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The Political Game of the U.S. Currency Issue towards China

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The currency issue towards China has become a heated topic on Capitol Hill in the U.S. during the last decade. Most researches focus on whether the RMB is overvalued in financial terms. For over two decades the explosive trade growth between the U.S. and China has brought deep social-economic impacts. To illustrate it, this paper uses various social-economic data across the states, and analyzes a typical currency bill towards China which was passed in 2010 by the White House. The empirical study shows that the social-economic factors play comprehensive roles in this political game. The local unemployment condition is relative to the voting result. If the unemployment rate in the home-state increases by 1 percent, the representing congressman would vote yes to the currency bill against China with a higher probability of 2.3 percent. Also a congressman from a state with a manufacturing advantage is more likely to support the aggressive currency bill towards China. Finally, the interest group and partisan ideology also influence congressman policy decisions. Political contribution from commercial sectors increases the probability of voting yes on the currency bill against China This paper links the social-economic impacts in a trade-linked world with policy-making impacts, and sheds light on understanding the complexity of trade policy.

Keywords: *China, currency policy, political economics*

Introduction

In the past decade the U.S. has pressured China on the RMB exchange rate issue frequently. This has cast a shadow on the bilateral trade between the largest economies in the world. The currency debate can be traced back to the year of 2003. The U.S. Secretary of Treasury John Snow expressed his concern about the RMB exchange rate issue during his visit to Beijing in September 2003. Snow said China should loosen currency controls in order to fulfill its international obligation. During the same month, Senator Schumer and Senator Graham put forward a bill regarding the RMB exchange rate. They criticized China for unfair trade and insisted on the RMB's appreciation. The bill stated

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that if China failed to do so, the U.S. would impose a tariff rate at a level of 27.5% on China's exports to the U.S. Since then, the currency issue became hot on Capitol Hill. Already by 2005, there were 22 bills raised in the Congress regarding this issue.

In July 2005, China announced it would reform its foreign exchange regime, abandon the RMB-dollar peg and peg to a basket of currencies instead. From July 2005 to July 2008 the RMB had appreciated against the U.S. dollar by over 20 percent. Even though the RMB had appreciated this much, the debate on the currency issue towards China did not stop at Capitol Hill. In March 2010 there were 130 congressmen to call on the Obama administration and to label China as a currency manipulator, which meant that more punitive measures could be taken against China. In September 2010 the White House passed a bill titled the Currency Reform for Fair Trade Act. This bill adds currency revaluation into the judgment of anti-dumping and countervailing subsidy by the administrative branches. The bill obviously was aimed at China, and inevitably incurred a new wave of heated debates on the currency issue between the two countries.

What is behind the continuous currency debates between the U.S. and China for such a long time? This question has caused intense attention among scholars. The mainstream opinion thinks the RMB has been undervalued, thing which is mainly caused by the Chinese government's intervention in the monetary market (Goldstein and Larry 2003, 2005, Williamson 2003, Goldstein 2004, Frankel 2005, Zhang and Chen 2013). Compared with the real purchasing power parity, the RMB's value deviates from its real value (Subramanian 2010).The Nobel Prize laureate in economics Paul Krugman is also a strong supporter of pressuring China to appreciate the RMB, he even advised the U.S. government to pose a tariff at a level of 25 percent on China's exports to the U.S., given the condition that a reasonable appreciation is not achieved (Krugman 2010). However some scholars debate that there is not obvious evidence for the RMB exchange rate's deviation from the reasonable level, there is no broad consensus as to whether the RMB is undervalued or by how much (Engel 2009, Mckinnon 2010, Fischer 2010).

The popular logic of the judgment that the RMB is undervalued is based on the fact that China has had large trade surpluses for years (Abdallah and Hoskins 2004, Mirjana 2011). However this logic simplifies the causation of international trade. Exchange rate is just one factor that influences a country's trade, also its effect on boosting trade by depreciation only lasts for a short time. In the long run a country's home-market effect and productivity level play mostly roles of import in the trade (Krugman 1980, Melitz 2003, Helpman et al. 2008). China's success of rapid trade growth during the past decades is based mostly on the improvement of the technology and its capability of providing high sophisticated products (Rodrik 2006). It seems the RMB is just the scapegoat of the unbalanced trade between the U.S. and China. Even Goldstein, the main figure who insists the RMB is undervalued, confessed that if employment in the US manufacturing sector had not (mainly for other

reasons) declined so much, the criticism of China in the U.S. would likely be more muted (Goldstein 2004).

So the financial explanation is not enough to understand the currency issue towards China in the U.S. The trade policy is the result of inter-influencing and interacting with different interests, ideologies and institutions (Bhagwati 1988). In the recent decades the research on the Political Economy of Trade sheds light on the understanding of trade policy. There are several disciplines and models in this field. In the Tariff Formation Model, the export industry lobbies for free trade and the import industry lobbies for protection by tariff The final trade policy is decided by the function of the resources input by the two kinds of lobbyist (Findlay and Wellisz 1982). The Political Support Model regards the government's protection for the declining industries, which is motivated by political support instead of seeking for social welfare objective (Hillman 1982). In the Protection For Sale Model the social welfare in constituencies and interest groups are endogenous factors in the government's objective function, it means the lobbyist's contribution level is based on the expectation of the trade policy chosen by the government, also that the government chooses a trade policy which maximizes the weighted sum of social welfare and the total contributions (Grossman and Helpman 1994). Based on the perspectives in such researches, this paper goes beyond the financial approach on this currency issue, and explores how the social-economic conditions are impacted in the U.S. and how they play roles in the political game for the currency issue towards China. We base our research on the fact that the bilateral trade between the U.S. and China has grown so rapidly during the past decades, it is inevitably going to bring social-economic changes in the U.S. Since the trade has brought winners and losers, there exist pros and cons regarding the trade with China. The currency issue towards China provides an arena for a wide variety of participants with different interests and purpose.

We use the Probit Model to analyze a typical congressional bill. The result of the empirical study shows that different kinds of factors impact the currency issue in the U.S. It is verified that the U.S. currency policy towards China is the result of a political game involving many participants.

This paper is organized as follows. Firstly we present facts and a theoretical analysis about how the bilateral trade influences the U.S.' social-economic environment and what is the role these social-economic factors play in the currency policy towards China (section 2). The methodology and data are depicted (section 3). Then we report the regression result of the model (section 4). The last section concludes (section 5).

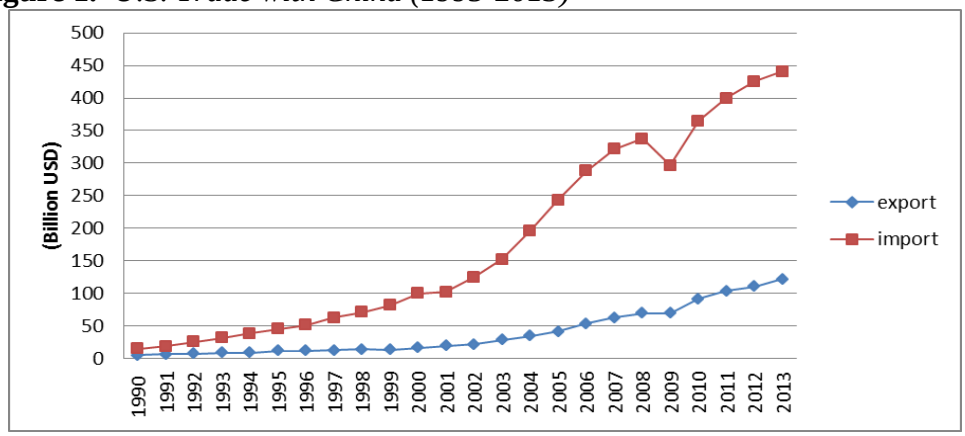
Facts and Theoretical Analysis

During the last decades, the Sino-U.S. trade has boomed. According to the statistics from the U.S. ITA (International Trade Administration), the bilateral trade grew at a rate of 14.7 percent annually during 1990-2013, dwarfing the U.S.' overall annual foreign trade growth with the world at 6.6 percent. In

1990, the Sino-U.S. trade just accounted for 2.3 percent of the U.S.' overall trade volume, China was then the 10th largest trade partner to the U.S. However in 2013, the Sino-U.S. trade scale grew 22 times and in 1990, accounted for 14.6 percent of the U.S.' overall trade volume. Currently China is the largest import source country and the third largest export destination country to the U.S.

Figure 1 indicates how China jumps from an unheeded place to a significant one in trade terms just in two decades. However at the same time the RMB exchange rate is thought the culprit the concern about the enlarging trade deficit with China is growing in the U.S.

Figure 1. *U.S. Trade with China (1995-2013)*



Source: ITA (U.S. International Trade Administration)

The overall bilateral trade is enormous enough to bring an impact on the local economy and society. Since the U.S. is a large country, different states vary in terms of location, natural and human resources, etc., the benefit from the bilateral trade varies across the states. Table 1 indicates the export and import status between China and the 20 largest states by GDP in the U.S. in 2013. Also we list the GDP volume in real terms and the economic structure for these states in Table 1. The far-west states such as Alaska, California and Washington State have a more close trade relationship with China. Nearly one third of Alaska's exports go to China, since it is close to China by location and has rich natural resources. The bilateral trades inevitably benefit such states' economies. However, for states such as Pennsylvania and Florida, the trade volumes are smaller, which means they get less benefits from the bilateral trade with China. Another significant characteristic of the trade with China is that the imports from China outweigh the exports to China for most states, which means the local economy in these states may face more severe impact by the bilateral trade.

Table 1. *Economic and Trade Conditions across States in 2013*

State Name	GDP (B USD)	Share of the agriculture (%)	Share of the manufacturing (%)	Trade with China (M USD)	Share of the export to China (%)	Share of the import from China (%)
California	2203	2.1	10.9	146793	9.7	34.2
Texas	1533	0.9	15.2	53578	3.8	13.7
New York	1311	0.3	5.2	27762	6.0	17.5
Florida	800	1.1	4.9	12991	2.0	16.3
Illinois	721	1.3	14.1	31392	8.5	20.6
Pennsylvania	645	0.8	12.0	1535	3.5	3.4
Ohio	565	1.1	17.7	15796	6.7	18.6
New Jersey	543	0.3	8.5	18321	4.2	14.1
North Carolina	471	1.6	20.9	14220	9.2	23.2
Georgia	455	1.6	11.5	21349	9.9	23.5
Virginia	453	0.6	9.4	6895	10.3	22.6
Massachusetts	446	0.2	10.1	6620	7.4	13.5
Michigan	433	1.3	19.0	11726	7.1	6.4
Washington	408	2.4	14.4	25549	20.4	17.6
Maryland	342	0.5	5.8	3403	4.8	10.7
Indiana	317	2.1	30.1	8140	3.9	14.9
Minnesota	312	4.5	14.0	11931	9.5	30.1
Colorado	294	1.4	7.3	2696	8.9	15.0
Tennessee	288	0.9	15.9	24696	7.0	34.5
Wisconsin	282	2.7	18.9	7506	7.2	26.3

Source: ITA (U.S. International Trade Administration), BEA (U.S. Bureau of Economic Analysis)

Whether a government is supported by its people depends mostly on factors such as domestic inflation, unemployment market condition and real interest rates in the financial market (Price and Sanders 1994). In the U.S., it will be more evident because of the political structure. The Congress is constituted by the Representatives and Senators coming from different states, they represent the benefit of local constituents. Also they have the pressure of tenures, in the White House the tenure is two years and in the Senate the tenure is six years. The U.S. politics and policy conflicts are grounded deeply in inter-regional struggles for political and economic advantages (Trubowitz 1993). In this sense, the impact of the obvious divergence on trade benefit across the states will be reflected in the juggling of trade policy towards China in the Congress. The winner will play a positive role, and on the contrary the loser will play negative role.

Based on this logic, we assume that the states with a strong export dependence on China will lead to representing the congressman's positive attitudes on the currency policy towards China. As for the import dependence on China, we assume the greater the dependence, the more negative the attitudes of the representing congressmen are. However the assumptions need verification by an empirical approach.

Going beyond the economic impact by the bilateral trade with China, we consider the social factors which are involved in the political game of the currency issue towards China. The U.S. is a country composed of immigrants from all over the world. According to data from the Labor Investigation Bureau, the U.S.'s total population grew at 9.7% from 2000 to 2010. However, and imbalance exists in the population structure. From 2000 to 2010 white Americans had a low growth rate of 5.7%, while the Hispanic Americans grew at a rate of 43.0% and the Asian Americans grew at a rate of 43.3%. These demographic factors may also influence the trade policy. Migrants have an inherent cultural connection with their original country or region. Normally they hope to keep a close link with their original country or region, so the demographic changes are bound to influence the policy. Also the trans-generational value of the world may change. In the following empirical study we will consider such factors.

Methodology and Data

To analyze the causation of the U.S. currency policy towards China, we select a congressional bill to simulate the voting results. Normally one voting process has two results, namely yes or no. We use number 1 to represent yes, and number 0 to represent no. The Probit Model is a type of binary classification model, it is used to estimate the probability that an observation with particular characteristics will fall into a specific one of the categories. So the Probit Model suits the bill voting analysis.

Assuming the dependent variable y is influenced by vector X (x_1, x_2, …… . x_k), the response probability that P equals 1 is an accumulation function of standard normal distribution:

$$P(y=1|x_1,x_2,...x_k)=\Phi(y)\equiv\int_{-\infty}^{y}\phi(v)dv \quad (1)$$

In the above equation $\phi(y)$ is a standard normal distribution density function as Equation (2), so for any vector X, the probability P will be strictly confined between 0 and 1.

$$\phi(y)=(2\pi)^{-1/2}\exp(-y^2/2) \quad (2)$$

Referring to the Probit Model, we build the following equation:

$$P(Vote_i=1|Eco_{i,}\ Soc_i, Pol_i)=\Phi(C+\alpha_1 Eco_i+\alpha_2 Soc_i+\alpha_3 Pol_i+\varepsilon_i \quad (3)$$

In the above equation, the dependent variable P stands for the probability that congressman i vote yes (representing by number 1), the independent variables include economic factors (*Eco*), social factors (*Soc*), and political factors (*Pol*). The letter C represents a constant number, α represents the coefficient of different variables, ε is the model disturbance, representing the omitted other influences on the voting process. Using Equation (3), we can get the information about how the different variables influence the voting result through the simulation of the real data.

At first, we choose the detailed variables of the three categories in Equation (3). As for the economic factors, firstly the bilateral trade is an important factor to influence the local economy, so we choose a trade variable. However the import and export may influence the local economy in different ways. Normally export benefits local economy and import brings tense competition to the local companies. Thus we use the import and export scale variable separately, representing by *Imp* and *Exp* in abbreviation. Secondly, the industrial structure may influence the bilateral trade, since the industrial structure can determine the regional comparative advantage in trade, according to Ricardo's trade theory. We select two typical industries, namely manufacturing and agriculture sectors (*Man* and *Agr* in abbreviation), and use their output volume to represent the industrial structure variable. Thirdly, the employment market is always concerned with the trade impact, so we use the local unemployment rate (*Unem* in abbreviation) as the variable.

As for social factors, we use the ratio of the Asian American population in one state as a variable of demographic influence, represented by *Asian* in abbreviation. In history Chinese culture has influenced the Asian area for a long time, we assume that Asian Americans share close culture ties to China, which is a positive factor to influence the U.S. policy-making. Also we use the median age of a state's population to represent the trans-generation influencing factor (*Med_age* in abbreviation).

Partisan forces play a significant role in the U.S. trade policy (Well, 2009). In general, the Republicans favor free trade more than the Democrats (Hiscox, 2001, Deisler, 2006). We use the dummy variable of the *Party* in the equation to observe the partisan influence. If a congressman is a Republican, the dummy *Party* will be 1, otherwise the dummy *Party* will be 0. Also the interest groups play a role in the U.S. policy-making, mainly by political contributions. According to the OPENSECRETS website, the lobby expenditure amounted to 3.3 billion USD in 2012, most of the expenditure from the commercial sector. We use the amount of political contributions from the commercial sectors received by the congressman as the other political variable (*Com_con* in abbreviation).

The bill sample is from the Currency Reform for Fair Trade Act, which was passed in the House on Sept. 29, 2010. This bill is a typical one and aims at pressuring China on the RMB exchange rate issue. We use this bill's voting result to study it empirically. The main clause of the bill involves an amendment regarding the Tariff Act in 1930. The bill adds a currency assessment into the judgment of anti-dumping and countervailing by administrative branches, which obviously flared the currency dispute between the U.S. and China. The voting result was 348 votes versus 79 to approve, illustrating the tough position in general held by Congress. Altogether there are 427 samples, 173 Republicans and 254 Democrats separately.

The relevant data of the voting is from the U.S. Library of Congress, trade between China across states is from the website of ITA (International Trade Administration). The unemployment rate, median age of population, and Asian American population across the states are from American Labor Statistic

website. The output of manufacturing and agriculture across the states are from the BEA (U.S. Bureau of Economic Analysis). The commercial political contributions and partisan characteristic of congressman is from the OPENSECRETS website.

Result

We use Stata 12.0 to do regression according to Equation (3). In order to observe the effects of different variables, we add variables step by step to the equation, and get the results shown in table 2.

Table 2. *Regression Results*

Variables	(1)	(2)	(3)	(4)
Imp	0.093**	0.075*	0.084*	0.092*
	(2.30)	(1.77)	(1.61)	(1.75)
Exp	-0.310**	-0.165	-0.095	-0.111
	(-2.37)	(-1.17)	(-0.58)	(-0.67)
Man	0.426**	0.404**	0.408*	0.425*
	(2.23)	(2.07)	(1.70)	(1.76)
Agr	-0.378***	-0.216*	-0.127	-0.144
	(-3.30)	(-1.75)	(-0.80)	(-0.901)
Unem	0.120**	0.104*	0.173**	0.185***
	(2.30)	(1.86)	(2.43)	(2.55)
Asian		-0.102	-0.344***	-0.357***
		(-1.15)	(-2.95)	(-3.01)
Med_Age		0.182***	0.179***	0.179**
		(4.31)	(3.63)	(3.60)
Party			-2.088***	-2.177***
			(-8.76)	(-8.58)
Com_Con				0.221*
				(1.71)
C	-0.062	-7.403***	-4.891***	-6.074***
	(-0.06)	(-3.70)	(-2.15)	(-3.05)
Log-likelihood	-187.25	-176.69	-116.90	-115.48
Obs.	427	427	427	427

marks：***, **, * represent separately the coefficient is significant on the level of 1%, 5% and 10%, the numbers in parentheses stand for Z data.

Comparing the results from the different columns, we find that most coefficients are statistically significant. As more variables are added to the equation, the value of log-likelihood increases, which is a sign of better explanation for the voting simulation. Ultimately we take the regression result in Column (4) as the final result to analyze.

The import and export variables influence voting in different ways. If a state imports more from China, the representing congressman is more likely to vote yes to the currency bill, which means the congressman is tougher in the currency issue towards China. It is understandable since the import is thought

to bring negative impact on local economy. Many Americans consider the depreciated RMB is the key reason for the flood of cheap Chinese commodities onto domestic market, so they put more pressure on their representative congressmen to act strongly against China. The influence of exports on the congressman's decision on the currency issue is in the opposite direction. However the coefficient of the export variable is insignificant. It is due to the smaller amount of exports to China compared to the imports from China, so the insignificancy is conceivable. According to data of the American International Administration, the import volume to China in 2012 amounted to 425 billion USD while the export volume from China amounted to only 111 billion USD; the export volume is much less than the import volume. The other explanation for this insignificancy is that the benefited partners always keep silent and the losers always vocalize fiercely, which is an understandable situation in modern society.

As for the industrial variables, the coefficient of manufacturing variable is positive and significant, which demonstrates the mounting impact on the U.S. manufacturing industry caused by the challenge from China's counterweight. The coefficient of the agriculture variable is negative but insignificant, the feasible reason is that the efficiency of U.S. agriculture sector is high and the employment scale is not as much as that for manufacturing, so the political voice in the agriculture sector is less than that of the industrial interest groups.

As expected, the coefficient of unemployment rate variable is positive and significant, which illustrates the local unemployment condition plays a critical role in pressuring the congressman to react in currency policy-making.

The regression results of the demographic variables indicate that, the higher a state's median age is, the more inclined the representing congressman is to vote yes on the RMB exchange rate bill. The coefficient of the Asian American ratio is negative and significant, which is in accordance with the expectancy and illustrates that the Asian American plays an active role in the currency issue towards China.

The coefficient of the partisan variable is positive and statistically significant. The Republicans are more inclined to deny the proposal to punish China on the currency issue compared with the Democrats. The result is consistent with some scholars' researches (Deisler 2005, Hiscox 2005). It indicates that the Republicans tend to favor free trade and the Democrats tend to favor protectionism comparatively. Also the coefficient of the commercial political contribution is positive and statistically significant, which demonstrates that the commercial political contributions received by congressmen play a role in their attitude on the currency issue towards China.

Since Equation (3) is based on the accumulation function of the standard normal distribution, we just get a rough relationship between the variables and the voting result. We do not get a detailed quantified relationship between the variables from the regression. Fortunately the Stata software provides a method to figure out the elasticity of the variables respective to the dependent variable. We use the "dprobit" command available in Stata 12.0, and get the quantified relationship shown in Table 3.

Table 3. *Elasticity of the Variables Respective to voting*

Variables	dF/dx	Std. Err.	z	P>|z|
Imp	0.011	0.007	1.75	0.081
Exp	-0.014	0.020	-0.67	0.503
Man	0.052	0.030	1.76	0.079
Agr	-0.018	0.030	-0.90	0.370
Unem	0.023	0.010	2.55	0.011
Asian	-0.044	0.016	-3.01	0.003
Med_Age	.022	0.007	3.60	0.000
Party	-0.398	0.042	-8.58	0.000
Bus_Con	0.013	0.007	1.71	0.087
Obs. P	0.8150			
Log likelihood	-115.48			
Pred. P	0.9372 (at x-bar)			

According to Table 3, if the import volume from China increases by 1 percent, the representing congressman would vote yes on the currency bill against China with a 1.1 percent higher probability. If the unemployment rate in home-state increases by 1 percent, the representing congressman would vote yes on the currency bill against China with a 2.3 percent higher probability. However if a congressman's home-state has 1 more percent Asian Americans, he or she would vote no on the currency bill against China with a 4.4 percent higher probability. More significant is the difference between the Republicans and the Democrats. On average the Republicans tend to vote no on the currency bill towards China with a 39.8 percent higher probability.

At the same time, Table 3 shows the data of Predict Accurate Percent by the model. The logic of the calculation of the index is that if the stimulated response probability rate is above 0.5 and the real rate is 1, we can say the model's prediction is correct. If the stimulated response probability rate is less than 0.5 and the real rate is 0, we can say the model's prediction is correct also. According to the calculation, the index of the Predict Accurate is 93.72 percent. This indicates that our model strongly explains the voting result.

Conclusion

The currency issue towards China in the U.S. has lasted for over a decade, the traditional financial explanation does not reveal the whole story. This paper is based on the fact that the explosive bilateral trade between the U.S. and China has brought deep social-economic impacts in the U.S., the currency issue just provides an arena for a political game players with different backgrounds participate in.

This empirical study shows that social-economic factors play a comprehensive role in the political game of the currency issue towards China. Among these factors, imports from China, the economic structure and unemployment rate in the home-state influence the representing congressman's attitude on the RMB exchange rate bill. The demographic factors such as the

ratio of Asian Americans and the median age of one state's population play significant roles too. Finally, the partisan factor and the commercial political contributions received by the congressman can also be active in the process of currency policy-making in the U.S. In general, the political game for the U.S. currency issue towards China involves a wide variety of participants who have different interests and purposes. The politician's aggressive gesture in the U.S. towards China on the currency issue is more regarded as a reflection of the worries of threats to the local economy and society posed by the bilateral trade between the U.S. and China.

To some extent this study helps to understand the complexity of the trade policy. How to deal with the social-economic changes in a trade-linked world is a big issue to any policy makers.

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