US pressure continues over value of Chinese currency

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A campaign is continuing in the US for protectionist measures to be taken against China in the wake of the failed attempt last month by Treasury Secretary John Snow to pressure the Beijing regime into re-valuing the Chinese currency, the yuan.

With their eye on next year's election, Democrat and Republican politicians, along with trade union officials and some sections of business, have been making populist accusations that the current pegged value of the yuan at 8.3 to the US dollar is too low. They are alleging that the currency valuation is allowing China to flood the US with cheap imports and is a major factor in both the record rate of US unemployment and the massive US trade deficit.

Snow returned from China with little more than a vague commitment that "progress" toward a revaluation would continue. In response, a group of US congressmen headed by Democratic senator Charles Schumer and Republican senator Lindsey Graham introduced new legislation into the Senate on September 9 that would impose a punitive 27.5 percent tariff on Chinese imports unless Beijing abandoned the yuan-dollar peg.

Schumer said the legislation "is a tough-love effort to get the Chinese to stop playing games with their currency". Graham said he had spoken for years about China "cheating" on trade. "I hope the Administration will act decisively in the near term before we lose additional jobs to an out-of-control China. My resolution and this bill will send a strong message from the Senate for corrective actions against Chinese trade abuses," he said.

In a Senate hearing on September 11, similar nationalist speeches were made by Republicans and Democrats as they competed to present themselves as defenders of the "millions of jobs" they claimed had been lost to China. The enthusiasm against China was so intense that commentator Fred Bergsten, director of the Institute for International Economics, predicted "a sharp reversal in US trade policy". "Call it protectionism, call it defending the industrial base... Trade policy will go up in smoke," he warned.

Alongside the congressional agitation, the US National Association of Manufacturers and other business groups are moving to file a case against China on the grounds it is using its currency to gain unfair trade advantages.

The populist calls for action against China have also been joined by other major industrial countries. At last month's G-7 financial minister's meeting in Dubai, a communiqué was issued calling for "a smooth adjustment of international imbalances, based on market mechanisms". Without explicitly mentioning China, the communiqué was widely understood to be part of a campaign against Beijing's policy of fixing the yuan to the dollar.

The yuan revaluation question illustrates the tendency in Washington and other capitals to scapegoat "unfair competition" from China for the economic and social problems at home. The arguments of the anti-China lobby, however, do not stand up to scrutiny. The value of the yuan has not altered since it was first pegged. The decline of manufacturing jobs in the US is primarily due to new technologies being utilised to shed labour, or the transfer of production overseas by American corporations to exploit cheaper labour and resources. The result has been the emergence over the past three decades of a highly integrated, globalised network of production.

The integration between US industry and China was highlighted in a report by the American Chamber of Commerce in Beijing on September 25. Its survey showed that 75 percent of US companies operating in China made profit last year, with 42 percent reporting their profit margin in the country was higher than their global average. Seven US companies were among the top 50 exporters from China last year. US giant Wal-Mart, for example, exports nearly $12 billion in goods to the US from its Chinese operations—10 percent of the US trade deficit with China.

The intertwining of the world economy is such that any adverse reaction in China to a yuan revaluation will necessarily impact in the US. Commentators are warning that it would not only have a detrimental impact on the profits of US companies operating in China, but could trigger financial instability which will rebound on the US.

In a congressional hearing on September 25, Morgan Stanley chief economist Stephen Roach defended Beijing's position. The US trade deficit with China, Roach testified, was "an unmistakable outgrowth of the US penchant for outsourcing and China's rapidly emerging role as a global outsourcing platform of choice". He declared: "The high cost industrial world needs China for competitive survival."

Analyst David Hale testified: "Most multinational companies are satisfied with Beijing's trade and investment policies. The major complaints are coming from small or medium-sized companies which don't have the capital to invest there or have not yet had time to penetrate the market there."

Business Week has run regular pieces warning that a revaluation of yuan could have other serious repercussions for the US. With a trade deficit running at close to $500 billion per year, the US requires massive capital inflows from overseas in order to prevent a plummeting fall in the value of the US dollar and stave off having to raise interest rates. China, which is running trade surpluses and has a high domestic savings rate, is now the second largest buyer of US debt. It holds $126 billion in Treasury securities, and plays a significant role in the stability of the US economy.

The September 26 edition commented: "Any decision by Beijing and other Asian economic powers to cut back on their US government debt purchases leaves the Treasury market at potential risk. With a stronger currency peg versus the dollar, China would purchase fewer bonds, as would Asian central banks if they were to cut back on currency market intervention (buying up US debt to help prop up their own currencies). And further weakness in the Treasury market with a resulting bump higher in interest rates, could weigh on the long-gestating US recovery. In that regard, US lawmakers should be very careful what they wish for."

The *Straits Times'* Linda Lim noted on September 15 that a drop in China's economic growth and exports would not benefit the US and would cause higher unemployment in China. She warned: "A rise in unemployment would threaten social stability in China, where an estimated 30 million or more are already out of work due to mass layoffs from the ongoing reform of state-owned enterprises and the fall in import barriers following China's 2001 accession to the World Trade Organisation."

Former Nobel Prize winner and the so-called "father of the euro", Robert Mundell, stated in a speech in Taipei on September 19 that revaluation of yuan "will be a disaster for China". Mundell declared: "It would not solve the problems of the US, Japan and Europe. It would cut off the brightest light for global expansion in China. China has said 'no' and rightly so, that is the right position to take."

In an earlier comment in Beijing, Mundell predicted that the 40 percent increase in the yuan being called for in some circles could halve China's annual economic growth, aggravate deflation and produce a financial crisis similar to that which occurred in South East Asia in 1997-1998.

One concern is the possibility that a revaluation could trigger a collapse in a growing property bubble in China's major cities. While the official statistics show that 20 percent of commercial property was unsold in 2002, more than $93 billion has been poured into the real estate market this year, a 47 percent increase compared to the same period last year.

A factor in the increase is the inflow of between $30 and $50 billion into Chinese real estate and bonds by short-term foreign and domestic investors, who are gambling that there will be a revaluation soon. There are fears that following a revaluation, the speculators would attempt to sell off their investments and realise a profit, leading to a fall in prices, panic and a property market collapse. China's banks, which have lent vast sums for property purchases, could be left with large numbers of loans on their books higher than the falling value of the mortgaged assets.

The US-based financial house Standard & Poor's warned on September 15 that confidence in Chinese banks was already so low that a heightened debt crisis could lead to their collapse. Paul Coughlin, Managing Director of Standard & Poor's Asia-Pacific Corporate & Government Ratings, said: "We learned from the Asian currency crisis in the 1990s that the combination of a weak banking system, floating exchange rates and free flows of capital can be a very dangerous combination. China's banking system is insolvent, with problem loans estimated by Standard & Poor's at 45 percent of total loans, and its risk control systems are ill-prepared to deal a rapid liberalisation of the exchange rate and capital controls."

The controversy over the Chinese currency is ultimately a manifestation of the broader instability within the world economy as an examination of the possible alternative outcomes indicates.

If the inflows of investment into China continue then the frenzy of speculation will worsen, expanding the size of the financial bubble in the stock and real estate markets, and creating the conditions for a financial crisis in the not-too-distant future.

On the other hand, if the yuan is floated this could create a series of problems for the debt-burdened Chinese banking system, leading to a sharp slowdown in economic growth and sharpening tensions between the Beijing regime and the Chinese working class.

And if the moves to impose steep tariffs against "Chinese imports" are successful such protectionist measures are certain to fuel international trade tensions in the wake of the collapse of the last month's World Trade Organisation meeting in Cancun.

While it is impossible to forecast the exact course of events, one prediction can be made. The least likely scenario is one in which the enormous contradictions within world capitalism, of which the conflicts over the yuan are an expression, will be resolved in an orderly fashion.