China widens trading range of the yuan

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The People's Bank of China last week widened the yuan's daily trading band from 0.5 percent to 1 percent. In the short term, the Chinese central bank will continue to intervene in currency markets to ensure that no major fluctuations damage China's struggling export industries. Nevertheless, the measure is a step toward a more market-based exchange rate that will also internationalise the country's currency.

US Treasury Secretary Tim Geithner welcomed the move as "very significant and very promising." The Obama administration has long pressured China to institute a more flexible yuan and further open up its financial sector. International Monetary Fund (IMF) head Christine Lagarde declared: "It's not a baby step, it's a very good step in the right direction."

The Western powers recognise that the yuan reform is part of a broader agenda by the dominant factions within the Chinese Communist Party (CCP) regime to permit global banks and corporations to restructure the country's remaining large state enterprises, especially protected areas such as banking.

Premier Wen Jiabao had openly criticised the major state banks on April 4. "Let me be frank," Wen declared, "Our banks earn profit too easily. Why? Because a small number of large banks have a monopoly." He insisted: "To break the monopoly, we must allow private capital to flow into the finance sector."

The Chinese central bank has tightly controlled the exchange rate between yuan and the US dollar since 1994 in order to maintain China's export competitiveness. In 2007, Beijing increased the yuan's daily trading band from 0.3 percent to 0.5 percent under pressure from Washington to revalue the currency. But the CCP regime halted any further widening of the trading band after the 2008-09 global financial crisis sent Chinese export industries into a tailspin, initially throwing 23 million internal migrant workers out of work.

Last week's widening of the trading band came after clear signs that exports cannot continue to power China's rapid economic expansion, as they have done for the past two decades. China's trade surplus halved in 2011 to just $155 billion, and the current account surplus fell below 4 percent of gross domestic product—down from a peak of 10 percent in 2007.

Before 1994, China's currency was relatively independent from the Western economies. The currency reform of that year marked a fundamental shift—pegging the yuan to the US dollar, while massively devaluing it to boost exports. The yuan-dollar peg was essential to the transformation of regions such as the Yangtze and Pearl River Deltas into the world's largest cheap labour manufacturing centres.

China's foreign currency reserves skyrocketed from $160 billion in 2000 to more than $3 trillion in 2011—due to massive inflows of export earnings and foreign capital. Most of the dollar reserves in turn were sent back to America via the purchase of US bonds—supposedly the safest investment at the time. Apart from $1.2 trillion in US federal bills, China holds some $400 billion worth of bonds in the US government-backed housing giants Freddie Mac and Fannie Mae.

US housing price rises in turn allowed American working class households, which increasingly depended on debt because of declining real wages, to undertake the consumption spending that fuelled

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production in China. Almost the entire Chinese boom rested on expanding exports. Domestic consumption accounted for just 35.6 percent of China's GDP in 2011—compared to America's 70 percent—due to the super-exploitation of Chinese workers.

China's depressed consumption levels led to the rapid accumulation of capital for investment, which now accounts for half its GDP—compared to the world average of 20 percent. This was viable only because US consumer spending was five times larger than China's, even as China's manufacturing output and fixed capital investment grew larger than those of the US.

As the 2008-09 crash demonstrated, any decline in external demand rapidly leads to a crisis of overproduction, factory closures and rising unemployment in China.

The Chinese financial system has been based on export-led production. The destruction of most state-owned enterprises in the 1990s, which used to provide housing and medical coverage for employees, forced workers to save what they could from their low wages in bank deposits. The banks set low interest rates for deposits, which were in turn crucial for the operations of the central bank. It was able to counter inflation and keep the currency stable by buying up the dollars flowing into the country from exports, and issuing bonds in yuan at low interest rates.

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In effect, Chinese savings subsidised the entire trade cycle. Some economists described this process as the "export of savings" to the US.

China's low interest rates also provided cheap credit to fuel a state-led investment boom in industries from telecoms and automobiles to metal manufacturing and infrastructure. Western corporations in these sectors formed joint-ventures and partnerships with Chinese state firms, reaping huge profits.

With the collapse of the US housing and financial bubbles in 2007-08, however, the happy "marriage" of US-China dollar recycling came to an end, and with it the "state-led" capitalist model in China.

Beijing's stimulus packages, which unleashed trillions of dollars of cheap credit after 2008, only exacerbated the resulting crisis by triggering a speculative property boom and threatening to generate colossal bad debts for the state banks and local governments. Already afflicted by low profit margins before the crisis, Chinese manufacturing profitability dived even further. Investors sought returns from property speculation, rather than production.

In response, the Chinese regime is seeking to further integrate China's financial and monetary system with the world's major finance centres such as New York and London in order to attract an influx of international capital and prop up the faltering economy.

Far from resolving the current economic difficulties, China's closer financial integration will make it ever more vulnerable to the global capitalist crisis and sudden shifts in the world markets. Beijing's economic policy-making will become ever more subject to the dictates from the major global banks and financial institutions for a deeper assault on the living standards of China's already exploited workers.

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