



Legislation to Sanction China: Will It Work?

Nicholas R. Lardy assesses the prospects and potential impact of legislation to impose duties on Chinese goods if it does not let its currency appreciate.

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Steve Weisman: Legislation to impose sanctions on China over its currency policies appears headed towards passage in the United States Senate. [The legislation passed on Oct. 11] But it has a doubtful prospect in the House. This is Steve Weisman with Nicholas Lardy, senior fellow at the Peterson Institute for International Economics. What would the legislation do?

Nicholas Lardy: The legislation would require, in the case of countervailing duty cases -- where the Chinese government is giving a subsidy to an export -- that if a subsidy was in fact found, when the countervailing duty was put on, it would also include an additional margin to take into account an estimate of how much the currency was undervalued.

So, if the margin were 10 or 15 percent, you might be adding another 10 or 15 percent on for currency. It would tend to make these dispute cases much more onerous for China, by virtue of the fact that the tariff that those goods would have to pay would be quite high.

Steve Weisman: We often hear that the undervaluation of the renminbi is an effective subsidy. But in legal terms, in World Trade Organization terms, would that bring a challenge?

Nicholas Lardy: The experts, I think, are divided on this. But many of them believe that even though the bill has been re-crafted over the year to make a greater effort to avoid losing a dispute settlement case, I think most of the experts think there's still a chance that this would be found not consistent with WTO principles, and that if the Chinese were to challenge it, that the United States might lose. The president specifically mentioned that yesterday.

Steve Weisman: Yes, the Administration, [Treasury] Secretary Geithner, President Obama, seemed concerned about that.

Nicholas Lardy: Yes. I think you don't want to set a precedent -- well, it wouldn't exactly be a precedent. But certainly if you believe in the international system, as the United States has for many many decades, you don't want to be taking overt actions that will in retrospect be shown to be inconsistent with the basic underlying principles. It would be an invitation for other countries to do the same thing.

Steve Weisman: The business community seems divided on this. In the House, Speaker Boehner, even a few weeks ago, was more neutral or receptive to this legislation, but now more recently is warning against it. Why is the business community divided?

Nicholas Lardy: They're divided obviously because they have very different interests. Really, the dividing line is [between] the very major multinational companies that have invested in China and are selling a lot of product in China, and smaller companies, in different industries that are facing import competition from China.

The first group is worried that if a currency bill passes, the Chinese will retaliate, and part of that retaliation might take the form of making it more difficult for them to expand their businesses in China. So they're basically [saying], "Don't rock the boat, we're expanding our businesses, we're generating a lot of business in China."

The smaller businesses that are facing import competition are clamoring for higher tariffs so that they have a possibility of continuing to thrive or to not lose jobs as rapidly as they have in the past. So it's basically small versus big.

Steve Weisman: That's interesting.

Nicholas Lardy: It's quite straight forward. The big ones really don't care about the exchange rate very much, because they're producing in China. If you're making big machines, for example, you're sourcing your steel in China, you're paying your wages in Chinese prices, you're selling your product.

So all of your transactions are in Chinese domestic currency, and, you know, whether it goes up or down would have a very small effect on your business. They are worried about the political ramifications of a currency bill that could make it more difficult for them to operate.

Steve Weisman: What are the Chinese doing against the dollar and other currencies?

Nicholas Lardy: They have been continuing since roughly June of 2010 a policy of very gradual appreciation against the dollar. It's cumulatively now in the neighborhood of seven percent.

Steve Weisman: Since?

Nicholas Lardy: Since June of 2010. There's been a lot of volatility in markets recently, and traders have actually pushed the value of the currency down in a lot of trading days in September. That gave the impression perhaps that appreciation had stopped.

But in terms of the central rate that is set at the beginning of every trading day, the Central Bank in China is still moving the rate up. And indeed the rate at which they have moved it up in recent weeks has actually stepped up a little bit. This week is an exception; it's a national holiday in China so there is no foreign exchange trading this week.

Steve Weisman: Against the basket of currencies, because of the depreciating value of the dollar, the Chinese appreciation is not so much?

Nicholas Lardy: Long term that's true if you take the whole period since June of 2010. The dollar has depreciated and even though the renminbi has been appreciating *vis-à-vis* the dollar has not translated into an appreciation on a trade weighted basis.

But given the volatility that has occurred in conjunction with the European crisis in recent weeks, the dollar has actually strengthened and in the last few weeks it looks now as if, since the Chinese are moving nominally against the dollar, and the dollar is appreciating against many currencies, that the rate of real appreciation of the trade weighted value of the renminbi has actually been quite rapid the last six or eight weeks.

Steve Weisman: Is the Chinese economy growing fast enough for the Chinese leadership to be less concerned about the economic effects of appreciating their currency against the dollar?

Nicholas Lardy: I think the only thing we can say with certainty is that there is a great deal of worry in Beijing about the European sovereign debt crisis and its implications for growth in Europe and in the United States. They came through the first round of the crisis, if that's what it turns out to be in retrospect, remarkably well. They had a very strong stimulus program that kept their growth rate from falling very much.

Steve Weisman: When you say the first round you mean 2008 or so?

Nicholas Lardy: Yes, 2008-09. Their growth rate came down a little bit, but nothing like the dramatic declines in output that we saw in most of the West. They have less room for maneuver today than they had in 2008-9. I think that they are worried that if there is a real recession coming back in Europe, that could even slow down U.S. growth significantly, and that it will be much tougher for them to keep their growth rate up.

I think that they are preoccupied with what's happening in Europe, with how the European politicians are handling the crisis and what the outcome of that will be. So I think their main attitude right now is one of great uncertainty about the way that the global economy will evolve over the next couple of quarters.

Steve Weisman: Join the club. Thanks, Nick.

Nicholas Lardy: Thank you.

