On Yuan’s Exchange Rate and its Impact to the Sino-US Bilateral Trade in the Post-Crisis Era *

Wenjing WU 1, Shangjie GAO 2

1 International Trade School of Hubei University of Economics, Wuhan, China
2 Economics and Management school of Wuhan University, Wuhan, China

Email: jessiawwj@yahoo.com.cn, leskgao@163.com

Abstract: In the post-crisis era, with China’s stable economic growth while the world economy increases weakly, especially with US’s ever-increasing unemployment and its huge international trade deficit, some Americans insist to attribute the cause of the Sino-US bilateral trade deficit to Yuan’s exchange rate. The writers hold the view that the Sino-US bilateral trade has nothing to do with Yuan’s rate. As a matter of fact, it happens due to certain invisible rate in the two countries. Yuan’s appreciation cannot eliminate the Sino-US bilateral trade deficit.

Keywords: Yuan; appreciation; Sino-US bilateral trade; deficit; US car finance; win-win

1 Introduction

Yuan’s exchange rate and the Sino-US bilateral trade are always the most heated economic issues worldwide. Although many specialists have already undergone this issue, no one can reach a conclusion definitely. Even in the post-crisis era, US is still the world’s most powerful economy, meanwhile, it creates the greatest recurrent item deficit. All of the trade deficit, the budget deficit and the low saving have pushed US into deeper abyss. Socialists and economists generally hold that US government should cut down its governmental and financial expenses and implement constrictive macroeconomic policies. The simplest solution is to depreciate the US dollar. However, Japan and Europe are not satisfied with the dollar’s depreciation and as a result, the US government begins to force China to appreciate Yuan.

From 2003, certain western countries with US and Japan as the representatives have raised a storm of demanding Yuan to appreciate. As the US and Europe governments intervened formally, the problem of Yuan’s appreciation has been much more heated than ever before. The main points are as follow: Yuan has caused the serious manufacturing unemployment in US and China should not stick to dollar as a stable rate regulation any more, instead, Yuan will be determined by the market force under the free competition-market principles. In March 2010, some US congressmen have put forward to tax on Yuan’s exchange rate, which has brought a new historical record to the Sino-US bilateral trade war.

In fact, while analyzed with John Dunning’s International Direct Investment theory, through public information including literal and data from China, US, international organizations, authoritative press, magazines, books and statistic report, a conclusion can be reached that Yuan’s rate has no direct causality with the Sino-US bilateral trade deficit. By applying the theory that development of hi-tech promotes the labor productivity, it is certified that the US high unemployment rate also has nothing to do with the Yuan’s rate.

We take the reasons for the tremendous difference as follow: First, US relative department has double counted the China mainland export through Hong Kong re-exports when they gather data. Second, US has made some mistakes during the data-gathering process. Due to the fact that China never implements the refund policy and carries out strict foreign exchange management, Chinese data is more convincing and accurate. Meanwhile, US formulate that some thousand dollars statistics may not be calculated in the data-gathering process. Hence, this part is a big loss.

Actually in 1995, Yuan’s rate has stood at 8.2-8.3 Yuan per dollar steadily. At the end of 20th century, two remarkable events were kept in our minds. One, from March 1991 to February 2000, the US economy kept increasing, established a new milestone and finally realized the ten-year prosperity. Second, during the whole 1990s, while the world economy stood still, China has set up an ever-increasingly high developing pace and then became one of the world’s most powerful economic countries, especially after the Asian Financial Crisis in 1998. Meantime, the US enjoyed a period with low inflation rate, low unemployment rate, low unemployment rate and low inflation rate. US GDP of this period was perfect from both points—total amount and growth rate. To sum up, the US macro economy functioned well in this “tough” period.

---

*This paper is under the Humanities & Social Sciences fund of Hubei Provincial Department of Education (2010b194) headed by Wu Wenjing.
2 Results of the Big Sino-US Bilateral Trade Deficit

Here is another example for the analysis, in the year 2003, according to data by the China’s customs, the Sino-US trade surplus is 58.61 billion. While by the US report, this figure becomes 124 trillion. The big difference lies in the fact that the US deficit data involve errors from its statistical techniques and methods. The China’s data are more accurate and closer to the real fact. So, we can find out that the US global balance is actually surplus instead of deficit.

We can also take the reasons for the big difference as follow. First, the US relative department has double counted China’s mainland export through Hong Kong re-exports. Second, US has made some mistakes during the data-gathering process. As China never implements the refund policy and carries out strict foreign exchange management, the China’s data is more convincing and accurate. Meanwhile, US formulates thousands of dollars that may not be calculated in the data-gathering process.

So, what results in the big Sino-US bilateral trade deficit?

1) The main reason for the Sino-US bilateral trade imbalance is the US regulatory policy for the hi-tech products exporting. The US government always considers the Sino-US bilateral trade from the point of security. Since 1979, US has carried out export regulatory policy aiming at China and they would not sacrifice their security consideration for China’s increasing export. However, they feel dissatisfied with the current bilateral trade deficit and Obama has therefore launched the biggest anti-dumping war against China’s car products’ export in 2009. This is indeed not fair to China.

2) US multinationals in China contribute to the deficit as well. As data shows, 56% of China’s import can be attributed to multinationals inside China and China is becoming one of the main channels for US multinationals to cut down their production costs and promote profits.

3) US does not count the profits from the multinationals investment into the US profits in their data-collection. By a survey to 245 US multinationals in China, 75% companies have gained profits and even 10% benefits a lot. What is more, the income of 44% companies has increased greatly in 2002. It’s surprised that the profitable rate the US multinationals have gained exceeds their global rate even if they are in such fierce competitive society in China. As a consequence, the Sino-US bilateral trade deficit will not exist if the part mentioned above has been counted in.
We consider the essence of the trade deficit as follow: The major US import comes from the production lines abroad, that is to say, the US multinationals import goods from their branches abroad and it is therefore trade among companies instead of trade among countries. According to data by 'Barrons', these sales revenue reaches 2 trillion dollars in 1996 and 35% is delivered to the US, which is regarded by the US government as trade deficit wrongly. The total amount of the US revenue is 3 trillion dollars in 2002. In the same period, the total amount of US import and foreign multinationals revenue in the US has reached 2.4 trillion dollars. Hence, the actual US’s trade surplus is 600 billion and this lies in the key to the US trade deficit.

Besides, we take the real reasons for the trade deficit. Firstly, in the 1970s, the world petroleum price increased dramatically due to the petroleum crisis. In addition, Japan and some competing developing countries have laid great pressure to the US. These have resulted in 152 billion dollars deficit in the US goods and services trade. Secondly, the deteriorating low saving rate forces the US to raise funds from the international financial markets, allocating funds in order to invest construction. The US trade deficit reflects the gap between the national low saving rate and the high investment rate. In another word, the deficit is essentially the expense paid by the long-term low saving rate. Lastly, the US multinationals play the role of production reflows in the US’s import.

4 Detailed Analysis

In the short term, the policy that Chinese Yuan’s rate sticks to US dollar cannot be changed.

In the long run, the best rate policy for an open and powerful economic trade country is to choose the floating rate policy according to the international experience. With the floating exchange rate, it is able to adapt to the fast-changing international trade and investment environment as soon and well as possible. However, the Chinese Government is not able to do it considering its special national conditions.

To begin with, during the process of Chinese industrialization, the employment of the redundant labor forces which come from rural areas has become one of the most serious contradictions in China. Suppose that China now implements the free floating rate policy, and then it’s likely that Chinese Yuan will soon appreciate and it will bring about great increase of Chinese products export price. As a result of this, products that made in China will lose the price competitiveness in the world market and China cannot become the ‘global factory’ anymore and will even lose its favorable manufacture development existing now. Other serious problems will follow, for instance, the manufacture recession, the high unemployment rate and finally lead to serious economic, social and political issues.

In the second place, the US is the world’s most powerful economic country and its GDP contributes one third to the total world amount. All currencies in the world are often easily manipulated by international specialized speculators except for US dollar. Chinese Yuan’s rate will be more stable when it sticks to the US dollar.

Additionally, as the US is the second biggest trade partner with China, China will benefit a lot from carrying out the stick-to-the US dollar policy. For instance, the Chinese Import & Export Enterprises will avoid exchange losses resulted from the floating rate effectively, estimate cost and revenue accurately, promote the international investors’ confidence in China and appeal to more foreign exchange.

Fourthly, from the point of politics, sticking to the US dollar will contribute positively to China. If China didn't implement the current policy, the US Government never needs to negotiate with China of this issue and it will weaken the Chinese chips when it negotiates in the world politics.

All in all, China cannot bear the loss resulting from Yuan’s appreciation, especially to those middle and small Chinese enterprises. In fact, China’s middle and small companies have been experienced serious financial shortage and many have even undergone bankruptcy under the 2008 global economic crisis. If Yuan’s appreciation reaches to 3% in a short period of time, they will face more losses.

Besides, the export figure is not the only thing that accounts. Taking the car export as an example, with China’s surpassing the US to be the world’s NO. 1 car sales and producing economy, US has launched the biggest antidumping trade war against China’s car products to America in 2009, which has also been followed by EU
and even some Asian countries. This is completely wrong to China. Actually, we cannot only consider the China’s car export from the sales figure. We should go into the essence of the problem: China’s car sales increase as a result of its promoted technology and the over-developed US car finance is the key for its sales recession.

As the “country on the wheels”, the US acquires very developed car finance which has lead to both its over car consumption and the over developed second hand car market. The “zero down payment and zero interest rate” car buying system after 911 have worsened this situation. The sale of US second hand car even reached 40 million which is twice to three times of that of the new car. The prosperity of the second hand car market in US means in certain degree its narrowing car market potentials.

From the example of car sales in both China and US, we can conclude that the rises of China’s export and its world ranking have also nothing to do with Yuan’s appreciation. But, it has very close relation with related governmental development measures, especially with the US related economic reciting polices.

5 Suggestions
It is well known that world historical development, especially the development of modern and contemporary globalization, tends to be antagonistic, conflictive and non-harmonious. Its theoretical demonstration is the “Ricardo Law”, namely the rule that the social productivity development and historical progress are at the expense of certain social classes and strata. Western countries after the Second World War have hence changed partly in certain ideas, productivity and specific regulations. Will China be fettered by the “Ricardo Law” in our transformational socialism and have to apply the antagonistic, conflictive and non-harmonious method to achieve the alienating “development”? The answer is absolutely no. Instead, we should stick to the harmony thoughts and policies of the western economies represented by the Ricardo Law” in order to probe into our socialist social harmony theory. China should not be the target of US attack any more, instead, China and the US are close partners, and both countries acquire many common interests. We should find a better access for the better development of both countries.

6 China should Keep a Steady Exchange Rate and Determine the Rate Independently
Yuan’s Exchange rate reformation should persist in general to the market principles, but Yuan’s appreciation and depreciation cannot be determined by the market force solely. When to adjust the appreciation rate and whether to adopt the free exchange rate depend entirely on the needs of China’s economy development and the changes of international economy situation instead of being manipulated by certain “world opinion”. It is strange that in the Asian financial crisis in late 1990s, China’s steady exchange rate policy has been praised highly by the world while now it becomes the target of “public attack”. According to our view, China’s export increase results from its promoted abilities of production and management rather than from Yuan’s underestimation. Steven Roach, the chief economist of Morgan Stanley, has pointed out that 65% of Chinese export can be attributed to US multinationals’ branches in China and Yuan’s appreciation has done no harm to the global product supply chain. Premier Wen Jiabao has also announced in 2009 that Yuan’s steady rate meets the whole world’s interests.

In the lecture of Professor Robert Mundell, the once winner of the Nobel Prize for Economic Sciences, he estimated highly Yuan’s steady exchange rate and claimed that its fluctuation would lead to unstable real rate. He held that Yuan’s fluctuation would decrease its function as a saving tool, leveled down the government’s management ability and weakened the role that Yuan has been playing in Asia and finally deviated from Yuan’s internationalization. Mundell warned that Yuan’s appreciation in a very short time would put the Southeast Asia in disastrous situation and he suggested keeping Yuan stable.

7 Seek Cooperation while Allowing Differences among Countries in order to Achieve Win-Win and Multi-Win
When Professor Phillip J. Bryson of Brigham Young University in the US lectured in Wuhan University in 2005, he claimed that Yuan’s appreciation pressure mainly stemmed from the US Congress over their cares to US’s recurrent item imbalance. As more and more US companies are conducting business in China, divergences also come out even within the US. It is a good illustration that the Bush Government rejected congressmen’s promotion to bring an accusation against China with the Yuan’s rate in 2004. Though Bryson emphasized that the US’s remarkable trade deficit would affect the confidence of US’s international investors, lead to the decrease of the US national debt, cause the increase of the US interest rate and unemployment, lead to economic recession and finally affect the US dominating position as the world economy engine. However, it cannot be neglected that 2% appreciation of Yuan’s rate in July 2005 has brought about a 0.5% GDP decrease and unemployment of 3 million people in China. For a period of time, the US financial crisis has somewhat relaxed the stress on Yuan’s appreciation and even Bryson also admitted latterly in 2008 that “Most American specialists have known for a long time that the US congress was wrong in its hasty evaluation of Sino-US trade relations...to the Yuan at all”, China has become the world’s biggest automobile sales.
country as well as the second biggest world trading economy in 2009, China’s success even under the world severe economic crisis has once again made Yuan under the great pressure of appreciation.

8 Enlarge Trade with Middle and Small European Countries & Companies in the Fast Developing Sino-EU Cooperation. Turn China from a Big Trade Country into a Strong Trade Country through High-Tech Innovations

China’s total Import and Export ranks 2nd worldwide in 2009 and China has become a very attractive trade partner for countries worldwide. While expanding eastward in 2004 into 25 and again into 27 countries, EU has ever since become China’s biggest trading partner. In the 45 countries in Europe, its majority, esp. in EU countries, are small countries like Belgium, Luxemburg and Ireland. These countries are small in size yet quite strong, esp. in international trade. Their products acquire the same high quality & high-tech just as the other several major European countries and even the US. In effect there is no essential technological difference among products in European countries. Middle & small enterprises are their economic pillar. With small domestic markets, these small European countries rely on importing raw materials & processing them into finished or semi-finished products in order to export. They have a saying in world economy with their flagship products with high technology and equipment. The major present trading partners of these small countries are still their neighboring EU members.

China should abandon the Big Country and Big Company complex and promote trade and economic cooperation with the EU, especially with the small European countries like Belgium and the European middle or small enterprises.

The world modernization is an international process from the very beginning. It begins with the starting of the international trade. Europe has become the world’s most successful country as the result of its foreign trade expansion accompanying the high-tech innovation. China has been the world’s No.2 import & export country in 2010, yet it mainly relies on the low labor costs & exporting quantity to support its foreign trade. It is still at low ranks in international transactions. China should learn form the other small European countries like Belgium and European middle or small enterprises. Belgian trade oriented industrial development model—namely to support middle and small high-tech enterprises, government—Non Governmental Organization—financial institutions establish direct communication, to set up the high efficiency economy, to support and prosper its economy through the foreign trade, to engage in economic adjustment in proper time, the trade expansion accompanying the technical innovation—can offer certain beneficial experiences to China’s trade and economic cooperation with both the US and the European countries, to China’s ongoing economy transformation, and also to construct an innovative strong China.

To sum up, China and the US are two powerful economic and political countries in the world. They have been playing their own key role in global markets. China should remain the steady exchange rate while the US should be more aware when it comes to its trade deficit and make efforts to settle down the problem within its government or relative departments. Economies of China and US are complementary; keeping current exchange rate policy is the prime choice for both countries.

China is the world’s biggest developing country. Its unstable economy will have great negative effect on the global economy. The US should stop bargaining with China when it comes to the Yuan’s rate issue. China and the US rely greatly on each other and are crucial trade partners mutually. The US government should discreetly appreciate the China’s development instead of being afraid of it and develop together with China rather than to contain the China’s development. Both China and the US should promote and perfect their internal market and seek new international markets so as to fulfill the final win-win and multi-win.

References