Yuan and absurdity of U.S. demand

The conventional wisdom is that once the value of the yuan is increased, the US trade deficit with China would start falling. This rationale has prompted many Americans to push for further, faster revaluation of the yuan even after China changed its currency policy.

For those who endorse such logic, yuan’s value is a paramount factor behind China’s and their countries’ trade balances. But for John Ross, former deputy mayor of London in charge of economic and business policy, the trade gap between a country and China would widen instead of narrowing down, at least in the short term, if the yuan’s value goes up.

Ross, a visiting professor at Antai College of Economics and Management in Shanghai, Joung University, says that once the yuan’s value rises the Americans would demand further revaluation, ultimately forcing the yuan to rise to a level that would not only disrupt China’s trade and economy, but also pose a threat to the entire world economy.

Moreover, the number of jobs in the US would not increase unless the federal government changes its economic policy and raises investments, which is the real solution to its problem. Pressuring China to raise the yuan’s value sharply will not help.

“Most people, particularly those abroad, don’t know the real situation. The reason they want the yuan to be revaluated further is because they think it would reduce China’s trade surplus. But let’s say up to 18 months, this is not true,” Ross says.

From what happened between 2005 and 2008, when the yuan rose 21 percent against the dollar, it’s clear that China’s “trade surplus rose, too,” Ross says. Any revaluation of the yuan raises the price of exports and reduces the price of imports, which means China’s trade surplus would get bigger as its currency rises.

By examining historical data, Ross has found that China’s exports and imports grew simultaneously after 2005 in terms of volume, but the prices of exports rose more slowly than the prices of imports. That is why its trade surplus with the US is bigger today.” There’s a big debate among economists over what would happen in the long term if the yuan rose further, he says. Some people think China’s trade surplus would increase, while others think it would fall in the long run. “But there’s no difference (in what they say) would happen in the short term,”

Ross sees the trend of trade deficit of the US is increasing because of China is simply not true, he says. “It’s because its (America’s) trade deficit with the rest of the world is rising, too.”

In other words, claiming that the trade deficit of the US is rising because of China is simply not true, he says. “It’s because it’s (America’s) trade deficit with the rest of the world is rising, too.”

The US has a trade deficit with about 90 countries. “If you reduce its trade deficit with China, all that would happen is that its trade deficit with some other country would increase.”

US hawks, however, have always targeted China and pressured it to deflate its currency to suit the tune of their demand. Even if there is a pledge to make the yuan more flexible by reforming its exchange rate mechanism and pegging it to a basket of currencies to better reflect the demand of the market, US politicians and industrial leaders say the market is a little too late and demand the Chinese currency be revaluated by up to 40 percent.

Forcing the value of the yuan to rise would cause further uncertainties in the world economy, which today faces other big challenges such as the European Union debt crisis. “We are not (living) in a normal stable economic environment; we are just about recovering from a very bad financial crisis and what happens in the next six to 18 months is very important and would have a very big effect,” he says. “The last thing the world needs at present is a short-term rise in China’s trade surplus because of an increase in the value of the yuan.” As the yuan’s value rises, the US would demand more revaluations, thus making it unaffordable for the Chinese and world economies.

“The point is that the US has not given it a really serious thought.” Ross says economic history shows that the only way for the US to increase exports and jobs is to raise its level of investment. The Americans are famous for their low savings rate while China, Japan and some other countries boast high savings that can be used for investment.

The US suffered job losses because of the global financial crisis and because the savings rate in America was (and still is) very low. “It’s very easy to explain the financial crisis in the US: The investment level of the US has not gone up in the past 150 years,” he says. “The only way the US could increase its growth rate, which can create more jobs, is to raise the level of investment in its domestic market.”

Ross accuses the US of trying to slow down growth of other countries by pressing them to open their markets, and exchange rate policies as a means of investment. “The two effective means of slowing down an economy are to increase the exchange rate of its currencies sharply and force it to reduce its level of investment,” Ross says. “This is what the US did for Japan in the 1970s and in later decades.”

“What are the two demands the US places on China? One is to raise the exchange rate of the yuan. The second is to increase the share of consumption,” he says. “But the increase in the share of consumption means reducing the share of exports that China produces. If China does two things simultaneously, then its economy would slow down a lot.”

Will that benefit China or, more importantly, the world economy?