China vs. the IMF

20/08/2015

Behind the IMF’s decision to refuse China’s currency reserve status is U.S. commitment to protect its hegemonic role in the global economy.

The global economy is slowing, and with it the volume of world trade. In response to the negative effect of the global trade slowdown on its own exports and economic growth, last week China introduced a 2.8% reduction in its currency exchange rate, the Renminbi-Yuan.

The move had immediate repercussions throughout the global economy. Currencies fell. Stock markets retreated broad and deep. Speculation grew whether the U.S. central bank would indeed raise interest rates next month or whether Japan would launch another round of quantitative easing (QE). Not so speculative, however, was the crescendo of complaints and charges against China raised from Washington to London to Tokyo within just hours of China’s currency move.

Especially from the ‘west’, and in particular from U.S. politicians, business press pundits and editorialists, China was castigated for daring to make such a move without a pre-announcement. Long standing threats from the U.S. Congress claiming that China manipulates its currency to the disadvantage of U.S. manufacturers and producers—and therefore should be somehow punished economically— were loudly revived by the circus of U.S. politicians running for office in 2016. “How dare it manipulate its currency, in violation of free market principles” was the indignant collective chant. “It should allow the currency to fluctuate according to market forces,” was the general media message. Behind this ideological spin, however, lay the real message: “How dare China try to take back our share of the shrinking global trade pie.”

Hypocrisy, Inaccuracy and Ideology

The complaints against China by the U.S. and its key global partners—Europe and Japan—are as hypocritical as they are inaccurate, however.

How inaccurate is revealed by the fact that China has actually allowed its currency to appreciate not depreciate—i.e. allowed it to rise—over the past decade, 2005-2015, making it and China's exports actually less competitive against the dollar and other currencies.

Here's some data in support of this point:

China's currency over the past decade has actually risen, i.e. appreciated in value. From an exchange rate of 8.3 to the US dollar in 2005 it rose to 6.2 to the dollar as of August 10, 2015 (note: A fall in the number represents a 'rise' in the exchange rate. Because China's currency buys fewer dollars, its value has risen). That 6.2 exchange represents an almost 25% 'rise' of the Renminbi-Yuan to the dollar. If China has allowed its currency to rise against the dollar over the past decade, it has in effect allowed its exports to become less, not more, competitive in relation to U.S. producers. U.S. manufacturers and exports have been allowed to become more competitive, not less. So where's the manipulation of its currency at the expense of U.S. producers that U.S. politicians so often complain about? Just the opposite has been happening. Of course, ideological arguments need not be based on fact.

Once the U.S. and UK discontinued their own quantitative easing (QE) policies by 2013, and thereafter allowed their currencies to drift upward in relation to other currencies, it was the Yen and Euro—not the China Yuan— that depreciated against the U.S. dollar. Japan and European exports thus did gain a competitive advantage against U.S. producers. The U.S. said and did nothing in reply.

In short, the Europeans and Japanese were allowed to do what China was supposed to have done. Did the U.S. complain and castigate Japan and Europe? No. Even though they, Japan and Europe, did what the U.S. complains China did, but actually didn't.

For example: since 2008 the European currency, the Euro, has depreciated by 18% against the U.S. dollar. Most of that has occurred this past year, after Europe's introduction of its QE program in early 2015, designed in part to 'manipulate' its currency to lower rates compared to the dollar. The U.S. not only did not oppose it. They actually encouraged it. And since Japan introduced its QE in 2013, the Yen has depreciated by 23% to the U.S. dollar. No complaints by the U.S. there either.

So it's ok for Japan and Europe to do what China hasn't. Conversely, China is criticized sharply for something it hasn't done but the Europeans and Japanese have. Such is the world of ideological—in contrast to policy—manipulation.

China has not only not depreciated its currency against the dollar, it has allowed other currencies to depreciate against its currency, the Yuan, by even more than the U.S. has allowed the Euro-Yen to depreciate against its dollar.

For example: since 2013 the Yen has depreciated by no less than 30% to the Yuan, and the Euro by 32%. Other currencies have also been allowed to depreciate similarly against the Yuan since 2013. For example, the Indonesian Rupiah, by 30%. South Korea's Won by 10%, and so on.

Facing the reality of a shrinking global trade pie and having allowed its own competitive position to decline relative to other currencies, China last week, August 10-14, allowed its currency for the first time in years to 'adjust', i.e. to decline—by a whopping 2.8% to the dollar. The Yuan officially fell, from 6.2 to 6.4 to the US dollar. What manipulation! What an affront to the rest of the global trading community!

Of course, a mere 2.8% depreciation is not going to result in China taking back from the Europeans, the Japanese, and even the U.S. producers the share of global exports it allowed them to claim in recent years by their manipulating QE their own currencies by 20% to 30%.

So what then is behind the China move? And what does China's devaluation have to do with the IMF? Furthermore, why is the U.S. really upset with China's recent token currency devaluation move last week?

The China-IMF Negotiations

In the days immediately leading up to China's decision to devaluate its currency last week, confidential negotiations were intensely underway between China and the IMF. The issue was China’s request that the IMF declare the Yuan-Renminbi as a global reserve and trading currency—like the U.S. dollar, UK pound, Euro, and the Yen. After all, China is the second largest economy in the world; the first if one adjusts output to world price differences. Its manufacturing output is as large as the U.S. And it is the number one trading country in the world. It is therefore quite appropriate—and inevitable—that its currency becomes a reserve trading currency alongside the others.

The IMF refused China’s request in early August. But it left the door open for possible future granting of reserve currency status to the Yuan. The IMF used as its excuse that China needed to allow its currency to fluctuate more according to market forces. So China last week cleverly responded to the IMF’s rejection by adjusting its band to allow market forces to lower its currency’s value.

Technical means by which it did this aside, in simple terms it merely allowed the currency to fluctuate, as it always had, slightly differently within the ‘band’ or range it had always been allowed to change. So, it actually followed the ‘market forces’ to devalue by 2.8%. By adopting a method that relied on market forces, China in effect eliminated the charge by U.S. politicians that it was not allowing market forces to determine its currency’s value, that it was therefore manipulating the market. It achieved a modest devaluation of 2.8% by also satisfying the IMF’s requirement that it let market forces determine its currency exchange rate as a precondition for IMF granting it reserve status. All of which proves, perhaps, that if one is sufficiently clever, even ideological manipulation at times may itself be manipulated.

China, IMF and Economic Power

Behind the IMF’s decision to refuse China’s currency reserve status is U.S. commitment to protect its hegemonic role in the global economy. The U.S. is opposed to allowing China’s currency reserve status and it is the U.S., with its allies, who control the majority votes in the IMF and determines what decisions it makes. That U.S. control was ‘baked into’ the IMF at its creation in 1944. Together with its key allies in the IMF (UK, Japan, Germany, France, Canada) the U.S. retains a very safe ‘control’ of the IMF’s majority voting rights and thus its decision making. The IMF’s director, Christina LaGarde, is employed at their pleasure. So the IMF does whatever the U.S. voting bloc tells it to do. It’s not by accident the IMF was and remains located in Washington D.C.

The U.S. has thus far been opposed for several reasons.

The Yuan as an official global trading currency would grant China yet another big ‘win’ in terms of growing global economic influence. China recently pulled off a major ‘economic coup’ earlier this year with the launch of its Asian Infrastructure Investment Bank (AIIB) that caught the U.S. by surprise.

The AIIB represents a direct institutional challenge to the sister institution of the IMF, the World Bank, that was also created in 1944. Both have functioned as key vehicles of U.S. economic global hegemony in numerous ways since 1944. China’s launch of the AIIB—which many U.S. allies participating in the World Bank-IMF also quickly joined contrary to US requests at the time—in effect set up a challenge to the World Bank-U.S. dominance.

Having suffered a major loss with the AIIB v. World Bank affair just months ago, the U.S. and key allies don’t want China to have more influence within the IMF as well. And to have granted reserve status to China’s currency last week might have jeopardized U.S. current efforts to quickly close the Trans Pacific Partnership (TPP) free trade deal now in sensitive, final negotiations. It would certainly have encouraged the Asian region’s potential TPP members to demand more last minute concessions from the U.S.

China has made a number of significant gains in influence in the global economy in recent years. It has provided significant loans and capital to African economies. It has begun penetrating Europe with financial assistance and investments, in the Euro periphery as well as to UK infrastructure and commercial real estate. It is now one of Germany’s major trading partners. China launched the BRICS group, a BRICS bank, and has initiated non-dollar trading between the BRICS economies—i.e. a long run threat to U.S. dollar reserve and trading dominance. China also recently closed a 10 year $40 billion energy trade deal with Russia, just as the U.S. was attempting to tighten sanctions on the latter. It has plans to establish an overland ‘Silk Road’ rail link directly to Europe, one of the largest global infrastructure projects in decades. All these developments, when combined, represent a rising economic challenge to U.S. global economic hegemony.

So, within just months from China’s big ‘win’ in the launch of the Asian Infrastructure Investment Bank, the AIIB, there was no way the U.S. was going to allow the IMF to grant reserve status to China's currency. At least not yet. The U.S. is not about to allow the IMF to simply 'give away' another economic benefit in the form of reserve currency status to China. It will demand something in return from China of equivalent importance to the U.S. Time will tell what that is. In the meantime, the U.S. can't keep China at bay and its currency from achieving reserve trading status forever. To do so would encourage China to try to form yet another competitive global institution—next time as a direct alternative to the IMF itself. And it may come to that. That's perhaps why the IMF has left the door still open to further negotiations.