Made in China, felt in America

Because the yuan is undervalued, U.S. interest rates are low, but manufacturing is declining, so the push is on to get China to float its currency

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If you bought a television, some toys or even a house recently, you may want to write a thank-you note - to China.

And you might want to stock up, since they might be more expensive soon.

China is having profound effects on our economy - from providing a steady flow of cheap goods to feed America's shopping habits to keeping mortgage rates low, as the nation invests in U.S. treasuries.

There's really one central reason. China's currency, the yuan, is locked at 8.28 yuan to the dollar, which means the exchange rate between the two never changes. So the yuan fails to reflect China's growing strength and is now, by most accounts, significantly undervalued.

That means China is able to keep selling cheap goods to the United States, which helps to hold overall prices and interest rates here relatively low. But it also puts a competitive handicap on companies here, and that's partly behind the demise of the manufacturing industry.

So U.S. politicians, economists and business executives are trying - so far unsuccessfully - to persuade China to float its currency by allowing the yuan to trade at its true value on the open market.

"The reality is that there should be a free market in currencies that would allow a company in Taiwan to have the same competitive situation as a company in China or a company in Brazil ... including the U.S.," said Commerce Bank chief economist Joel Naroff.

Yuan hurts U.S. trade

Perhaps even more important, the undervalued yuan has been a huge factor in the United States' ballooning trade deficit. Nearly a quarter of the $686-billion annualized trade deficit can be attributed to China, experts say. Economists estimate China's currency is undervalued by as much as 40 percent.

The yuan has become a political and economic hot button. It's full of complexities and debate, since no one seems to agree on just how big an impact unlocking the yuan could have - and whether the positives would outweigh the negatives.

Last week, the Bush administration and congressional representatives suggested that China was finally moving toward a revaluation.

"They [administration officials] have convinced us that the likelihood of real progress with China on currency revaluation is very real and could well occur in a very short while, in the next few months," Sen. Charles Schumer (D-N.Y.) told reporters on Thursday.

Schumer and Sen. Lindsey Graham (R-S.C.) had proposed a bill that would impose a 27.5 percent tariff on Chinese imports in an effort to force China to begin a revaluation. They agreed to delay a vote on the bill when Treasury Secretary John Snow and Federal Reserve Chairman Alan Greenspan assured them progress was being made. Greenspan has suggested such a tariff would imply a protectionist stance that could hurt the United States' place in the international economy.

Indeed, many experts believe that the United States shouldn't play such a significant role in deciding China's currency valuation, especially since China has, so far, rebuffed all foreign requests to consider any changes. As a result, some still question whether any yuan shift will happen.

"It should be revalued, but it's probably not going to be," said Usha Haley, an international business professor at the University of New Haven. "There are no positives for China."

China depends on the peg to keep product demand strong, maintain job growth for its huge workforce and stabilize the economy, experts say.

China might be willing to shift its currency valuation by 5 to 10 percent - but that's far too little to make a real dent in the problem, Haley said. Even then, some experts suggested, China probably won't rely on a free-floating currency whose value is determined by the financial markets; instead it could shift the value, but still link the yuan to a market basket of other currencies.

China could also start with a small change and ease into a fully floated currency, with incremental changes over several years. In the long run, other experts said, a floated yuan may help China by preventing the overheating of its economy and allowing the government to gain more control over its monetary and banking systems.

But even while solving old problems, a freely floating currency could create new ones, for Americans and Chinese alike.

Take the real estate market. The longer the yuan is pegged to the dollar, the more trade surplus China's government has to invest in U.S. Treasuries. That has, in part, kept mortgage rates, which are tied to the movement of Treasuries, relatively low. If the yuan floats, those long-term interest rates might rise.

That could, in turn, cause a slowdown in the housing market. But it probably won't lead to any sort of collapse. "In order to seriously do damage to the housing market, we'd have to see interest rates rise by 1.5 percent, and I just don't see it," said Doug Duncan, the chief economist for the Mortgage Bankers Association of America.

Floated yuan = inflation?

More worrisome to some economists is the potential increase in overall consumer prices.

"This is a very important part of keeping our inflation down in light of all the oil price increases we've been seeing," said Jeremy Siegel, a finance professor at the University of Pennsylvania's Wharton School of Business in Philadelphia. "We can't have the threat of another inflationary factor coming from abroad."

But the world includes far more than China and the United States, and the other economic competitors from Asia and Europe, combined with a gradual revaluation, might make price gains moderate. That's especially true since other Asian countries also peg their currencies, at least somewhat, to the dollar so they can remain competitive with China. If China were to shift its yuan, other countries would probably follow suit.

That same international story, however, may mean that there's little hope for a rebound in U.S. manufacturing, despite talk of new jobs and new money flowing back into the United States with a yuan shift. Greenspan has said revaluing the yuan would likely not create new jobs in the sector.

"It's been 30 years since the peak of our manufacturing employment," Siegel said. "There are broad-based forces that are so strong, they're going to overwhelm anything that has to do with the yuan."

Some manufacturers are at least hoping a floating yuan will help stop the bleeding - and maybe improve the industry's chances a bit.

"Some of the jobs may be in China permanently and others will move to other Asian countries, but some high-tech jobs will stay here," said Bob Cassidy, director of international trade and services at Collier Shannon Scott, a Washington, D.C., law firm. Cassidy is also an adviser to the China Currency Coalition, a group of industrial, labor and service organizations pushing for the yuan's revaluation.

Manufacturer Doug Burnett, who co-chairs the coalition, pointed to his own business, Burnett Manufacturing Co. in Cary, Ill., as a key example. The circuit board maker has gone from having $22 million in sales and 250 employees in 1999 to $9.8 million in sales and 83 employees now.

"The Chinese are cheating, to the detriment of American manufacturing and the American worker," Burnett said. "Instead of losing jobs, we would start to generate jobs that are good-paying jobs that would help stabilize and build the middle class."

Even more important than the jobs, he said, is the chance that investors will sink money into research and development here, allowing the companies now on the verge of moving or folding to stay.

Yet, the intense debate over whether U.S. jobs will be created and whether prices will rise begs the question: Why bother pushing the issue forward?

That's when experts point to the strong desire for free trade, an equal playing field and the need to follow the rules.

"The international trading system is based on the notion of fairly valued currencies and that countries don't subsidize their exports," said Peter Morici, a University of Maryland economist. "What China is doing is driving a Mack truck through the road of international trade."

Nonetheless, change won't happen overnight.

"It took us a decade to get into this, it'll take a decade to get out," said Mark Zandi, chief economist of Economy.com in West Chester, Pa.

Getting current on Chinese

currency

The yuan has been pegged at about 8.3 to a dollar since May 2005, meaning that one yuan is worth about a dime.

The yuan is also known as the renminbi, meaning "people's currency."

Experts say it is undervalued by as much as 40 percent.

During the Asian financial crisis in 1998, the peg between the yuan and the dollar allowed China to remain relatively unaffected. At the time, officials praised the link between the currencies.

The U.S. annualized trade deficit is now at a record $686 billion.

The United States' annualized trade deficit with China is approaching $170 billion.

China's annualized trade surplus stands at about $72 billion, based on data from the first five months of the year.