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Don’t Blame the Yuan
By R. Glenn Hubbard
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Policy makers are blaming our trade deficit with China for U.S. job losses in manufacturing. We are told that pushing China to revalue its currency against the dollar would stem job loss here. This argument is both unpersuasive (it does not survive careful scrutiny) and unfortunate (it detracts from steps policy makers could take to address concerns of U.S. workers).

First, some facts. U.S. manufacturing is not being hollowed out by trade with China. China is the latest in a series of countries with low labor and manufacturing costs to gain prominence on the economic stage. Meanwhile, in the U.S., we continue to be a nation that makes things: As a share of real GDP, real goods production was higher in the first quarter of this year than in the peak years of the 1950s and '60s. What has declined is manufacturing employment relative to total employment, as productivity growth in U.S. manufacturing has become a global standard and some "business services" jobs are outsourced for manufacturing. The decline in manufacturing employment resembles that in agriculture in the last century, in which robust productivity growth characterized American performance, and millions of workers exited agriculture for other segments of the economy.

Now to China. Low-priced Chinese goods clearly benefit American consumers. But isn't the Chinese currency undervalued? Yes. So why not urge China to increase its value? Be careful what you ask for: Pressure for revaluation is bringing hot money to China, adding froth to asset prices. China's banks already have the largest scale nonperforming-loan problem in the world. Failure to fix the banks first could lead to financial instability and a banking crisis in the event of a sudden revaluation.

This is not to say that we lack constructive suggestions. Sitting on $360 billion of reserves, China could and should take steps to recapitalize banks and foster better lending standards (the recent increase in reserve requirements in China was, indeed, an attempt to restrain speculative lending). China should also be encouraged to open its goods markets, stimulating imports and making Chinese consumers better off. By tilting at the currency windmill, policy makers miss crucial points of leverage.

While scapegoating China for job loss in American manufacturing is unpersuasive, the deeper worry is that such quixotic policy will divert attention from policies that would actually help U.S. workers. First, President Bush proposed Personal Re-employment Accounts, which would provide substantial funds to unemployed workers to defray costs of training or finding a new job. Second, his proposal to use tax subsidies to encourage private health insurance -- a pilot for which was enacted in the recent Trade Adjustment Assistance Act -- offers support for individuals adversely affected by trade dislocations. Third, repealing the steel tariffs -- which the administration can do after the upcoming International Trade Commission review next month -- would provide a boost (three manufacturing jobs were lost for each one protected in the steel industry). While these steps are not as powerful as the positive effects of tax cuts in the pipeline, they are constructive.

There is no "silver bullet" to reduce the job losses in American manufacturing: Fashioning Chinese currency revaluation as one risks both unwelcome international consequences and failure to take helpful steps at home.

Mr. Hubbard, a professor of economics and finance at Columbia, was, until March, chairman of President Bush's Council of Economic Advisers.