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Even a doubling of the yuan's value is not going to begin to eliminate China's cost advantages.

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Politicians around the world seem convinced that if only China would stop tilting the scales of international currency rates, many of their economic woes would just melt away. If only Chinese goods weren't so temptingly cheap, Americans, currently engaged in the borrowing rampage of the millennium, would suddenly rediscover their Puritan roots. Mexicans, South Africans and, who knows, maybe even Europeans might see manufacturing plants again sprouting on their soil, instead of packing up and moving to China. The popular view is that by maintaining its decade-long peg to the dollar, China has prevented the natural currency appreciation that fast-growing economies normally experience.

Well, here is the news. China probably will allow its currency, the yuan, to strengthen a little bit against the dollar sometime later this year. But, although on balance this will be a good thing for everyone, it is hardly going to reshape the patterns of 21st-century economic growth.

Think about the United States, whose citizens have yet to realize that if they go on spending more than they earn, year after year, they will collectively go broke. In 2004, the United States spent about $600 billion more than it earned. Sure, if you look just at China's bilateral trade with the United States, it appears to be responsible for $80 billion of the problem. But this widely cited figure is something of an accounting illusion because, for many goods, China is just the last stop in a complex global manufacturing chain. High-end components are imported into China for final assembly and transshipment to the United States. Those nifty liquid-crystal computer screens may say made in china but they ought to say final assembly in china. Indeed, only 20 percent of the typical product imported by the United States from China actually represents Chinese value added. Since an appreciation of the yuan is not going to affect the cost of the other 80 percent, it is going to have only a limited effect on price.

Of course, if China devalues its exchange rate, there is every reason to believe that other Asian currencies would follow. Even so, the impact is likely to disappoint those who think that the exchange-rate misalignments account for the lion's share of the United States' borrowing problems. U.S. Federal Reserve chairman Alan Greenspan is among those who recently voiced optimism that the dollar's decline to date will slice a big chunk off the U.S. deficit. Unfortunately, extensive empirical experience tells us otherwise. Middle-of-the-road estimates of how trade responds to exchange rates imply that a drastic 20 percent across-the-board decline of the dollar will eliminate at most one-third of the deficit.

Will a rise in the yuan at least have stemmed the Chinese manufacturing juggernaut? Not much. Walk down the streets of Beijing and you can buy a wide range of manufactured goods for 20 percent of what you'd pay in the United States or Europe. A modest increase in costs is hardly going to be decisive. Even at a discount chain like Wal-Mart, a big part of the price you pay for a Chinese good represents local, Western retailing costs.

People seem to forget that Japan has been running giant trade surpluses for most of the last 30 years, even though its currency has appreciated by a couple hundred percent against the dollar over the same period. Currency movements can be very helpful but they are not a panacea for deeper structural imbalances in the global economy. According to International Monetary Fund estimates, China has more than 150 million unemployed workers. Even a doubling of the yuan's value is not going to begin to eliminate China's long-term cost advantages.

Currency flexibility in China won't bring back the halcyon days of the 1970s to German manufacturing, and it won't bring mass silicon-chip manufacturing back to the United States. It will encourage the Chinese to buy more high-end American goods and services, and perhaps more agriculture goods as well. From China's perspective, introducing some currency flexibility will help prevent the economy from overheating and keep inflation pressures under check. And whereas today markets are mostly looking toward a stronger value for the yuan, someday things will flip. Inevitably, China will face a political or financial crisis, or both, that will have speculators racing for the exits. And when that happens, if China is still sitting on a currency peg, the country could easily suffer a catastrophic 1990s Asian-style currency crisis. The time to get out of a currency peg is now, while everyone wants to buy yuan instead of dump them.

China may well be the economic story of the 21st century, as so many prognosticators have opined. And with 1.3 billion people, it really ought to have its own independent exchange rate, just the way Europe and the United States do. But if Western policymakers think that all their growth and financial problems are going to be solved when China finally floats its exchange rate, they had better guess again.

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