

China's Controlled Reform To Keep Currency Stable

by Mary Burdman

The People's Bank of China, the nation's central bank, ended the peg of the renminbi (RMB) to the U.S. dollar and adjusted the RMB-dollar exchange rate by 2.1%, to 8.11 to the dollar, on July 21. The RMB had been directly pegged to the dollar since 1995. The PBOC announcement, issued late in the day from Beijing, said that beginning July 21, "China will reform the exchange-rate regime by moving into a managed floating-exchange-rate regime, based on market supply and demand, with reference to a basket of currencies." The aim of the PBOC is to maintain a "basically stable" RMB exchange rate, "so as to promote the basic equilibrium of the balance of payments and safeguard macroeconomic and financial stability." In a press statement July 19, after a two-day meeting in Hohhot, Inner Mongolia, of the PBOC's head officers and provincial branches, the Bank announced it would keep the RMB rate "basically stable at a reasonable and balanced level" in the second half of 2005.

The daily dollar-RMB trading price "will continue to be allowed to float within a band of 0.3% around the central parity published by the PBOC" each day, "while the trading prices of the non-U.S. dollar currencies against the RMB will be allowed to move within a certain band announced by the PBOC," the Bank's statement said. It will adjust the exchange-rate band "when necessary according to market development as well as the economic and financial situation." Malaysia ended the dollar peg of its currency, the ringgit, the same day.

This very important decision in Beijing, was *not* the change which the Bush Administration, some members of Congress, and central banks in Japan and elsewhere have been demanding of China since the beginning of 2003. The pressure has been as heavy as that exerted on Japan to sign on to the 1985 "Plaza Accord"—which plunged Japan into a huge financial bubble and bust—and as that on China to *de-value* during the height of the 1997-98 Asian financial crisis, which China rejected then.

High-level economists in Beijing are emphasizing that China has not in reality "converted to 'floating' its currency." The PBOC statement is very carefully worded: The RMB exchange rate is now being determined "in reference to" a basket of currencies, including the U.S. dollar and others. The dollar peg was very specific; now, that is not the case. This situation gives the People's Bank "a free hand" to maintain

the “basic stability” of the currency, without being forced into specific valuations due to other currencies’ gyrations.

Solemn Statement

There were important political considerations for this move, especially because China does *not* want a trade war with the United States or European Union. It would have been extremely difficult, given the current world economic situation, for Beijing to hold onto the fixed peg to the dollar for much longer. However, pronouncements in various international publications, asserting that this was simply the “initial” step to a “free” float, or that the matter had been secretly pre-announced to the U.S. Administration, are reminiscent of the after-the-fact self-congratulations of former Western

government leaders, on their alleged pre-arrangement of the fall of the Berlin Wall. The People’s Bank was quick to correct these sentiments.

On July 26, the Bank issued a “solemn statement” to deny that the 2.1% revaluation of the RMB is just a “first step” towards further increases. While welcoming “responsible and objective” coverage of its decision, the PBOC announced, “certain foreign media have misled the public and even wrongly speculated that the revaluation of RMB by 2% was only the first step in a series of adjustments, which could ‘lead to expectations for further RMB revaluation by the People’s Bank of China in the non-distant future.’ ” This is not the case; the revaluation “does not in the least imply an initial move which warrants further actions in the future.”

LaRouche: China Currency Collapse Would Finish Dollar

In a telephone discussion with a West Coast LaRouche Youth Movement meeting on July 23, 2005, Lyndon LaRouche responded to a query concerning the significance of reports that the Chinese currency, the renminbi, was no longer pegged to the dollar, and whether the United States would react in some way.

Well, first of all, don’t believe any of the reports of the type you’re reflecting in your remarks. No such thing happened.

Under tremendous pressure from the United States government, China made a compromise to establish a float of the value of its currency within a bracket; within a range, a fairly small range. In other words, the Chinese currency is not a free-floating currency. So, it’s not been allowed to float. It’s been allowed to adjust, an adjusting float within a certain bracket which will be very tightly managed by the Chinese government.

Most of the things you’ve heard about this in the press—forget. Most of the reports you’ve heard, forget.

Now, what you’re faced with, is the following situation: If the Chinese currency were to collapse, the United States would collapse immediately. So, you don’t want a soaring increase of the value of the Chinese currency. Nor do you want a collapse of the value of the Chinese currency, either one. You want the currencies, the reserves of China, of South Korea, and Japan, for example, to remain at about their present levels. Some margin for fluctuation is allowable. The margin will have to be determined by governments, because the fluctuations will have to occur, in the overall picture—it will not be a uniform adjustment, commodity by commodity. It will have to be an adjustment

on a selective basis. And therefore, what the net effect will be, there will be a slight degree of float, within a regulated interval, in which the float will be reflected in an *average* change in price, not a uniform standard, across the board, change in price. So, there’d be an adjustment.

Now, if the U.S. system were to collapse, or the Chinese currency were to collapse, or the Japanese currency, or South Korean currency, you’d have an immediate collapse of the dollar. You’d have an immediate collapse of Europe. You would have a Dark Age over this planet, if you had that kind of system. So, if anything like that were to happen, forget it, buddy! Get off the planet! It’s coming down!

So, don’t believe what you hear. And don’t try to ask yourself, or ask others, or answer questions, where somebody assumes that what happened in the Chinese currency is what was reported as the “Snow job”—that is, the Treasury Secretary Snow, who does Snow jobs for Bush and the Vice President, or the President of Vice. Don’t believe any of it. It’s all garbage. It’s misinformation.

So don’t try to answer the question, or interpret the question that’s posed to you, because the question itself is a fraud. There was no free float of the Chinese currency. There was no general devaluation or revaluation, or anything of the currency. There was an agreement, under tremendous U.S. pressure, from the Snow-job administration, the Bush-Cheney Administration. There was tremendous pressure for the Chinese to concede, to have some flexibility in the value of the currency, the exchange rate of the currency. And that was a *U.S.-pressed, U.S.-demanded concession*.

And, if they don’t tell you that—tell them, they’re full of you-know-what. Because it’s not “the Chinese decided.” The Chinese didn’t decide. They decided to accept a negotiated demand, pressed upon them, *by the United States government*.

The entire process of reform “must proceed in a gradual way,” the Bank stressed, and the reform is not a matter of the “quantitative adjustment” of the exchange rate, but its “improvement.”

PBOC monetary committee member Li Deshui had already made a “solemn” declaration on Beijing’s intentions to keep effective currency controls firmly in place, in a July 22 interview. China’s “last economic and financial defense” is the fact that its currency is not fully convertible, he said. The government will “not easily allow” a change in the policy. “There’s more than \$800 billion to \$1 trillion of hedge funds in the world and the Chinese financial system is relatively weak,” Li said in an interview with Bloomberg News, also published in *China Daily*. “If the yuan becomes fully convertible it would be attacked by these hedge funds. Over the next five years, I do not foresee the renminbi becoming fully convertible,” Li said. “Our banks are not good enough and the monetary system is not quite up to international standards.”

Li Deshui said that the RMB would be traded against the currencies of China’s major trading partners: “I’m not talking about just yen, euros, and pounds,” he said. “You name the currency, it’s in the basket.” No one in Beijing has specified which currencies are in the “basket” and how they are weighted. China’s main trading partners are the European Union, the United States, Japan, Hong Kong, the ASEAN bloc, South Korea, Taiwan, Russia, Australia, and Canada.

The timing of the rate adjustment does reflect international politics, but reflects, even more, big strains on China because of the collapsing U.S. economy. Between January and June of this year, China’s exports shot up 32.7% year-on-year to \$342.34 billion, while imports were up just 14%, at \$302.69 billion. The foreign trade balance shifted from a \$6.8 billion deficit a year ago, to a current surplus of \$40 billion. As a result, China’s foreign-exchange reserves have skyrocketed, to \$711 billion, an increase of over \$100 billion just in 2005. This rate of increase is nearly double that of early 2004; if it continues, China’s forex reserves could hit \$1 trillion in a year. The U.S. trade gap with China hit a record \$162 billion in 2004, and the National Association of Manufacturers is saying the deficit will hit an astonishing \$225 billion this year.

Beijing took advantage of the recent strength of the U.S. dollar and the withdrawal of some speculative capital to make its quick decision for a slight RMB appreciation, State Information Center economist Dr. Gao Huiqing told the *Beijing Times* July 23, according to a Xinhua report. He Fan, assistant director of the Institute of World Economics and Politics of the Chinese Academy of Social Science, also noted that China had taken advantage of an unexpected opportunity to change the RMB rate, without giving opportunities to speculators. At their current rate of growth, China’s foreign-exchange reserves might even exceed those of Japan by year-end. This would push China to the “frontline” of the complicated conflicts of international economy and finance, making financial

macro-control very difficult, He Fan said. The RMB appreciation can help ease this.

Slow Down Exports

The 2.1% adjustment, small as it is, will have the effect of “slowly slowing down” the rate of export growth, by making the RMB slightly more expensive. The biggest problem with the export boom, is that it is being generated by foreign-owned enterprises in China, and not by Chinese industry. Foreign enterprises accounted for 57% of export volume in 2004, the Chinese Ministry of Commerce reported July 12, and these enterprises employed 24 million people, 10% of China’s non-agricultural labor force. The revaluation will win Beijing time for internal economic and financial development, and help adjust capital flows, by encouraging greater outflows of Chinese investment.

Wang Xiaoguang, of the Economic Research Institute of the State Development and Reform Commission called the export increases “an ephemeral joy,” and said that slower trade growth in the latter half of 2005 might pose a severe challenge to China’s economy. “A strategic transformation must occur in coastal China to shake off its excessive reliance on foreign investment and exports. Stimulating domestic consumption and employment is a better choice to resist the slow-down,” Wang said.

Xinhua also quoted Fan Jianping, director of the Economic Forecast Department of the State Information Center, calling for the government to invest more in infrastructure, such as transportation, power grids, water supply, medical care, and education. “It would be safer to invigorate the Chinese economy through domestic investment and consumption,” Fan said. He also called for raising Chinese citizens’ incomes. “Although the ratio of China’s fiscal revenue has risen to 20% of the GDP, the growth in citizens’ income is left far behind,” he said. Between 1997 and 2003, China’s fiscal revenue has grown twice as fast as urban residents’ income, and over three times as fast as rural residents’ income.

In an interview with the *People’s Daily* published July 23, an unnamed PBOC spokesperson said that the RMB rate reform “was necessary for alleviating unbalanced foreign trade, expanding domestic demand,” and increasing China’s relations with the rest of the world. The recent years’ “continuous expansion of China’s double surplus, in current account and capital account, has aggravated the imbalance of international payments.” Changing the exchange rate will help China’s development strategy of “domestic demand and optimizing resource allocation; will contribute to enhancing the independence of the monetary policy”; will “increase financial control and regulation; and help maintain a basic balance of imports and exports,” the spokesman said. Any “major fluctuation of RMB exchange rate will exert great impact on China’s economic and financial stability and so does not conform to China’s fundamental interests,” the PBOC spokesman warned.