

**OPEN FORUM****ON THE OLYMPIC TORCH****U.S. needs a new vision of China relations**

Geoffrey Garrett

Monday, March 31, 2008

In the run-up to the Ohio primary, Sen. Hillary Clinton captured prevailing sentiments in middle America about China: "China's steel comes here, and our jobs go there. We play by the rules, and they manipulate their currency."

In fact, however, China is actually doing what America has long demanded to cure the economic imbalances between the two countries: It has allowed its currency, the renminbi, to appreciate by 15 percent against the dollar since mid-2005.

But no one in Washington is trumpeting this exchange rate victory, because the U.S. bilateral trade deficit with China, which a stronger renminbi was supposed to reduce, hit an all-time high of \$256 billion last year.

This staggering trade deficit only fans other concerns when it comes to China. Its military aspirations, its impact on the environment and global energy markets, its human-rights record, and its approach to Taiwan, all generate anxiety in Washington.

The United States needs a new vision for its relations with China, one based on further economic integration, not protectionism. This is the best way to keep America prosperous, promote democracy in China, and ensure peace and stability in the Asia-Pacific region.

Here are three trade secrets that should inform a "straight talk" revolution in Washington where China is concerned.

First, the trade deficit with China isn't going away anytime soon, even though a stronger renminbi and America's economic slowdown have caused U.S. exports to China to grow twice as quickly as Chinese exports to America in the past two years.

The trade deficit keeps growing because of the massive imbalance between U.S. exports and imports where China is concerned. The U.S. exports to China less than one-fifth as much as it imports from China. Even if U.S. export growth to China continues to outpace increases in imports from China, the bilateral deficit will continue to expand for years to come.

A second secret is that the bulk of Chinese exports to the United States are not really made "by China." They are not even really "made in China."

The Chinese economy today is, in large measure, an assembly platform for American and foreign companies to turn components designed and made elsewhere into final products, and then to export them to the rest of the world. More than 60 percent of "Chinese exports" are, in fact, the sales outside China of multinational firms operating in China.

What Apple says on the back of every iPod is true: "designed by Apple in California, assembled in China" from chips, hard drives and screens made in America, Korea and Japan. Chinese assembly adds only a tiny amount to the value of each iPod.

The iPod is not a new millennium icon because of its components. Nor does it beat the competition on price. iPods are must-have gadgets because of their elegant and simple design, a design created in Silicon Valley, with almost all the profits returning to Apple and its U.S. shareholders.

The fact that iPods are not assembled in the United States certainly costs assembly line jobs in America. But these are in the lowest tech and lowest part of the production process. Much better American jobs are created, in design, financing, marketing, logistics and distribution. This is a very positive trade-off.

The final China trade secret is that Americans have benefited from the vast quantities of dollars and Treasury bills (estimated at \$750 billion) China has purchased in recent years to manage the dollar-renminbi exchange rate. China-funded credit kept U.S. interest rates low after 9/11 and the dot-com bust, fueling both consumer spending and the rapid run-up in housing prices.

The only way for Beijing to allow the renminbi to appreciate was to sell dollars and Treasury bills, which it has been doing in increasing volumes. But this has put upward pressure on interest rates and tightened U.S. credit markets. China did not cause the subprime meltdown, but the sale of its dollar-based assets will hinder an American recovery.

China and the United States are increasingly entwined economically, creating both opportunities and challenges. There is every reason to believe that the benefits of economic integration outweigh the costs. You just wouldn't know it, listening to the political debate in this country.

Rather than pander to understandable insecurities in middle America by bashing Beijing, U.S. leaders need to pro-actively shape a pragmatic, sustainable consensus on China policy. Turning trade secrets into widely understood economic facts of life for the American people is a very good place to start.

*Geoffrey Garrett is president of the Pacific Council on International Policy and a professor at the University of Southern California.*

*This article appeared on page B - 5 of the San Francisco Chronicle*