

“China-US Currency War Reflects Deeper Problems – Time for a Karaoke Summit?”

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China and the US are arguing over the value of the yuan. However the problem is deeper than the value of China's currency. The problem reflects radically different views of their role in the world and in history by China and the US.

The View from the US

The US and developed countries generally see China as being increasingly protectionist. This, they believe, is resulting in its huge trade surplus with the rest of the world. This is having the effect of transferring jobs from their countries to China. If it revalued the yuan, they argue, it would lead to Chinese consumers buying more from the developed countries and that would reduce their unemployment.

The US does not understand why the Chinese find this argument so hard to accept. If China revalues the yuan, they say, wouldn't it lead its economy to be better able to withstand future export shocks because more of the demand would be domestic and thus lead China to be less dependent on fickle developed countries whose economies could in the future still be unpredictable?

The US and developed countries wonder, why wouldn't China support them given that they have done so much to ignore problems that China has created for America's own exporters, particularly those that create software and movies which they say are routinely pirated in China? And given what they regard as China's frequent willingness to go around WTO rules, which has the effect of making it hard for foreign companies to expand in China, why would China not help them out a little on the currency issue?.

The View from China

China sees the US in particular and the developed countries generally as being increasingly protectionist. This results in part, it believes, from their huge fiscal irresponsibility which has led their economies to fall into a dangerous situation and thus leads them to try to block exports from China so they can protect their jobs at home. It believes that the best thing it can do is to stimulate its won economy so that this sucks in exports from the developed countries thus helping their economies.

China does not understand why Americans in particular find this argument so hard to accept and why they continue to press on the currency issue. China has consistently, despite a lot of good advice to the contrary from its own economists, continued to invest in US Treasury bonds, thus allowing the US to spend way above its means and continue to fund its huge budget deficits. And China has acted as a good corporate global citizen in injecting a massive stimulus into its

economy which everyone knows has saved the world from another Great Depression. It did this despite the risks to its own economy, many of which are now becoming more apparent.

China wonders, why wouldn't the US support the present value of the Chinese currency when China has done so much to help the US? Particularly when China too has domestic needs of its own, especially to keep its own population, which also suffers from unemployment, particularly amongst young graduates, employed? But, China believes, instead of supporting China in its laudable effort to help the global economy and additionally that of the US, the US is actually doing the opposite and making things harder for the Chinese economy, which a yuan appreciation would only make worse!

Balancing the Long- and the Short-Term

So where is the truth of the matter? We might expect a country with a 2000 year history to take a long-term view and one with a 200 year history to take a shorter view. If so, that is how it appears to be panning out.

The US is particularly influenced by the short-term employment problems it is experiencing and thus is focusing on what it believes is the best short-term solution, an appreciation in the yuan. This, it thinks, would move some jobs back to the US. To the extent that the US is focused on the long-term, it sees a yuan appreciation helping China to buy more American exports and taking the load off the US consumer. But the short-term is the real focus of the US because it is in deep economic pain at this very moment.

China is more focused on the long-term. It is acutely aware that when Japan revalued the yen in similar circumstances in the early 90s, it contributed to a long period of economic stagnation that exists in Japan even to this day. It doesn't want that to happen to it.

To the extent that China is focused on the short-term, it is focusing on two issues. The first is avoiding a repeat of the significant job losses it experienced in early 2009 when the effects of the global recession first hit China. The second focus is to keep the value of the yuan at the current rate and no higher to help its fledgling move to foster indigenous innovation, which it is afraid will be snuffed out if its emerging technology export sector is priced out of the market by an over-valued yuan.

China Growing Up

We are in the middle of a longer-term process where global economic power is shifting from the developing to the developed world. In this transition, the incumbents, the developed countries are trying to protect themselves against what they see as being the likelihood of a long-term decline in their living standards relative to the emerging economies, who are the challengers to the old order.

China is the main challenger. It sees itself as gaining strength in the global economy. It therefore has a long view, aiming to set the institutional and infrastructural conditions that will lead it to continue to gain in strength. These include building the domestic institutions and the financial environment that contribute to this goal.

China sees currency maneuvers as only a minor part of the overall picture and does not want to allow them to get in the way of an overall global long-term strategy for building China's global economic strength. As a strengthening challenger it does not want to trade away what it sees in the very best case as only short-term and minimal benefits for the much larger ones that will accrue over the longer-term if it sticks to its guns and keeps its currency at current levels.

On the other hand, the US is concerned about its weakening global position. Therefore it is focusing on the short-term tactics that will help slow down this trend. It does not wish to allow

long-term possibilities to get in the way of gaining benefits immediately because it needs these to counter a rapidly-worsening fiscal and diplomatic position. Its goal is to continue the benefits of incumbency for as long as possible until the game gives out. It is aware that it still is a powerful albeit weakening global force and will play this advantage as long as it possibly can.

Until recently China accepted its subordinate global status but it has now crossed the Rubicon and will accept it no longer. However the US has not yet reconciled itself to this new assertiveness. China's goal is to leave its technological inferiority behind so it is no longer dependent on foreigners to dictate the way it operates. But the US and the developed world want the old rules to stay, particularly in the area of trade. China is saying now that it wants new rules. That is what is really behind the currency disagreement

Both Chinese and US Strategies May Have Serious Unintended Consequences

None of this is to say that a yuan appreciation could not be a good thing. But the point of the article is that it is a far more complex issue than the official US or even Chinese positions make out, and it has far wider ramifications than those commonly pointed to by economists in both China and the US.

For once thing, as long as China does not appreciate the yuan, it will make US exporters compete harder, so that in the longer-term, they will be stronger. This is exactly what happened to Japanese exporters in the 90s when Japan revalued the yen. Japanese exporters just became savagely more competitive and the US never really caught up despite having been given a significant currency advantage. If China does not appreciate the yuan, its favored position, it will actually hurt its own exporters in the longer-term by making them try less hard

If China appreciates the yuan, it will actually hurt US exporters long-term by making it easier for American exports to be competitive in the short-term and lessening the incentive for US companies to become more competitive.

True, by not appreciating the yuan, China will help its low-cost, low-tech commodity suppliers. But China wants to promote indigenous innovation. In that case, just from this perspective alone, a yuan appreciation would help toughen them up and make them more competitive.

But, as we said above, there are other macro-economic and micro-economic factors to consider so these considerations cannot be the only things to be taken into account.

Relationship vs. Interests

What this all says is that this is a really complex situation and we simplify the situation at our peril. Given this complexity, China and the US have to work on achieving a warmer relationship in which each side does not hunker down in entrenched positions but instead focuses on the long-term and the short-term interests of each party.

The China-US relationship has increasingly focused on interests, not relationship. The recent China-US summit last October was a failure. There was clearly no warmth in the dialog on either side. Things are only getting worse right now. The currency war talk is making them even worse. That is not good for either side

Right now the answer is not to talk more economics. It is to get the relationship right. Right now another summit is urgently needed. This summit should focus on building human bridges, not econometric models.

The advisers to the Chinese and US leaders this time should be psychologists and relationship counselors, not economists. The two sets of leaders should go for karaoke and a massage

together and share a few bowls of noodles and some – or maybe a lot – of Chinese rice wine -
huang jiu.

That will do everyone a whole lot more good than trying to work out the “true” value of the yuan.

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