The American Conclusion:

Yuan Appreciation or Economy Devastation

In 1930, the Hoover Administration attempted to pass a bill imposing steep tariffs on all foreign imports. Since 1930, calls to reform foreign economic policy have become even more common. On September 29, 2010, Bloomberg Newsweek reported that the United States’ House of Representatives passed a bill allowing and encouraging strict importation laws on goods from China to America (Christie and Rastello). Prompting this bill is the claim that China is manipulating its currency to undercut the United States’ economy. Both bills were introduced because America wants to protect its foreign interests.

Although the 1930 bill was abolished and the 2010 bill still awaits the Senate’s final vote, this continual controversy has caused a re-examination of economic and political policies. Due to faulty American-protectionist thinking, issues such as American unemployment, China’s rapidly increasing GDP, and the ever-expanding trade deficit between the United States and China, the United States’ government and public are beginning to fear the Chinese economy. Thus, the government is trying to pass the 2010 Currency Reform for Fair Trade Act to force China to appreciate its currency. If these American fears perpetuate and cause Congress to continue to try to hurt the Chinese economy, disastrous effects will be seen across the globe.

The bill currently in the Senate known as the Currency Reform for Fair Trade Act is merely an amendment to the Tariff Act of 1930, otherwise known as the Smoot-Hawley Act (United States). Robert Sobel, American business history writer with a Ph.D. in history, records the Smoot-Hawley Act making tariffs increase an average of 40 percent on imported goods at the beginning of the Great Depression. Past senators like Joseph Grundy defended it, saying it would make American-made products seem inexpensive compared to their foreign counterparts (Sobel
Robert Sobel also records that American consumers then bought American products instead of the now more expensive foreign imports. The anticipated result would be more money circulating through the United States’ economy, bringing it out of depression (Sobel 86).

Sobel relates the immediate consequences of the Tariff of 1930 as being advantageous to the United States’ economy, such preventing unemployment rates from continuing to decrease (Sobel 88). Unfortunately, the benefits were enjoyed for only a few months until other countries interpreted the tariff as a sign of United States’ isolationism. Consequently, Encyclopædia Britannica Online reports that imports to and exports from Europe and other parts of the world were severely limited, falling by two-thirds from the year 1929 to 1932 (Smoot-Hawley). As America’s economy failed, the world trade market fell with it. In the year 1934, President Franklin Roosevelt recognized the need for more open trade, so he implemented the Reciprocal Trade Agreements Act, lowering tariffs on imported goods to reasonable levels (Smoot-Hawley).

Although the Tariff of 1930 was abolished and replaced with a more liberal trade policy, democrats and republicans alike are once again joining forces to try and enforce the bill with a few added limitations. The Currency Reform for Fair Trade Act text amends and enacts the 1930 bill by specifying that in order for a country to be charged with a high importation tariff, its currency must be considered “fundamentally undervalued” (United States). In determining whether or not the currency is undervalued, or is worth less compared to the US dollar, a few characteristics of a country’s economy are evaluated using data from the past 18 months of economic activity, such as a large amount of foreign asset reserves and significant global account surpluses (United States). The bill serves as a warning to other countries that if their currency is considered undervalued, they will suffer a financial penalty.
The qualifying statements left China as the only country meeting the criteria. China’s account surplus has remained at a steady figure of 0.7%-0.8% of the global gross domestic product (GDP), beating the all-time record from 1920 when the United States had a surplus of 0.4% of the global GDP (Kostohryz). As of June in 2010, China possessed 2.45 trillion dollars in foreign asset reserves, with 65% of the reserves held being US dollars (Rabinovitch and Xin). China continues to encourage the accumulation of foreign asset reserves under a system called hoarding. Hoarding occurs when a central bank receives foreign monies and allows the funds to remain as a large savings account, or non-productive wealth that isn’t circulated back into the economy (Gorga 109). Since U.S. dollars are packed away in China’s central banks, the money never enters the market. The value of the dollar remains the same because the same amount of dollars is still in the market. Because the Chinese currency, the yuan, is continuously being circulated back through the market, its value decreases and remains undervalued relative to the US dollar (Kostohryz: Part 1).

However, because China bought mass amounts of United States’ treasury securities, China was the main reason the U.S. economy did not crumble when Lehman Brothers went bankrupt at the end of 2008. Bo Zhiyue, a senior research fellow at the East Asia Institute of the National University of Singapore, relates the information by saying, “Within twelve months from October 2007 to October 2008, China’s holdings of U.S. treasury securities expanded from US$459.1 billion to US$652.9 billion, but a net of almost US$200 billion” (Zhiyue 256). The Chinese investment acted as a stimulus for the economy and a barrier toward the spiraling inflation. It is for this very reason that the US economy is still functioning after the recession of 2008-2009.
Even though China is using its increasingly powerful influence on the global market to help the United States, the Chinese government is also using its influence to manipulate its currency (Kostohryz: Part 1). The government controls the value of the yuan most influentially by buying United States dollars off of the market, and then hoarding the money. When US dollars are taken out of the market, the value of the dollar increases because it becomes more scarce, thus worth more (Kostohryz: Part 1). The government is not hoarding the yuan, so the ratio of yuan to dollars is kept high to low. This is a preferable situation for the Chinese because of their high levels of trade with the United States. If a Chinese product were to sell for 15 US dollars in America, the Chinese could exchange that money for about 100 yuan at the current exchange rate of 1 dollar to 6.684 yuan (XE). Thus, the Chinese economy increases, and they are able to sell more products, creating more yuan in the market. The yuan continues to lose its value, or depreciate.

Although the economic trade benefits of the undervalued yuan keep the Chinese content with their profits, it frustrates the United States Government. Presidential candidate George W. Bush determined the country’s future relations with China in 1999 by calling China “a competitor, not a strategic partner” (qtd. in McCormick 211). Ten years later, the United States was still just as concerned about the growth and power of the Chinese economy. Tim Geitner, the United States’ Secretary of the Treasury, responded to questions from the Senate Finance Committee in January of 2009, telling them, and consequently, the world, “President Obama – backed by the conclusions of a broad range of economists – believes that China is manipulating its currency.” Geithner also told the committee that the new administration would “use aggressively all the diplomatic avenues” to change China’s currency practices (qtd. in Zhiyue
Because the U.S. consistently says it must compete with China, it shows the fear of China’s power and the desire to be the unrivaled country.

The frustrated government’s attitude has also begun to trickle down to the general American public. Estimates reported by investment and trading expert, Robert Kostohryz, state that the United States has lost around 2-3 million jobs since 2001 because of the depreciated yuan (Kostohryz: Part 2). The approximated hurt done by China to the American public prompts responses like one from an everyday American blog user, Kim Woodbridge. On an article talking about the yuan value, she posted, “I didn’t know anything about this – China purposefully keeping the yuan undervalued – it’s very interesting. And as an American, a little frightening” (Woodbridge). A study conducted by the Chicago Council on Foreign Affairs concludes Ms. Woodbridge’s reaction to be common among Americans. On a survey asking Americans to rank U.S. government foreign policy objectives by importance, job protection was recorded as the highest priority (qtd. in Page and Xie 31). Because China is viewed as the culprit of stealing what is most important to Americans, Americans are beginning to want to work against the Chinese economy to protect their income.

Fortunately for Chinese trade and currency practices, the jobs displaced due to a depreciated yuan are minimal, if not negligible. Sheng-Wei Wang, founder of the China-U.S. Friendship Exchange, provides two main reasons for the exaggerated claims of American job loss due to Chinese finance practices. These reasons are a reduced overseas demand for the United States’ goods and increased production efficiency within the United States (Wang 236). The U.S.’s higher efficiency leads to fewer workers needed in the factories. The U.S. Department of Labor estimated that only 1% of the 15 million American jobs lost could be attributed to China (qtd. in Wang 236). However, the money lost in the job sector of the
American economy is given to the American consumer who saves money on the less expensive Chinese goods.

However, the main reason that the American public and government alike are starting to become more wary of Chinese economic strategies is because they are afraid China will become stronger than America. According to Jing Men, senior researcher at the Brussels Institute of Contemporary China Studies, “Many Americans regard China as the main challenger to the U.S.’s superpower status” (Devuyst and Men 301). This idea could be at least partially consequential to China’s rapidly rising GDP, which according to the International Monetary Fund, has risen and will continue to rise around 10% per year (International 64). The United States’ GDP, however, has been decreasing in recent years. The year 2010 was the first year America’s GDP began to increase, but only by less than 3% (International 70). If these growth estimates remain accurate, China’s GDP will be greater than the United States’ GDP within the next 20 years, making China’s economy the largest in the world.

The trade inequality with China also makes Americans nervous. The United States has a 226 billion dollar trade deficit with China, which means China is selling much more to America than America is to China (U.S. Census Bureau). The United States does not like this arrangement, partially because it causes so much dependence on the Chinese economy. Americans also do not like it because it is believed to be “unfair trade.” In a poll done by the Chicago Council of Global Affairs, Americans were asked to report whether or not six individual countries practiced fair trade. Out of the six countries, only China’s trade practices were labeled unfair by a majority of Americans – 67% (qtd. in Page and Xie 26). In order to level out the playing field, the U.S. government is trying to make the Chinese appreciate the yuan, believing
Chinese profits from trade will lower and will not experience too much growth from seemingly unlimited exportation abilities.

However, the United States fails to acknowledge a couple key details in the assumption that receiving so many imported goods from China is detrimental to the United States. First, because of the low prices Chinese trade offers to Americans, Fareed Zakaria, editor of Newsweek, reports that American consumers saved around 600 billion dollars from the years 1995 to 2005, or 60 billion dollars a year (qtd. in Page and Xie 16).

Second, Sheng-Wei Wang notes that appreciating the yuan by 10% will at maximum decrease the U.S. trade deficit by 1% (Wang 236). If this occurs, for Chinese companies to make the same profits with the appreciated yuan, they would have to sell their products at higher prices. The 2.26 billion dollars the U.S. gained from the decrease in the trade deficit will result in 60 billion dollars lost that American consumers save a year from reduced Chinese goods’ prices.
Third, Wang also observes that Chinese exports like shoes, textiles and automobiles make less than 5 cents for every dollar sold (Wang 235). A sharp increase in the value of the yuan would wipe out the profits and the businesses. Fourth and final, the decreased prices would end for firms using Chinese imports in their production. United States’ firms would no longer be more competitive. It would not allow circulation of funds back in the United States’ economy (Sutter 205). The small benefits of the appreciated yuan would not help any country in the long run.

If the United States Senate were to pass the Currency Reform for Fair Trade Act, the initial results would probably be profitable to the United States like the tariff in 1930. Since Chinese goods would be more expensive, more American consumers would begin to buy American products unaffected by the tariff. However, after only a couple months, the bill would begin to backfire. Bo Zhiyue, senior research fellow at the East Asian Institute of the National University of Singapore, warns that by imposing high tariffs, the United States risks retaliatory duties or other counterattacks from China (Zhiyue 268). Since United States exports to China are approaching figures close to one trillion dollars, the impact of an import duty on American exports would destroy the American economy (U.S.-China Trade).

Even without a trade war erupting, the tariff on Chinese imported goods would hurt the American economy. Robert Sutter, past director of the foreign affairs and national defense division of the Congressional Research Service, explains that Chinese factories and factory workers are so much more efficient and less inexpensive than the United States’ manufacturing system (Sutter 193). China can then support a greater demand from the American public for the goods. The American manufacturing sector would not be able to support the demand, so products would have a high demand and low supply. This scarcity would cause prices to increase, hurting
middle- and lower-class American consumers. Inflationary pressures on the U.S. dollar would increase, causing a harmful strain on the American banking system.

China must take more actions to really have an effect on the economy other than just adjusting the value of the currency. Such actions include reforming the financial system, making sure the market price reflects the total cost of production, and maintaining price stability. However, a bill proposed by senators without a sufficient background in foreign relations or economics is not going to be what solves these weighty issues. Because the American economy is so intertwined with the Chinese economy, a bill trying to push the Chinese economy down just so the United States can feel secure would be difficult and even unreasonable to pass. If the United States persists in trying to control China through duties imposed on artificially low trade and currency practices, it will hurt the United States economy. As Albert Camus, 1957 Nobel Prize winner, wrote, “You have to be very rich or very poor to live without a trade” (Camus). Although the American conclusion may be to appreciate the yuan or watch the economy die, a more comprehensive solution needs to be introduced. If not, the economic repercussions from the bill will mean disaster for the United States, China, and the world.


