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## Ridiculous logic of politicizing Chinese yuan exchange rate

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The China-made clothes are sold at a Marshalls store in New York, the United States, March 18, 2010. The Americans may find that the appreciation of China's RMB will increase their living cost, as many goods they have been consuming are made in China.(Xinhua/Wu Kaixiang)

by Xinhua writers Ye Shuhong, Wu Liming

BEIJING, March 18 (Xinhua) -- Some politicians in the West are playing the game of politicizing China's RMB exchange rate again.

With mid-term elections looming in the United States, some U.S. senators have proposed legislation at a high-profile press conference at the Capitol Hill on Tuesday to press China to appreciate its currency.

They have threatened Beijing with duties on some of its exports if it fails to revalue its currency and pressured the Obama administration to lable China a "currency manipulator."

According to their logic, China's currency, the Chinese yuan or Reminbi, is "undervalued," which avails Chinese exporters of an "unfair competition advantage" and leads to the huge trade deficit on the U.S. side. Accordingly, their conclusion is: raising the value of the yuan against the U.S. dollar is the sole solution.

It has become a customary practice for Western politicians to press for appreciation of the yuan when their domestic economy is in trouble.

"It's always easier to blame someone else for your failings," said British newspaper The Sunday Telegraph on Sunday.

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Is the yuan really undervalued?

Liam Halligan, chief economist at Prosperity Capital Management, argued that the Chinese yuan may not be undervalued as much as Western politicians think.

Although Chinese exports rose by 46 percent in the first two months of 2010, the rise was from a very low base -- with February 2009 being the epicenter of the U.S.-sparked sub-prime storm, he said.

He also pointed out that China's trade surplus dropped by 51 percent in the same period. That means China's gain in exports was outweighed by an import surge.

China began its currency reform to unpeg the yuan against the U.S. dollar in July 2005, the yuan has appreciated 21 percent against the U.S. dollar, or 16 percent in real terms.

Chinese Premier Wen Jiabao said last Friday that China did not depreciate the yuan "from July 2008 to February 2009 when the global economy was in extreme trouble," instead, it appreciated the yuan "in real terms by 14.5 percent."

Secondly, would a sharp appreciation of the yuan cut the trade deficit against China as the West claims?

The answer is a clear "No."

In most cases, the deficit of some Western countries's trade with China originates from their trade policies and structure; therefore, pressing for the appreciation of the yuan will not help resolve the trade imbalance.

The trade between China and the United States is a good example.

The majority of China's exports to the United States are labor-intensive commodities, while U.S. exports to China are, in most cases, technology or capital-intensive high-value added products. This situation conforms to the principle of seeking comparative advantages in a free trade world.

However, Washington has long pursued a biased policy of limiting the sale of high technology and related products to China, leading to the trade imbalance across the Pacific.

Just as Steve Forbes put it, the United States started in the 1970s to put pressure on Japan to change the value of the yen. The result is that "the dollar today has fallen 75 percent against yen, and we still have a trade deficit."

What's more, the deficit of the West against China is not as "huge" as those people have claimed.

The West often ignores a very important fact: a majority of China's exports to the Western developed world are produced by foreign-funded companies or joint ventures with foreign partners, and huge profits go back into the pockets of the West.

Statistics show that, from 1995 to 2005, 62 percent of the increase of China's exports came from foreign-funded companies in China.

It is widely accepted that appreciating the yuan is, by no means, a catholicon to heal the trade imbalance.

"The dollar depreciated sharply against the currencies of Canada and the Eurozone after 2002, yet our bilateral deficit with both those regions continued to grow," said Daniel Griswold, director of the Center for Trade Policy Studies at the Cato Institute.

He predicted that China would remain competitive in a broad range of manufactured products "even if the yuan were 25 percent higher."

As a matter of fact, quite a lot of member companies of the U.S.-China Business Council do not regard the yuan exchange rate as a major element affecting their competitive edge in the Chinese market. On the contrary, these companies are concerned with the politicizing of the currency issue, fearing a possible negative impact on their exports to China.

Making an issue of the yuan rate is not helpful to resolving the trade deficit. Instead, it will bring upsets and twists to the recovery process of the global economy at large.

As foreign-funded companies and joint ventures account for a big percentage of the export-oriented enterprises in China, the sharp appreciation of the yuan would increase the cost of their products and services. Their exports would drop dramatically and the customers in the West would have to spend more, which implies a blow to the global trade and economic recovery.

Pressuring China to revalue the yuan would also raise the expectations on overall appreciation of Asian currencies, which could lead to speculation and gambling of "hot money", thus disturbing the Asian and global financial order as a whole.

The Sunday Telegraph reported that currency derivative traders, having sucked up the White House spin, on Monday were betting on a 3 percent rise against the dollar.

It is well-known the Chinese economy has become a major engine for the world economy. A stable yuan is of vital significance to the global economic development and the stability of the international monetary system.

The United Nations Conference on Trade and Development (UNCTAD) warned on Tuesday that "expecting that China will leave its exchange rate to the mercy of totally unreliable markets and risk a Japan-like appreciation shock ignores the importance of its domestic and external stability for the region and for the globe."

In short, pressing China for a sharp appreciation of the yuan will bring benefit to no-one. The world is skeptical of the motives of those politicians who are eager to politicize the exchange rate. What the West, including the U.S., has to do is to readjust their policy, reform economic structure and take on their due international responsibility.

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