Frontier
Vol. 43, No. 11, Sep 26 –Oct 2, 2010

NOTE

Revaluation of Yuan

Bharat Jhunjhunwala writes :

Major countries of the world have been asking China to allow revaluation of the Yuan. The story is like this. Multinational companies were anxious to invest in China in order to make profit from low wages and absence of regulation. Trade union activity was prohibited and no action was taken against polluting units. This led to a huge inflow of dollars into China from two channels. Large amounts came as Foreign Direct Investment. Companies remitted dollars for setting up factories. More dollars were coming through export incomes. This inflow of dollars should have led to a decline in the value of dollar in the normal course of business. But the Chinese government did not allow such adjustment of exchange rates to take place.

The Chinese Government was concerned that revaluation of the Yuan would make Chinese goods expensive in the world markets. Presently the exchange rate is about 7 Yuan to a dollar. And, the Chinese government forcibly maintained a low exchange rate so that exports remained buoyant and Chinese workers were not thrown out of their jobs. Bank of China bought large amounts of dollars that came into the economy. The inflow was not allowed to create an excess supply in the Chinese foreign exchange market. Bank of China invested these dollars abroad-mainly in US Government Bonds. Thus the price of dollars in China remained high because the inflow was diverted to New York. Consequently, the price of Yuan remained low and the party went on smoothly.

Indian exporters were affected by this policy. The American consumer had to pay the normal price for buying a T-Shirt made in India. Government of India did not manipulate the exchange rate of rupee. The exchange rate was Rs 50 to a dollar a few years ago; it rose to Rs 39-fell back to Rs 49 and is presently hovering around Rs 45 to a dollar. Indian exporters have to readjust their dollar-denominated sale price according to this fluctuation. This causes much trouble in selling goods in foreign markets.

The low exchange rate of the Yuan causes trouble for the developed countries as well. They get cheap Chinese goods which is a plus point. But their industries close down because of supply of cheap goods. They also incur a huge debt. China is buying US Government Bonds in large quantities. This money has to be repaid by the US at a later date. Another danger is that China may suddenly sell these bonds and engineer a crash of the US economy.

Recently the Chinese Government has indicated a change in this cheap-Yuan policy. One reason that demand for Chinese goods in America is declining anyway.

Second reason is that China stands to lose billions of dollars due to decline in the value of its foreign exchange reserves. China has accumulated huge foreign exchange reserves to the tune of $2.5 trillion. This is equal to about 21/2 years' income of India. Most of these reserves are invested in US Government Bonds. But the value of the US

Dollar is declining. This is imposing a huge loss upon China. China does not want to buy more dollars in this situation. Thus, of late, it is allowing the price of Yuan to increase.

The increase in value of Yuan appears beneficial for India on the first glance. Indian industries will not have to compete with cheap Chinese imports. Then exporters will not have to compete with cheap Chinese goods in foreign markets. But this benefit may be small. Reason is that price of goods produced from other developing countries will remain low. □□□