Preface

The US is accusing China of playing a “dirty game” involving currency manipulation and mercantilism, claiming that these policies have created the massive bilateral trade deficit and destroyed America’s manufacturing industry. China is also accused of causing the global financial crisis, impeding the recovery of the world economy from the great recession, perpetuating higher oil (and copper) prices, aggressively buying up the corporate world, and threatening American security. These unsubstantiated and exaggerated allegations are typical products of the blame-it-on-foreigners and do-as-I-say culture. Furthermore, the US is ambivalent towards China’s accumulation of foreign reserves (mostly US Treasury securities). China’s accumulation of reserves is taken to be indicative of an undervalued currency and a threat to the US; meanwhile America is apprehensive about the possibility that China may stop buying Treasury securities, effectively cutting America’s credit lines. As a result, China finds itself in a classic damned-if-you-do, damned-if-you-don’t position.

Just before the completion of the manuscript in September 2011, I was visiting the Beijing Institute of Technology where I presented a paper on why revaluation of the yuan will not work. The visit was rather informative with respect to some of the issues addressed in this book. The claim that the Chinese do not spend enough gave me a different impression from what I saw: luxury cars, busy restaurants and bustling shopping malls. I also found out how generous the Chinese are with guests. Generosity and not spending do not go together. The Chinese, I would say, spend adequately while striking a balance with saving. And they do not have the habit of spending money that they have not yet earned. I also observed examples that are counterintuitive with respect to the claim that things are cheap in China because of an undervalued currency. A ride on the subway in Beijing costs 2 yuan – about 1/20th the cost in my home city, Melbourne. I am not sure how the cost of a subway ride is related to the exchange rate – it is not. These are just two observations that have reinforced my belief in what is written in this book.

While this book is mostly about the bilateral trade deficit of the US with China and the consequent trade dispute, it also deals with all matters arising from Sinophobia. It addresses the three pillars of the current

debate. The first is whether or not the Chinese yuan is undervalued. The second is whether or not the presumed undervaluation of the yuan is the cause of the massive US trade deficit with China. If so the revaluation of the yuan is the means whereby the trade balance can be corrected. The third is whether or not Chinese exchange rate and trade policies are illegal and/or immoral. The thorough analysis presented in this book leads us to the following conclusions. First, the yuan may or may not be undervalued – claims of undervaluation are motivated by political agenda rather than sound economics. Second, even if the yuan was undervalued, its revaluation will not affect the trade deficit, just like the appreciation of the yen from over 300 to under 80 has not made any difference to the US deficit with Japan. Third, Chinese economic policies are not immoral and do not violate the rules of the World Trade Organization (WTO) and the International Monetary Fund (IMF). It is also concluded that the US trade deficit with China is an American problem that America must deal with decisively.

Following an introductory chapter in which the issues under consideration are discussed briefly, Chapters 2 and 3 deal with the history and structure of the international monetary system and international financial and trading relations. The discussion is helpful for putting the underlying issues into perspective. For example, to deal with the accusation that China is pursuing mercantilist policies, it is helpful to understand the concept of mercantilism and how it has evolved. And a discussion of the issue regarding whether or not China is violating IMF rules by adopting a fixed exchange rate regime requires some understanding of the current rules and regulations governing exchange rate regime choice.

Chapter 4 is about exchange rate misalignment and the measurement of the equilibrium exchange rate. It is demonstrated that there are no reliable estimates of the equilibrium exchange rate – hence no one knows whether or not the yuan is undervalued. In Chapters 5, 6 and 7 we will see why the relation between the exchange rate and the trade balance is not as straightforward as it is typically portrayed to be. Several factors impede the transmission of the effect of changes in the exchange rate to prices, volumes and consequently the trade balance. Chapter 8 presents an evaluation of Chinese policies and what China is accused of. Chapters 9 and 10 portray the US trade deficit as an American problem resulting from too much debt-financed spending, too little saving, the demise of manufacturing industry, and the dominance of the financial sector. Concluding thoughts are presented in Chapter 11.

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Naturally, I am the only one responsible for any errors and omissions that may be found in this book. It is dedicated to my beloved children, Nisreen and Danny.

Imad A. Moosa
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