for the tough conditions facing American workers. The Washington consensus is that Beijing's currency policy a fixed peg of 8.3 renminbi per dollar has given China an unfair competitive advantage that is robbing Americans of market share and jobs. Pressure is mounting for China to revalue its currency. If it doesn't do so, Congress is threatening to impose stiff tariffs on all Chinese goods sold in the U.S. The drumbeat of protectionism is growing louder by the day.

Yet the economics of China bashing are not nearly as compelling as Washington believes. That's because the politicians themselves are central to this problem. America's gaping trade deficit didn't appear out of thin air. It is a direct outgrowth of an unprecedented shrinkage in overall U.S. savings, with the personal-savings rate having fallen nearly to zero and the federal government's budget having swung perilously from surplus to deficit. Lacking in domestic savings, the U.S. has had to import surplus capital from abroad in order to grow thereby running up massive current-account and trade deficits. Were it not for a profligate Washington, America's savings rate would be higher and the trade deficit would be lower.
The politics of China bashing is misplaced for two other reasons: as long as the U.S. must trade with someone to make up for its own savings shortfall, it is to the advantage of American consumers to have access to low-cost, high-quality Chinese products. Moreover, China's export juggernaut is not what it appears to be. Fully 62% of the country's export growth over the past decade came from Chinese subsidiaries of multinationals headquartered elsewhere in the world in Asia, Europe, and America. The West may be surprised at the damage it inflicts on itself if it restricts trade with China.

U.S. politicians have no patience for these macroeconomic arguments. In their minds, it's all about pinning the distress of beleaguered American workers on China. The recent surge of Chinese textile products into U.S. and European markets has only fueled the flames of protectionism. A mid-April procedural vote on a bill that would impose 27.5% tariffs on all Chinese goods sold in the U.S. passed the Senate by a stunning 67-33 votes, with final deliberation slated for the end of the summer. It will take deft political maneuvering to avoid a further escalation of these trade tensions between Washington and Beijing. Always in search of a scapegoat to deflect attention from its own reckless fiscal policies, Washington is not about to blink. Neither does China want to be put in the position of having to tamper with its stability anchor the currency peg especially if its financial system and economy would be put at risk.

Compromise is critical. Some adjustments in Chinese trade and currency policy, along with efforts to stimulate its anemic private consumption, would go a long way toward defusing the political tensions in Washington. Similarly, if U.S. fiscal authorities were to adopt a credible program of budgetary restraint, America's savings would improve and its excess spending would be tempered allowing the trade deficit to begin receding.

Seventy years ago, protectionism marked one of the darkest periods in contemporary economic history: the Great Depression. Memories are dim of how destructive the endgame can be. This slippery slope must be avoided at all costs.

With reporting by Stephen Roach is chief economist and director of global economic analysis at Morgan Stanley
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Ryan-Hunter Dear Colleague

Congress of the United States
Washington, DC 20515

Did H.R. 782 Just Get "Lucy'd" by the Department of Commerce?

Dear Colleague:

The Department of Commerce announced March 30th its preliminary determination to apply the countervailing duty (anti-subsidy) law to non-market economy countries such as China. The agency's preliminary calculations show Chinese subsidies of 10%-20% on exports to the United States of coated paper. We welcome this provisional decision, which is long overdue. However, this decision in no way lessens the need for legislation on Chinese subsidies, including exchange-rate misalignment.

In its petition filed last year, NewPage Corporation of Ohio alleged exchange-rate manipulation by the Chinese government. Twenty days later, Commerce refused to even begin investigating the claim. In the November 27th, 2006 Federal Register notice, Commerce stated:

"Petitioner has not sufficiently alleged the elements necessary for the imposition of a countervailing duty and did not support the allegation with reasonably available information. Therefore, we do not plan to investigate the currency manipulation program."

H.R. 782 clarifies the elements necessary for the imposition of countervailing duties in U.S. law, in a manner consistent with Articles 1, 2, and 3 of the WTO's Subsidies and Countervailing Measures (SCM) Agreement. Specifically, Section 103(a) provides that exchange-rate misalignment satisfies the SCM Agreement's three criteria for WTO-prohibited countervailable export subsidies: (1) a financial contribution by the exporter's government; (2) a benefit conferred on the exporters; and (3) export-contingency.

The Commerce Department's failure to act underscores the need for Congress to clarify the status of exchange-rate misalignment by any country as a prohibited countervailable export subsidy.

Under Article I, Section 8, Clause 3 of the U.S. Constitution, Congress has the power to regulate commerce with foreign nations. Unless Congress exercises its constitutional authority to express statutorily that exchange-rate misalignment is a prohibited countervailable export subsidy, there will be confusion, delay or denial of a remedy to
U.S. industries. H.R. 782 is the only bill that adequately clarifies Congressional intent in favor of U.S. producers on this pressing issue.

To cosponsor H.R. 782 or request additional information, please contact Philip Fawcett (philip.fawcett@mail.house.gov) in Congressman Tim Ryan's office or Lorissa Bounds (lorissa.bounds@mail.house.gov) in Congressman Duncan Hunter's office.

Sincerely,

Tim Ryan
Member of Congress

Duncan Hunter
Member of Congress
Appendix 5.2 pg.84

Ryan-Hunter Dear Colleague

February 15, 2008
Protect US Industries from Foreign Currency Misalignment

COSPONSOR THE CURRENCY REFORM FOR FAIR TRADE ACT OF 2007,
H.R. 2942

Dear Colleague:

Last year, as many of you know, we updated our Fair Currency Trade Act (H.R. 782), which many of you cosponsored, and reintroduced it as the Currency Reform for Trade Act of 2007 (H.R. 2942). We hope you will take this opportunity to join us in cosponsoring this new legislation and continue to support American industries being harmed by misaligned foreign currencies. China’s undervalued yuan is, effectively, a 40 percent tax on all U.S. agriculture and manufacturing exports, and contributing greatly to our soaring trade deficit.

With respect to that deficit, things are getting worse, not better. On February 14, 2008, the Bureau of Economic Analysis released its Trades in Goods and Services Report which showed that trade in goods with China in 2007 ballooned to an all-time annual high of $256 billion, up from $233 billion in 2006. These huge deficits, which go back many years, represent the loss of US-produced goods, and US jobs. According to the Bureau of Labor Statistics, the US lost 3,280,000 manufacturing jobs since 2000, when Congress ratified China’s bid for WTO membership. That represents a decrease of over 19 percent of all manufacturing jobs since 2000.

Now, with most economic indicators showing a notable downturn, and growth in the fourth quarter of 2007 at an anemic 0.6 percent, it is more important than ever that we take action to level the playing field with foreign countries that do not abide by existing law.

The Currency Reform for Fair Trade Act would provide trade remedies that are consistent with international law and would enable injured U.S. companies and workers to defend themselves against the damaging effects of currency undervaluation.

If you would like to cosponsor this bipartisan legislation, please contact Stephen Cerny (steve.cerny@mail.house.gov) in Congressman Ryan’s office at 5-5261 or Lorissa Bounds (lorissa.bounds@mail.house.gov) in Congressman Hunter’s office at 5-5672.

Sincerely,

/s/
Tim Ryan
Member of Congress

/s/
Duncan Hunter
Member of Congress
CURRICULUM VITAE

Chazmon Gates
Legislative Assistant
U.S. Congress

EDUCATION

January 2006 to May 2008
Master of Arts in Government
The Johns Hopkins University
Thesis: A Study on Why the U.S. Must Be Cautious In Attempts to Accelerate Appreciation of the RMB.

August 2001 to May 2005
Bachelor of Arts in Mass Communication
The University of Arkansas-Pine Bluff

PROFESSIONAL EXPERIENCE

December 2006 to present
Legislative Assistant, Congressman Mike Ross (AR-04), United States Congress.
Duties: Advise Congressman on policy and congressional votes; prepare policy speeches, Energy and Commerce Committee statements, and issue briefs.

August 2005 to December 2006
Legislative Correspondent, Congressman Marion Berry (AR-01), United States Congress.
Policy Portfolio: Foreign Affairs, Housing, Postal, and Religion.
Duties: Draft constituent correspondence, research policy and congressional votes.

ACTIVITIES AND HONORS

2008 Student Service Award, Johns Hopkins University
2007 National Security Colloquium, National Defense University
2007 to present Board Member At-large, Congressional Legislative Staff Association
2007 President, Congressional Black Associates
2004 to 2005 Student Government Association President, University of Arkansas-Pine Bluff