# China Trade & Currency Rates With Economist Robert Shapiro

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Two prominent and interrelated stories have dominated the landscape of international business headlines recently: currency valuations and China trade policy.

Earlier today, I spoke with Dr. Robert Shapiro of Sonecon, LLC. Dr.

Shapiro was Under Secretary of Commerce for Economic Affairs during the Clinton administration, and the principal architect of President Clinton's 1992 economic program.

"In order to understand why these issues are emerging now," Shapiro said, "you have to look at the largest single factor in the global economy: Emerging economies are growing quickly, and developed economies are growing rather slowly. This is the overarching fact in the global economy today. "

According to Shapiro, that kind of economic imbalance can lead to trouble on both sides of the economic divide. "Due to a slowdown in the developed world, there has been a slowdown in the demand for goods produced in the emerging world. There is a great deal of competition in the developing world for those dollars—and Euros and yen," he said.

So the nations of the developing world are searching for a price edge—and the easiest way to find that price edge is to reduce the value of your currency relative to your economic rivals. So the game in the developing world becomes this exchange rate competition among nations searching for an exchange rate relationship edge, vis-à-vis the dollar the yen and the Euro.

But, as Shapiro points out, this is not a sustainable strategy: "This is a short term response—and that's what makes it dangerous"

What's the danger? If the short-term currency rate war doesn't generate enough of an edge for developing nations, then the next logical step is protectionism. That protectionism can take many forms—from restrictions on imports to direct government subsidy of industry.

And the dangers of going down that road are pretty well defined: A downward international spiral of tariff walls and government funded industries instead of free economies.

But that's a quite separate issue from what we now face with China:

"We're not in a currency war with the Chinese—but we are in a currency argument," Shapiro says.

As he points out, the currency issues with China have been taken to embody the U.S. trade imbalance in the popular imagination of the American public.

"We've been there before with Japan," Shapiro points out.

"The difference is that we were—and are—in direct competition with Japan. And we're not with China." China doesn't produce the automobiles or the pharmaceuticals—or a hundred other things—that we are in direct competition with Japan and Europe over, Shapiro notes.

But, according to Shapiro, there is a simple explanation: "Domestic politics."

"China embodies people's frustration that employment has not recovered. They are attributing it to trade, though that's not correct. But it is an important syllogism in American politics—but that's a political syllogism, not an economic one," he says.

And then there is the talk of economic rebalancing.

A headline from today's Wall Street journal reads **Geithner's Goal: Rebalanced World Economy.**

While the policy implications of rebalancing are enormous, understanding the economic argument is a fairly straightforward proposition: The United States needs to save and invest more, while consuming less — and China needs to save and invest less, while consuming more.

But China is resistant to this shift.

Why? According to Shapiro: "First of all, it's succeeding brilliantly for China."

As it now stands, China is insulated from the global banking system.

They have experienced very little loss from the global economic meltdown. And not surprisingly they like it that way.

But like the issues Shapiro raised earlier, regarding the currency rate war in the developing world, this trajectory can't be sustained forever by the Chinese. China does not have a modern bond or stock market. And, eventually, they will need to build them if they are to sustain continued economic progress.

But perhaps the more intractable problem is the issue that Shapiro frames thusly: "The persistent issue of relatively low consumption is driven by a total absence of a social safety net."

"In China," he says, "they call it pay or die."

He paints a rather disturbing portrait of social services in modern day China: "If you're hit by a car in front of the Beijing Central Hospital, the largest hospital in the country, and you cannot pay the bill, they'll take you outside and you can bleed to death in the street — or more likely in the alley behind the hospital."

"If that's what you're facing, there is a very large incentive to save at a very high rate."

It's difficult to argue with that kind of analysis.

More from Dr. Shapiro can be found at **his website**.

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