Orlando Sentinel

China a manipulator? Don't give it currency

(FILES) This file photo illustration taken on August 9, 2016 shows Chinese 100 yuan notes in Beijing. China's foreign exchange reserves plunged by $69 billion in November to a five-year low, according to central bank data released on December 7, 2016 as policy-makers battled to support the yuan currency against a resurgent dollar. / AFP PHOTO / Fred DUFOURFRED DUFOUR/AFP /Getty Images ** OUTS - ELSENT, FPG, CM - OUTS * NM, PH, VA if sourced by CT, LA or MoD ** (FRED DUFOUR / AFP/Getty Images)

By **Jerry Haar**
Guest columnist

DECEMBER 16, 2016

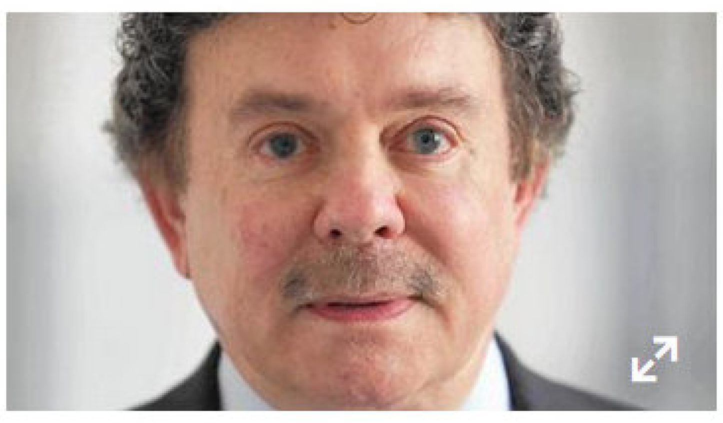
One of the hallmarks of the recent presidential campaign is the president-elect's accusations that China is "the single greatest currency manipulator that's ever been on this planet." Donald Trump is neither a lone voice nor a partisan adversary in citing China for manipulating its currency to gain an (unfair) export advantage in global commerce.

The issue is a bipartisan one that has loomed large since Democrat Sen. Chuck Schumer and Republican Sen. Lindsey Graham co-sponsored the first Chinese currency bill in 2005. While the bill did not become law, it has been on the radar screen of both Congress and the executive branch for more than a decade.

To be cited for unfair currency practices, however, a country has to have a trade surplus larger than $20 billion, or 0.1 percent of gross domestic product; a trade surplus with the U.S. that is more than 3 percent of that country's GDP; and purchases of foreign currency amounting to more than 2 percent of the country's GDP in a one-year period. By that definition, China does not qualify as a currency manipulator, although China, Japan, Germany, South Korea and Taiwan are all presently on a "watch list" by the administration.

Clearly, a nation has the legal monopoly power to create money to achieve special policy goals such as price stability or full employment, but to call it manipulation may not be accurate. As Matthew Slaughter, dean of Dartmouth's Tuck School of Business exclaims: "If Zhou Xiaochuan, governor of the People's Bank of China, is a currency manipulator, then Janet Yellen is an interest-rate manipulator."

With a trade deficit with China exceeding $366 billion, it is no wonder that country is in the cross hairs of those who believe that China is engaging in unfair trade practices through currency manipulation (in this case devaluation).



Jerry Haar (Courtesy photo)

But as Yale economist Stephen Roach points out, America's trade deficit is multilateral — we run deficits with 88 countries; and if we put pressure on one bilateral exchange rate (the dollar-yuan), it will be redirected elsewhere to other trading partners. Our miserably low national savings rate and enormous federal budget deficit are major factors, as well, in this imbalance, not to mention the lack of an export mentality among small and medium-size U.S. firms (only 5 percent export).

Devaluation of the yuan boosts exports to countries with stronger currencies such as the U.S. However, there are huge negative consequences, as well: Imported capital goods and consumer products become more expensive; debt servicing is costlier; domestic producers raise prices; and travel and investment overseas are dearer.

What about currency manipulation not just to boost trade but to attract an increasing amount of foreign direct investment? After all, FDI brings in capital and know-how and creates jobs and recurring tax revenue. In a forthcoming article in the Global Economy Journal, I and two colleagues at EAFIT University in Colombia seek to answer that question.

Using a comprehensive database with 51 emerging countries studied over a 13-year period, we find that devaluation does increase private equity investment — in the short-term only. Moreover, only an annual devaluation above 6.12 percent has significant effects in fostering private equity investment during the time period studied.

As for investments in firms in the early stages of development, such as technology start-ups, currency devaluation does not produce any benefit. Currency devaluation cannot compensate for factors such as time to exit, systematic risk, and the absence of stable economic rules and liquid capital. The bottom line of our study is that devaluation itself is not sufficient to encourage the appetite of the investors. Other variables that weigh heavily must be present, including institutional quality, credit availability, investment in education and adequate infrastructure.

So, does China manipulate its currency, devaluing it, to make its exports cheaper? It may have at one time, but no longer. In fact, just the opposite has been occurring — the yuan has been appreciating. China has spent hundreds of billions of dollars from its foreign reserves over the past year to support its value and to prevent it from weakening more drastically.

With the lifting of currency controls, Chinese individuals and firms have moved $1 trillion out of the country over the past two years as their own economy has slowed due to economic sluggishness worldwide. But the government is now clamping down and limiting hard currency outflows including overseas acquisitions by domestic companies.

If the incoming administration seeks to level the playing field in trade with China, rather than focus on currency manipulation, it should zero in on China's numerous unfair trade policies and practices. That's the winning formula to bring the benefits of trade to American companies and workers.

Jerry Haar is a Public Policy Fellow at the Woodrow Wilson International Center for Scholars in Washington, D.C., and a professor of management and international business at Florida International University.