

Are We Drinking The Kool-Aid?

BY MARION MARKING



Despite the name of this magazine, we are apologists for no one.

But it is difficult to ignore how certain Western-produced business magazines and news programs have been harping, for months on end, on China's so-called currency manipulation—and US efforts as global watchdog to level the playing field, especially for Americans.

We suppose this is to be expected. As this issue went to press, the US Congress was deliberating on a bill that would slap China with tariffs if it doesn't raise the value of the yuan. The bill gained overwhelming support in the US House of Representatives. The US Senate is expected to follow suit since, as Dr Ellen Palanca of the Ateneo de Manila University economics department says, "It is good politics to [blame] China for their problems."

Palanca, who is also director of Ateneo's Confucius Institute, believes that "China is being used as the scapegoat for the failed US economy, particularly its trade deficit and unemployment problems."

David Sullivan, head honcho at the Hong Kong-based Trade Finance Corporation, agrees. "The dollar has been weak because of US economic fundamentals and policy," he explains. "And because of US institutional speculation in currency markets," not the weak renminbi (RMB).

Climbing the Value Chain

The anti-China sentiment in America seems to be, from a third-party standpoint, nothing but sour grapes. Americans, reeling from a recession and already at a loss on how to compete with cheap, China-made goods, must dread the specter of a China dominating the market for high-value products and services as well.

"China will shift production from mostly labor-intensive products to capital-intensive and high-tech products," says Palanca. "The trend has actually started."

That is why, despite an uphill battle over the last 10 years, China's Ministry of Education sought to push education expenditures to 4% of GDP. The highest it has gone so far is 3.48% of GDP in 2008.

The citizens of China have responded by flocking to the many new institutions for higher learning put up by the government. Enrollments topped one million in 1997. By 2007, the figure had hit 5.5 million.

Four years ago, China spent US\$42 (0.82%) per capita on education compared to America's US\$2,684 (6.1%). The gap is already closing, which is worrisome to Americans.

Says TFC's Sullivan, "Goods produced by the USA are not competitive," mainly due to their high cost. But, he adds, "Over 50% of US voters have low skills, and the US government is simply protecting these voters."

But protecting voter sentiment can only go so far. Palanca says, "Over the last three or four years, the yuan has appreciated around 20%, while the US dollar has depreciated a lot."

"Even with another 20% revaluation, with the high hourly-wage rates in the US, companies will not find it profitable to produce these products at home," she points out. "If the yuan becomes too high, US firms in China will bring manufacturing to other developing countries."

Market Forces

US policymakers have been lamenting China's US\$201-billion trade surplus with the US during the first nine months of 2010.

Sen. Charles Schumer, a Democrat from New York, is among those who point to the weak renminbi as a reason for the trade gap—even going so far as to admonish the Chinese to stop buying dollars.

But JP Tanchanco, head of investment firm T1W, an active player in global dollar inflows into the US, says, "the Chinese trade surplus should not necessarily lead to drastic currency appreciation."

The US dollar is still the world's reserve currency, "So all exports sales are still transacted in USD not RMB."

"It's a no-brainer for any economist," laughs Tanchanco, pointing out that there has "been no significant, real, currency demand for the Chinese yuan to push it to appreciate."

The US has, therefore, very little leverage in the current argument; especially since, as Tanchanco notes, "China-US trade only accounts for about 12% of total Chinese trade."

Trading Away American Jobs

Whatever the rest of the world thinks, Americans are hell bent on circling their wagons—even to the point of attacking one of their own in their crusade to drive up the renminbi.

US Treasury Secretary Timothy Geithner drew brickbats from both Democrats and Republicans last April after he decided to delay the release of his department's half-yearly report on which countries are manipulating their currencies.

Geithner and his boss, US President Barack Obama, were accused by Republicans of "trading away" American jobs, while China was accused of stealing 2.4 manufacturing jobs from Americans.

It mattered little that all the Obama administration was trying to do was create a more agreeable atmosphere before the G20. After all, China still presents a humongous foreign market for American goods.

Sullivan thinks the US gives the Asian behemoth too much credit, while missing the point entirely. He says, "China cannot adjust their own economic



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- ▶ parameters easily with such a fragile balance," between the haves and the have-nots.

Meanwhile, "their own house is a mess," Sullivan says of post-credit-crunch America.

"China had no sub-prime, financial crisis, liquidity crunch, etc. Maybe they suffer from the necessity of rising labor costs, but not too many people live in 4,000-square-foot houses with pools and barbecues."

In the US, he says, "the barbecues, pools, and SUVs are still owned by mortgage defaulters."

Rather than going after China, he thinks the US should clean up its own mess. Sullivan (who has worked in the global financial industry since the scandalous 1980s) asks, "What action is being taken against the speculators who created sub-prime in the first place?"

Psycho-economics

Sullivan's frustration is shared by Tanchanco, who points out a number of factors that impact a country's exchange rate, something certain "political policymakers, probably, do not understand."

Tanchanco clarifies, "It all boils down to psycho-economics." He says the Chinese represent the quintessential risk-averse Asian, who puts a high value on savings, while Americans are typically big spenders.

According to Tanchanco, "Asians spend a portion of what they earn, but invest more in order to multiply their existing cash supply."

US economic policies, on the other hand, "have been created to increase consumer spending through long-term financing."

He laments how American consumers "or even high-net-worth people, like Michael Jackson, for instance, have been trained to believe that it is okay to spend more than what you have presently earned."

What It Means to ASEAN

In the unlikely scenario of an overnight spike in the value of the Chinese yuan, what would happen? Apart from the US Congress, hardly anyone thinks that America will benefit substantially in any way.

Even the Western press, benefiting from the exchange of ideas among people whose only bias is solid economics and an expansive world view, has lately been, little by little, forced to admit that a strong renminbi may not be the answer.

Palanca, Sullivan, and Tanchanco all agree: Inflation in China will likely benefit Southeast Asia more than the US.

Manufacturers, according to Palanca, will move from China "to emerging Southeast Asian countries with favorable investment conditions such as cheap and easy to train labor, political stability, etc. [Already] it has been observed that some are moving to Vietnam and Indonesia."

But, Sullivan qualifies, "Southeast Asia needs to invest in infrastructure. Compared to China, only Singapore has good enough infrastructure. If countries like the Philippines do not improve infrastructure, then it is difficult for them to attract production lines even if the yuan appreciates."

The Philippines already enjoys a trade surplus with China, Palanca points out. "However, the peso is growing stronger. This will cancel out the effect of the stronger yuan," she predicts.

But no one on this side of the world thinks China will succumb to US pressure.

"Gradually, not dramatically," is how the renminbi will rise, according to Tanchanco.

Palanca concurs. "It has, so far, been gradual in response to the pressure to revalue its currency."

She also says, however, that although "China does not want to look like it can be dictated upon, this time the pressure is not just from the US and Europe, but also from fellow Asian countries. So it's hard to tell."

In the meantime, the rest of the world is treated to the spectacle of two giants battling each other on the world stage, complete with sound and fury, leaked diplomatic papers, and the threat of war.

"The US government knows it has no real grounds to pressure China into buying its products," Sullivan concludes. "They know China will never do so. So, they escalate the pressure until another four years passes... and then, another President." ■