US presses again on Chinese yuan and imports

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The Bush administration is again applying pressure on China to revalue its currency, the yuan, supposedly to halt "unfair" competition with US manufacturers and reduce the huge US trade deficit with China.

A number of resolutions have been drafted by the US Congress pushing for a revaluation of the yuan, which is currently pegged to the greenback at 8.28 yuan to one dollar. Last month, the Senate voted 67-33 to allow a vote on a bill that would impose a 27.5 percent penalty tariff on Chinese imports if China failed to revalue the yuan within six months.

Pressure for a revaluation of the Chinese currency by the US and the European powers is not new—they claim that the yuan has been kept artificially low, arguably by as much as 40 percent, to give Chinese exports an "unfair" advantage in world markets. Politicians and trade union officials in the US have frequently linked the low yuan value to the loss of three million manufacturing jobs under the Bush administration.

Since 2003, the US government has repeatedly urged China to move toward a flexible currency regime and has sent trade officials to China to discuss the matter on several occasions. The officials have returned with promises of the Chinese government's "willingness" the carry out currency reform but no definite timetable.

With the lifting of the quota regime on international textiles this year, which is allowing China's low-cost exports to dominate the world market, textile and other industry groups in the US are again pushing the Bush administration for "action". In 2004, the US had a trade deficit of $162 billion with China and analysts expect the deficit could rise to $240 billion this year due to a flood of Chinese textiles and other goods.

In order to demonstrate that the latest round of pressure is not just rhetoric, the US Treasury Department is in the process of finalising a report on China's currency. Before holding a meeting with a delegation from the Chinese central banks and ministry of finance last week, Treasury Secretary John Snow told reporters: "It clearly is time for the Chinese to act. They've said they want to do it. They've affirmed their commitment to doing it. Now is the time." Last weekend, the US Department of Commerce, citing massive increases in Chinese exports of garments since January, imposed a quota limiting garment import growth to 7.5 percent a year.

Praising the stepped-up pressure, Frank Vargo, the vice president of US National Association of Manufacturers, one of the business lobbies pushing for a yuan revaluation, said: "The administration has made a major shift by saying the time for China to act is now. The administration has really changed the game here and we are pleased with that."

While they have committed themselves to an eventual revaluation of the yuan, Chinese authorities are fearful of the consequences for the banking system if they move too fast. Their fears were confirmed on May 10 when the world's major currencies experienced turmoil following a report in the English-language version of the Chinese regime's mouthpiece, the *People's Daily*, which claimed that the government would carry out a 6.3 percent revaluation of the yuan after a meeting with US financial officials.

The Chinese central bank had to deny the report, declaring it was a serious error caused by a bad translation. The vice-governor of the Chinese central bank, Wu Xiaoling, criticised the pressure from the US Congress. "We are making efforts in our work but we never thought that in the first quarter of this year that they would put out such a plan. China had a trade deficit with Asian countries, including Japan and South Korea. Theoretically, nobody can really come up with an accurate value of the exchange rate."

What happened last week was probably a test of market reaction, which confirmed the Chinese government's fear of financial instability. Uncertainty is still looming over China's financial viability, especially due to the huge levels of bad debt held by the major state-owned banks. According to an estimate by the European banking group ABN AMRO, China needs $220 billion in fresh capital, of which $160 billion needs to go to just the four largest state-owned commercial banks, to balance the books. This figure might even be too low. Standard & Poor's has estimated that the Agricultural Bank of China alone needs $190 billion.

There is also disagreement over the impact of a revaluation on China's exports. The US investment house Morgan Stanley issued a report last February which claimed that because of the rising prices for oil, raw materials and other imports—which would be lowered in the event of a revaluation—an increase in the yuan's value against the dollar would not be an obstacle to Chinese export growth.

This view is not shared by China's National Statistics Bureau. In a report published on May 11, the bureau estimated that even a 3 to 5 percent appreciation of the yuan could slow export growth to below 10 percent—down from 35 percent last year. The fear in Beijing is that any significant fall in export growth could cause the loss of millions of jobs and threaten social stability.

The uncertainty surrounding the Chinese currency and the prospect of protectionist moves against Chinese exports has led to nervousness in international financial circles. While sections of the US corporate elite consider Chinese exports to be a threat to their industries, the major transnational corporations, many of them US-based, reap huge profits by exploiting cheap Chinese labour. From their standpoint, the trade deficit with the US is "beneficial".

In an article published on May 9, the *Financial Times* (FT) pointed out that China is not like Japan, where the trade surplus with the US stems from the activities of Japanese-based companies: “China’s trade surplus, by contrast, is largely a story of foreign multinationals. Foreign companies account for about 57 percent of China’s exports—a share that has steadily risen over the past 15 years. In high-tech exports, the foreign share is well over 80 percent.”

A graphic example of how the profit hierarchy is dominated by major transnationals is the production of personal computers, China’s second largest export item after garments. The highest profit margin—80 percent—is in the production of silicon chips. Designed by US firms like Intel and AMD, the manufacture of chips and liquid crystal display monitors is contracted out mainly to Taiwanese or Korean firms.

The next biggest slice of the profit goes to distributors like Dell or Hewlett-Packard in the US or Europe.

The FT commented: “Only the lowest profit margins, on the manufacturing of simpler components and the computer’s final assembly, are collected in China, and even these may be collected by foreign-controlled firms. At the end of the day, at least three-quarters of the total profits generated by the production of a computer will be collected by American firms that produce the software, design the chips and distribute the finished product. Less than 5 percent of the profits will go to Chinese firms. This kind of ‘trade deficit’ makes the deficit country—in this case, the US—richer, not poorer.”

Overtaking Japan as the world’s third largest exporter last year, China had a huge trade deficit of $127 billion with Japan, South Korea, Taiwan and Southeast Asia. Transnational corporations have used these countries to supply parts, equipment or raw materials to Chinese-based factories. Japanese corporations, in particular, have used the so-called “mother plant” model to produce capital goods at home and shift much of the final assembly to China. By 2004, Japanese exports to China were 2.4 times larger than in 2000.

The result is the concentration of Asian exports to the US via China, and the creation of the so-called “dollar recycling” process. In order to keep the values of their currencies low and thus ensure the US continues to buy exports from East Asia, Asian central banks now hold more than $1.9 trillion of foreign currency reserves, much of it accumulated through buying US-based assets or government bonds. China had accumulated $659 billion of foreign currency reserves by the first quarter of this year—40 percent of GDP and nearly four times the level in 2000 ($168 billion).

The build-up of dollar-denominated financial assets in China has raised serious concerns about the sustainability of the process. A revaluation of Chinese currency, even by a small percentage, would translate into huge financial losses. Other Asian central banks are facing the same problem. In order not to risk too much by having all their eggs in the one basket, every financial player is seeking to shift some of its foreign currency reserves into other currencies, such as the euro. Reports earlier this year that South Korean and Japanese authorities were considering lessening their dollar holdings caused severe market turbulence because of fears that such moves could spark a rush out of US dollars and a financial crisis.

A further complicating factor is that a large portion of China’s increased foreign currency reserves comes from speculative sources betting on a revaluation of yuan against the dollar. In 2004, some $85 billion of the increase was considered to be “hot money”. These funds largely went to the real estate market, creating an investment bubble that accounted for 20 percent of fixed asset investment in China last year. Average property prices increased 14.4 percent in 2004. Despite an official increase in the mortgage rate from 5.31 percent to 5.51 percent in March, the average property price was up by 12.5 percent in the first quarter compared to the same period last year. A revaluation could trigger a collapse in the property market, as investors sell off in the expectation of a speculative gain.

In a comment published on May 9, Morgan Stanley Asia chief economist Andy Xie warned that in the present stage of the business cycle the global economy was experiencing an “unusual conflict of interest between China and the US”.

Higher prices for oil and other raw materials—stemming in part from increased Chinese demand—were responsible for half the increase in the US trade deficit between 2002 and 2004. Xie argued that it was therefore in the interest of the US to have another Asian financial crisis like that of 1997-98, after which the US experienced a financial boom:

“A hard landing for China’s investment could serve this purpose nicely. If China’s investment were to crash, I estimate the lower import prices [for oil and raw materials] for the US could bring its trade deficit down by one-third. The inflationary pressure on the US economy would also likely dissipate. The dollar would strengthen, similar to what occurred during the Asian financial crisis. The Fed could cut interest rates, which would prolong the US housing bubble.”

At the same time, Xie warned, such a scenario would seriously damage the US as well, given the massive integration of the two economies:

“Ten million workers in the US may be associated with China trade, and 15 percent of the profits of the S&P [Standard & Poor’s] 500 companies may come from markups on Chinese products. A serious disruption to China trade would be quite damaging to the US economy. Indeed, the confidence crisis from a protectionist bill could have severe negative implications on both the US stock and property markets.”

The intensive debate over the consequences of a yuan revaluation underscores the deepening contradictions of the global capitalist economy. Economists make one warning after another, but none of them has any solutions, other than suggesting that the various national governments somehow try to regulate the massive forces of the global economy. It becomes increasingly apparent that neither the lowering and lifting of interest rates in the US, nor “macroeconomic control” exercised by the Chinese government, can resolve the economic problems, even in the short term.