

Chinese currency manipulations and global economy



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[This article deals with China's deceptive manipulations of foreign exchange rates. Part II of the article, dealing with adverse implications of China's currency manipulations on the global economy, will appear next week.]

CHINA, Malaysia, and Saudi Arabia are the three major trading partners of the US that maintain a conventional fixed exchange rate (FER) regime. By nature, FER regimes entail frequent intervention by Central Banks to maintain the relative value of the domestic currency close to its parity value. Because of the size of its economy and magnitude of its global trading, China's undervalued FER is breeding undesirable distortions and persistent imbalances in current accounts among countries and between trading partners.

The core question is what constitutes currency manipulation and is China a currency manipulator? In this context the following points

NO NONSENSE

After the initiation of economic reforms in 1979 China's economy grew at a record average growth rate of 9.7%. Given this gargantuan growth, many economists contend the yuan may be undervalued by 15% to 40%. This translates effectively into a 15% to 40% subsidy to Chinese exporters, providing a nearly insuperable price advantage over US and many European producers (and Bangladesh).

merit highlighting:

—Under the IMF rules, a country can "fix," "float," or adopt a wide array of transitional exchange rate regimes and is permitted to intervene when mediation is warranted to offset erratic market fluctuations. Currency manipulation, as defined in the surveillance provision of the IMF's Article IV refers to "protracted large-scale intervention in one direction in the exchange market." China has consistently violated these provisions to keep the yuan artificially undervalued and gain undue mercantilist export advantage. Estimates of China's currency purchases run between two and three billion dollars per day.

—Exchange rate manipulation depends on how a country's real (inflation-adjusted), trade-weighted exchange rate fluctuates against the backdrop of its overall balance-of-payments (BOP) position.

—China's nominal exchange rate has been fixed at roughly 8.28 yuan per US dollar since 1994. Morris Goldstein (Institute for International

Economics, December 9, 2003) argued that: "US dollar has been falling on a real trade weighted basis over the past 20 months or so, and that real, trade-weighted value of the renminbi has been falling along with it -- and this at a time when China has been running surpluses on both the current and capital accounts in its balance of payments and has been experiencing very large increases in international reserves." These surpluses and reserves would call for an appreciation of real exchange rate, not depreciation.

— After upward revaluation of its currency in last July from 8.23 to 8.11, Beijing indicated that it would abandon the peg and reference movement in the yuan against a basket of currencies (for example, dollar, yen, euro, Korean won, etc). Even then the yuan index has been moving in tandem with the dollar index. As of March 28 and April 6 it was trading at 8.0212 and 8.0098 yuan per dollar. The 8.0098 is the highest appreciation in 12 years.

This steady relationship is due to the constraints of the daily range of plus or minus 0.3% in dollar-yuan fluctuations compared to the previous exchange rate announced daily by the central bank of China.

—China has a very restricted foreign exchange market. Even though it allows "convertibility" in the current account, the capital account is "non-convertible." This means Chinese citizens cannot legally convert their enormous holdings of yuan-denominated deposits into dollar-denominated assets. I advance two plausible reasons behind this "non-convertibility" of yuan stance: (a) to keep dollar-yuan exchange rate fluctuations under control and (b) to keep currency speculators off from making a market for yuan.

The above discussions make China culpable of currency manipulation. Its obsessions with the "peg" by resorting to various deceptive tricks is guided to make exports to the US cheaper, and imports to China more expensive, which contributed to its burgeoning trade

surplus.

On March 28, the state-run China Business News reported that the mainland's reserves hit \$854 billion in February, outstripping Japan's reserves of \$850 billion for the first time. In 2005 China's trade surplus with the US was \$202 billion. The January trade deficit with China was \$17.9 billion, up from \$16.3 billion in December. During his visit to China US Commerce Secretary Carlos Gutierrez on March 28 called upon China to

— open its markets to give foreign competitors the same market access that Chinese exporters enjoy abroad.

— stop currency manipulation and instead adopt a more flexible market determined currency value and

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Since Chinese and the US exporters compete in many of the same markets worldwide, US goods fail to benefit from the export price advantage when dollar slides downward because of the co-movement

of the dollar and the yuan. The co-movement phenomenon, as I ascribe it, implies that as US prices fall, so do the prices of the Chinese goods (and vice-versa) they are competing against.

China is holding a significant part of its massive reserves in US bonds and other assets. A January 2006 estimate indicate that it held \$262.6 billion in US Treasury Securities making it the second largest single investor after Japan. By propelling demand for US Treasuries (keeping bond prices high), China has helped to keep market interest rates lower in the US economy. But China's currency manipulation through unremitting intervention to keep the yuan undervalued, the gaping scale of its trade surplus with the US, and the rising concerns over the leverage being built through its holdings of US assets are drawing strings of frictions with Washington. The result is:

— The US and the EU on March 30 filed a trade case contending that China is imposing high taxes on imported auto parts contravening commitments made prior to joining World Trade Organization (WTO) in 2001.

— Senators Charles Schumer and Lindsay Graham proposed a bill to impose 27.5% tariffs on Chinese imports to the United States unless Chinese currency dispute is resolved. The Bush administration

strongly opposed this bill.

— An alternative bill with milder sanctions is now being reviewed by the administration which would require the Treasury Department to determine whether the yuan of China or currency of any other country is "fundamentally misaligned." The sanctions would include US vote against loans from WB, IMF, and ADB and so on.

Over the last four weeks the dollar-yuan exchange rate has shown a bit more volatility, making market watchers conjecture whether Beijing was blinking to appease the US Senators. Maybe not, as David Cohen (Asia, March 28) argues that bigger moves had come on days of wide swings in the dollar in worldwide markets -- when Beijing might have tolerated more movement in dollar-yuan to limit the swing vs. the overall index of the unspecified basket of foreign currencies.

Many economists recommend China to tolerate continued gradual appreciation of approximately 5% over the course of this year. Such a move is not as striking as the 50% or so appreciation of the Japanese yen soon after the 1985 Plaza Accord. It is further argued that by simply maintaining the 0.3% trading band per day, the yuan could appreciate by as much as 20% during a single quarter. But the Asian Development Bank on April 6 predicted that China's currency may appreciate by

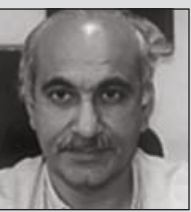
only 3% this year. It appears that Beijing is content to ride on the current stance of a snail's pace gradual currency appreciation.

The European Commission backed China's gradual approach rebuffing US calls for speed up steps to boost the yuan. "An abrupt de-pegging of the renminbi, and possibly other Asian currencies, from the dollar could give rise to a sudden reversal of Asian capital flows into the US, which might risk an excessive additional downward movement of the dollar against the euro," said the commission document, which was prepared for an April 6 meeting of European finance ministers in Vienna.

Blame the US as one might, notwithstanding that the Bush administration has worked assiduously on this issue for years. But China has responded with lip service while showing virtually no gesture until recently to revalue its currency. China's emergence as a manufacturing powerhouse at the expense of the US raises economic security concerns and the question whether a country that loses its ability to produce tangible goods will long remain an economic power. How long can the US play on an uneven playing field is a question raised in professional and business circles.

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49.5 per cent of how much?



M.J. AKBAR

ARDON me, but I have this inconsiderate habit of looking at the wrong end of a statistic. Let me explain. When I hear the Honourable Arjun Singh declare that 49.5% of our best and brightest college students shall henceforth come from a particular combination of castes, I want to know not what the 49% consists of, but what that combination of castes constitutes.

Whenever there is a caste-based allotment of the fish and loaves of Indian development, it is ipso facto an allotment to Hindus, for the simple and obvious reason that caste is a Hindu phenomenon. Muslims, Sikhs and Christians, to name the three prominent Indian minorities, have no caste. Some formula-fudgers have tried to solve this dilemma by the theory that the poorer minorities, all converts, have retained a sub-identity of caste beneath their new faith.

But if the percentage game is going to be played into overtime, as is being done by this government, in educational institutions and jobs, the two most significant tools of empowerment, then a democratically elected government of India has no right to exclude minorities from this game. Arjun Singh has always positioned himself as a champion of minorities. Where are they when he has made his most significant political play?

This is the kind of thing that sounds very nice in Delhi but is a hoax outside, where real life begins. It is a linguistic tidbit thrown towards minorities who have been excluded from the meal at the main table. It is only partially true, and ineffective for at least two reasons.

Minorities have a near impossible task in finding evidence for a sub-identity; and when they do it is generally from the bottom of the heap, which means they do not get a place in the limited queue. If the Honourable Arjun Singh can find one Muslim who has been admitted into a quality educational institution because he is a "Backward," it would be welcome addition to my knowledge.

Politics is a more fluid science than demographics. But when Mayawati strategises about elections, she does not automatically include "sub-identity Muslims" as part of her Dalit vote bank, nor

does Mulayam Singh Yadav assume that "sub-identity Muslims" are an extension of his "Backward Yadav" vote base. They know that these are separate interests and they make a conscious attempt to harmonise varied interest on a common platform. But when it comes to allocation in educational institutions or jobs, the harmony becomes distinctly atonal.

Imran Ali and Yoginder Sikand have reported the findings of a recent study done by them, in collaboration with ActionAid (India), Jahangirabad Media Institute and Indian Social Institute, New Delhi to examine the "social, economic and educational" condition of Indian Muslims. A few, necessarily brief, quotations from their report:

— Some "low" caste Muslim respondents pointed out that while their castes had been included in the official list of Other Backward

Castes, they had not benefited from this provision. Government facilities for the OBCs, they said, had been cornered almost entirely by more numerous and influential Hindu OBCs.

— The high degree of Muslim poverty is evidenced from the fact that 41.9% respondents (in rural areas) have a total annual household income of less than Rs 10,000, 17.5% between Rs 10,001-Rs 20,000, 5.4% between Rs 20,001-Rs 30,000 and only 0.1% between Rs 30,001-Rs 40,000.

— Many Muslim families complain of being deliberately neglected in government programmes meant for alleviating rural poverty.

— Overall, as this survey suggests, Muslims are among the most marginalised communities in India in terms of economic and educational indices and also in

terms of political empowerment.

A host of factors, as we have tried to show, have been responsible for the marginalisation of Muslims as a whole. This calls for urgent steps to ameliorate their condition.

According to the 2001 census, Hindus constitute 80.5% of India's population, Muslims 13.4%, Christians 2.3%, Sikhs 1.9%. Others make up the remaining two per cent. The minorities are not included in reservations, nor are the upper castes: between them, the minorities and the upper castes would add up to 40%. So in real terms, 60% per cent of India is being guaranteed 50% of the seats in the best educational institutions. Do the math.

But mathematics is not a principle. What is the principle, if there is any? To help the underprivileged? Then why are India's minorities excluded from the bonanza?

Is it impolite, or, worse, unpatriotic, to raise such a question? A subconscious fear is exploited whenever Muslims make any economic demand, like reservations, that they are reviving the ghost of partition. 1947 is over. Anyone born before India became free will be 60 years old next year. How long is the political class going to fool Indian Muslims by frightening them in public and purchasing their ever-available leaders in private?

I have never been comfortable with minorityism. In fact, I have tended to anger Indian Muslims by asking them a difficult question: at what stage of their history did they become a minority? Were Muslims of North India a minority under Mughal rule two hundred years ago? Were the Muslims of Hyderabad a minority when the Nizam was in power sixty years ago? The answer is, no. In other words, a minority status is not a function of numbers; it is a function of empowerment. The Brahmin has a minuscule population and lives across all economic layers, but no Brahmin sees himself as a minority, because he is socially and politically empowered. Democracy is the greatest blessing the dispossessed can have, for it is the only system that finds space for progressive empowerment.

But if the percentage game is going to be played into overtime, as is being done by this government, in educational institutions and jobs, the two most significant tools of empowerment, then a democratically elected government of India has no right to exclude minorities from this game. Arjun Singh has always positioned himself as a champion of minorities. Where are they when he has made his most significant political play?

If we are to get social change peacefully, then there is a legiti-

mate place for positive discrimination. No one in his senses, for instance, can argue against positive discrimination for Scheduled Castes and Tribes: they carry a burden of neglect and enslavement that India should be ashamed of.

But a good idea has been perverted by excess. If half the students of a quality institution are there because of quotas rather than intellectual ability then they will affect the quality of the institution. Instead of the institution raising the standards of the students, students will lower the standards of the institution. The young are not unreasonable; the old do not have a monopoly on wisdom. Students have accepted existing levels of quotas because they too can see its limited need. But students will not allow politics to drag their schools into a swamp. Politicians can think no further than the next elections. The young have their whole lives to consider.

Caste is a fact, but is it a virtue? Government policy should seek to eliminate differences rather than consolidate them. And is caste the only statistic that the mighty government has? Is there no other definition of poverty?

I could argue that market forces have done more to change a repellent reality like untouchability than all government diktats put together. Urbanization, driven by either choice

or need, has not eliminated casteism, but it has dulled its cruelties. Does anyone know who is touching whom on a crowded Mumbai bus? Does anyone care? Can anyone afford to care?

A theory is floating through Delhi, and will doubtless find its way into national conversation, that Arjun Singh did not inform Prime Minister Manmohan Singh before this cynical mid-term twist of the knife. This is partly because of the Prime Minister's credibility with the middle class; it does not want to believe that its hero would sully his clean hands with conventional Congress vote-bank politics.

A more cynical view is that the Prime Minister has denied foreknowledge of so many critical decisions that have been made by his government that one more can easily be added to the list. By being too non-political the Prime Minister might have spared himself into a corner. He could end up as Prime Minister of only a happy Stock Exchange and a forlorn Indo-US nuclear deal. In the beginning, the middle and the end, a Prime Minister's function is political. Dr Manmohan Singh may want to escape from politics. But politics will catch up with him.

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Thaksin takes time off to plan part two A response to Tata and GoB

MARIA CHIMPRABHA

THAKSIN Shinawatra may be down, but he is not out yet. He may step aside, but his regime is alive and kicking.

After his audience with His Majesty the King on Tuesday, Thaksin surprised the country by announcing he would step aside and would not seek the post of prime minister in the next government. However, he would continue to serve as caretaker prime minister until a successor is found. He assumed that Parliament, despite all the legal and constitutional problems, could open a session in order to nominate and vote for a new prime minister, which would be a top Thai Rak Thai member.

Thaksin also made it clear that he would not wash his hands off politics as he would serve as an MP and continue as leader of his Thai Rak Thai Party. Thaksin retreat may have failed to stabilize Thai politics but it opened a small hole to let off some steam. Thaksin's successor will be widely looked upon as Thaksin's nominee.

Former Democrat Party leader Chuan Leekpai noted: "Thaksin's decision to step aside does not help the democratic process move on. Nobody is certain when Parliament will have all 500 MPs. Moreover, the Thaksin regime is still alive.

"We should not be alarmed or happy with his decision to step aside because we have to see

whether the Thaksin regime is still around or not. If he is gone, but the practices of Thaksin remain in place then evils in our society will continue. These include tax avoidance, budget allocation to constituencies that vote Thai Rak Thai and dominance over independent institutions. It will be dangerous to the country if the Thaksin regime fortifies its roots."

The April 2 election, which was boycotted by the opposition parties, turned out to be a referendum on Thaksin. The Thai Rak Thai garnered about 16 million votes, but there were 10 million votes of "abstain" -- "no" votes against Thaksin and his party. The number of spoiled ballots almost reached 2 million. This indicated that, unlike the previous two elections, Thaksin failed to win a mandate this time.

Calls for Thaksin to resign unconditionally from politics began about three months ago, immediately after his family's tax-free sale of Shin Corporation to Temasek Holdings of Singapore for Bt73.3 billion. Thaksin's political fortunes have quickly tumbled. The People's Alliance for Democracy staged a series of rallies to expose the alleged corruption, nepotism, and abuse of power permeating Thaksin's administration. Academics, students, the middleclass and entrepreneurs joined the anti-Thaksin rallies, forcing the former telecom tycoon to dissolve Parliament.

But this did not satisfy urban

voters who demanded that Thaksin leave the political scene completely. They made their voices heard at the polls on Sunday, stunning the Thai Rak Thai Party.

Still, Thaksin took comfort in the fact that his party won 16 million votes, compared with 19 million votes in the last election, which would still enable him to continue as prime minister.

But pressure on him continued, in part because he never fully and clearly explained the Shin Corp deal.

Thaksin has been making a series of tactical retreats, which culminated with Tuesday's announcement.

Thaksin told his Cabinet on Tuesday that he had to step aside temporarily, otherwise people would make such an issue of his presence that it would be impossible to convene Parliament. This dilemma faces the entire country, not just Thaksin.

There are 39 constituencies that will have to hold by-election on April 23. In these constituencies, candidates who ran unopposed failed to get at least 20 per cent of the eligible votes.

If by-elections were to be held in the current form and with the old candidates, it would be impossible for them to produce MPs as there would still be an overwhelming number of protest votes.

The Election Commission is now doing everything it can to get as many MPs running as possible. It

ruled that even political parties that did not field candidates in Sunday's election can do so in the by-elections. This ruling might violate electoral law.

The political deadlock will continue if 30 days after Sunday's election the number of MPs falls short of the 500 required to reconvene Parliament. The Constitution Court will have the final say if this occurs.

Still, Thaksin yesterday signaled another retreat by moving out of Government House and appointing Chidchai Wannasathid, first deputy prime minister, to run the government during the transition period. He said he would like to take his time off.

PAD leader Sondhi Limthongkul indicated that the protestors would give Thaksin one month to really step down otherwise they would start rallying again.

Now, Thaksin has really backed off in order to make a comeback. During this time, according to a political source, he will rest and travel to find some fresh ideas. He can manage national policies from behind the scenes as he still controls Thai Rak Thai.

After the political reform process is completed, he can make a comeback. Then he will write a second chapter of The Thaksin Era.

Maria Chimprabha writes for The Nation, Thailand. Reprinted by arrangement.

NIZAM AHMAD

THIS is in reference to Dr. Wahiduddin Mahmud's two-part analysis of Tata's investment in western Bangladesh, the pricing of gas, and Tata's response to Dr. Mahmud among others.

In my opinion, pricing is best left to the producer of gas. However, if the producer is a government entity pricing will be faulty. The inherent nature of public ownerships is one of poor market knowledge, distrust in the market process, wastage, inefficiency, and shying away from competition under various political pretenses or development theories. Thus, a government assigning country's top economist to suggest gas pricing is of no significance.

PetroBangla, if privatised, or any private owners of gas fields, can themselves be the proper organisation if employing bright managers, highly skilled, and well paid, to determine, autonomously, prices for any large or unique buyers. However, continuous bureaucratic government management of PetroBangla depletes its potential as a producer in negotiation with a buyer. Pure private ownership of gas fields is not in consideration and unless it is, infrastructure development or FDI will remain wanting.

Government can fix the gas price today, but how will they fix the value of Taka or Dollar, or fix the cost of prerequisites that go to produce gas. Values of fiat curren-

cies are shrinking rapidly and prices, if fixed, cannot be effective when currencies fail to hold a value permanently despite continuous attempts of central banks. Currencies that are 100 per cent reserve backed, or metal backed, and unchanging in value are no longer in vogue.

However, prices, in liberal economies, do not remain fixed and no investor may have all factors in control unless in a socialist economy. Prices fluctuate with demand and supply and enable producers, consumers, and investors, to suitably react and respond to change in prices. The material in question is only gas and not any ultra sensitive or strategic as nuclear fuel that deserves special consideration as fixed prices.

Furthermore, we erroneously perceive FDIs to bring big benefits to the country but in reality, such investments do not unless government reduces its comprehensive hold over economy. Presently, the people on whose land the investment or steel mills will be built will be least benefited. Land will be nationalised by the government with some compensation to the people. With free market in Bangladesh, each landowner or any other resource owner would become enormously wealthy by selling or renting their property, or by some other commercial arrangement directly with Tata.

Any big investor, instead of worrying about who is saying what in the media or within the power circle, would normally pledge to

build schools, hospitals, or roads, and to boost the socio-economic condition of that area and to create a friendly reputation that big companies often lack. Currently, corporate social responsibility [CSR] is a common phenomenon. Tata could also offer company shares to landowners and to the people of that region for greater participation, shared ownership, and long-term profits.

At present, other than few paan and teaspoons, job openings as peons, chhapris, gatekeepers, and workers, and newly erected slums and shanties for accommodation; there will be no other major gains for the common lot in Tata areas of investment. The gainers, in multiple ways, would be those having close connections with the government and hold access to the corridors of power. Rural folks do not have any access to power and suffer economically and financially due to complex rules and regulations of the government or imposed on investors.

In free market conditions, modest gas reserve situations, as in Bangladesh, would attract smaller investments from Tata with gas prices unfixed. If gas reserves increase, prices would fall and vice versa. Investments would proportionately increase or fall in relation to gas prices. The producer of gas could also hold the option to choose its currency of payment under a multiple but competitive currencies as in a free market. Only in economies where government is a commanding factor,

intending investors as Tata can make demands and conditions to fix prices for a long period. Price capping in electricity or others may be in the developed world as well but only with dire consequences in production and other distortions. Unhindered market processes, if allowed, can correctly decide the nature, terms, and type of investments to everyone's satisfaction, a win-win arrangement that no expert studies by the government can achieve.

However, if government must at all be the deciding and negotiating body, let it be the regional local government in Bangladesh not Dhaka. The local bodies can always solicit expert advice from the private sector, multilateral agencies, and the like, as the central government does now.

We should not forget that the people of Bangladesh shed enough blood and endured sufferings for Bangabandhu's autonomy movement, and that struggle will continue until every region, zilla, upzilla, union, and finally the man himself is autonomous in Bangladesh.

Surely, a major signal to global or domestic investors would be a free market free of bureaucratic intervention to attract investors and build the country's poor infrastructure not a successful government negotiation with Tata.

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