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ECONOMIC VIEW

# It's No Time for Protectionism

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WHAT approach will the Obama administration and the Democratic majority in Congress take on international economic policy? It is too early to say for sure, but the signs so far are worrying.

Just before his confirmation as Treasury secretary, Timothy F. Geithner turned up the heat on the Chinese regarding the dollar-yuan exchange rate. President Obama, he said, "believes that China is manipulating its currency. Countries like China cannot continue to get a free pass for undermining fair-trade principles."

Like many economists, I cringe whenever I hear the term "fair trade." It is not that I am against fairness — who is? — but the word "fair" is so amorphous in this context as to defy definition. Most often, the slogan "fair trade" is little more than a rallying cry for protectionism.

Just days after Mr. Geithner pointed his finger at China, Wen Jiabao, the Chinese prime minister, pointed his own finger right back. Speaking at the World Economic Forum in Davos, Mr. Wen blamed the United States for the economic crisis the world is now experiencing. He talked in particular of "the failure of financial supervision."

Most likely, Mr. Wen was aware that one of the important players in the United States supervisory system has been Mr. Geithner, who until recently was president of the Federal Reserve Bank of New York. In that role, Mr. Geithner was, for example, the primary federal regulator for Citigroup. Mr. Wen may have been suggesting — quite rightly — that the new Treasury secretary should focus his energy on fixing problems a bit closer to home.

But timing aside, is Mr. Geithner right about the currency question? Are Americans hurt by China's exchange-rate policy?

Critics of China say it is keeping the yuan undervalued to gain an advantage in the international marketplace. A cheaper yuan makes Chinese goods less expensive in the United States and American goods more expensive in China. As a result, American producers find it harder to compete with Chinese imports in the United States and to sell their own exports in China.

There is, however, another side to the story. The loss to American producers comes with a gain to the many millions of American consumers who prefer to pay less for the goods they buy.

The situation is much the same as when the price of imported oil falls, as it has done in recent months. Domestic oil producers may see lower profits, but American consumers are better off every time they fill up their tanks. Consumers similarly gain when a cheap yuan reduces the prices of T-shirts and televisions imported from China.

Mr. Geithner and other China critics might also want to ponder how the Chinese keep the yuan undervalued. The essence of the policy is supplying yuan and demanding dollars on foreign-exchange markets. The dollars that China accumulates in these transactions are then invested in United States Treasury securities.

So when the Treasury secretary complains about the undervalued yuan, his message to the Chinese boils down to this: Stop lending us money.

Not surprisingly, after Mr. Geithner made his remarks about the Chinese currency, the prices of Treasuries fell and yields rose. If China took him seriously, long-term interest rates would rise even more. As the United States embarks on a path of unusually large budget deficits, the nation's chief financial officer should pause and think carefully before turning up the heat on one of its biggest creditors.

Perhaps the oddest thing about Mr. Geithner's move is that his complaint seems out of date. The yuan-dollar exchange rate has moved considerably in recent years. After a long period of completely fixing the exchange rate, China allowed its currency to start moving in July 2005. Since then, it has appreciated by 21 percent.

Mr. Geithner might think that the yuan needs to move more, but why shine a bright light on the issue at this particular moment? Olivier Blanchard, the chief economist of the International Monetary Fund, had it right when he said: "It is probably not the right time to focus on the Chinese exchange rate, given that it is not a central element of the world crisis. There are many other things we should be thinking about."

DIRECTING attention to the China currency issue amid a worldwide recession and growing fears of depression is more than a distraction. It is downright counterproductive. Senators Charles E. Schumer, Democrat of New York, and Lindsey Graham, Republican of South Carolina, have long proposed dealing with the yuan undervaluation by imposing tariffs on Chinese imports. The Treasury secretary's comments risk stoking those protectionist embers.

Indeed, protectionist influences seem to be finding their way into the stimulus bill winding its way through Congress. The bill passed by the House included a provision banning the use of foreign iron and steel in infrastructure projects. The Senate has adopted a somewhat more flexible restriction (after voting down an amendment by John McCain to strip the "Buy American" provision from the bill).

Despite having hired many first-rate economists with impeccable free-trade credentials, the president has been only tepid in his public opposition to this creeping protectionism.

This may be a good time to recall the legacy of Senator Reed Smoot of Utah and Representative Willis Hawley of Oregon, both Republicans. The 1930 tariff bill that bears their name did not cause the Great Depression, but it contributed to a plunge in world trade and undoubtedly was a step in the wrong direction.

As we sort through the wreckage of our own financial crisis, a retreat into economic isolationism is one mistake we want to be sure not to repeat.