# WHO IS THE EXCHANGE RATE MANIPULATOR: CHINA OR AMERICA?

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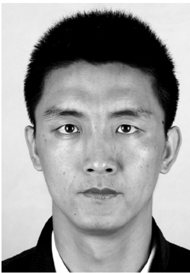

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**Abstract:** The manipulation of the US dollar and other countries' currencies has been a longstanding American prerogative, thus American politicians and scholars are accustomed to labeling countries that fight against American policies on the US dollar as "currency manipulators." The substance of America's accusation of currency manipulation against China is that when America starts to control dollars in order to transfer its domestic economic problems abroad, China is expected to do nothing and simply live with an unstable RMB exchange rate. Obviously, there is a great difference between China and Japan. China will never allow itself to become "the second Japan" that swallows bitter pills like the Plaza Accord.

**Key words:** currency manipulation; currency system; managed floating

Since 2002, US politicians and academics have been accusing China of currency manipulation. In the US presidential election of November 2012, China's exchange rate policies became a campaign issue between US presidential candidates Barack Obama and Mitt Romney. Romney even threatened that once he was elected President of the United States, he would officially designate China as a currency manipulator. Is China really a currency manipulator? This article argues that the answer can be found by examining the role played by currency manipulation in the international monetary system.

## The United States is the Largest Currency Manipulator in the World

In Marx's view, in order for a currency to function as a world currency, it must consist of a real monetary commodity that is capable of: (1) acting as a general



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means of payment to balance the international balance of payments; (2) serving as a general means of making purchases, thereby facilitating trade of material goods between countries; and (3) functioning as the absolute social incarnation of the general wealth that is transferred between countries. Gold and silver have natural characteristics that make them suited to the role of a world currency, but the fact that they became world currencies was the result of the circulation of world trade. Of course, under conditions in which gold and silver are serving as world currencies, international trade requires the amount of gold and silver in circulation to change regularly; it is the same with domestic trade.

When gold and silver are serving as the world currency, an expansion of world trade requires an increase in their supply. However, the ability to increase the supply depends on the natural limits of the supply and the level of mining technology, not on any government agencies or market players. Therefore, natural limits dictate that the supply of gold and silver cannot keep up with the continuous expansion of world trade. In effect, the supply of gold and silver cannot be controlled by any country. This reflects the maximum limitation on the ability of gold and silver to function as a super-sovereign world currency, but it also reflects the superiority of gold and silver in the following respect. When gold and silver served as a world currency, the result was that no country, whether strong or weak, could control its distribution.

Gold and silver as world currency embody what Marx called a "cosmopolitan relationship between people," not "a nationalistic relationship." Under such conditions it is inevitable that gold and silver will stand above the notes and coins that countries circulate within their boundaries, the so called "sovereign currencies." Gold is the most suitable metal for a world currency because no matter what country gives it a nationalistic form (e.g. in the form of sovereign gold coins), as long as it flows out of the domestic realm and begins to circulate internationally, the nationalistic form will disappear completely in the cosmopolitan economic relations. When this happens, gold begins to show the true colors that nature has given it. International trade during the ascendancy of gold and silver was such that no country had the ability to control the supply of the world currency. That right belonged to the gold mines. Consequently, gold was not a tool of the national interests of any country; it reflected global commodity exchange relations, and thus embodied the sheer economic strength of countries.

Since the flow of gold between countries depended on the commodity demand between those countries, the world currency would flow into surplus countries and run out of deficit countries. The "commodity–currency" liquidity mechanism was entirely based on the history and reality that currency is rooted in the commodity form. World financial history shows that regardless of whether the world currency is in the form of gold or silver, a value symbol representing gold and silver, or even a purely paper currency, they all flow between trading countries by the mechanism



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of the “commodity–currency” relationship, which is a reflection of the growth or decline of national economic strength.

Gold and silver had the limitation that their supply could not increase along with the expansion of international trade. This created an opportunity for sovereign currencies to play the role of world currency. Because countries absorbed gold and silver from the world market through industry and trade, those countries whose economies were in a dominant position vis-à-vis the world absorbed most of the gold and silver. This gave economically dominant countries the ability to ensure that their sovereign currencies were convertible into gold and silver at fixed ratios. Less developed countries, who were trying to develop their economies by trading with the advanced countries, were forced to accept the latter’s paper money as the medium of exchange. Thus the banknotes of the economically advanced countries broke through the natural limitations on the growth of the world money supply. Such countries stood far above the rest of the world due to their ability to manipulate the value of their own currency and thereby the prices of the commodities produced by other countries.

The first country to gain the ability to manipulate its currency and achieve global currency hegemony was the United Kingdom. History has shown that, in the heyday of the British Empire, the international gold standard actually became the British pound standard. The British Empire’s enormous economic advantage overwhelmed the rest of the world. At the same time, the Empire took responsibility for maintaining the international order of finance and trade (although this order was unfair). During the decline of the British Empire, the UK went from being a creditor nation with a trade surplus to a debtor nation with a trade deficit. As a result, the Empire became the source of worsening problems in the world economy. The depth of the financial and economic crises that occurred during the decline of the British Empire was rare in the history of capitalism. For instance, the Great Depression of 1929–33 was triggered when the British used currency manipulation to shift the crisis to the United States. Thus, the hegemonic position of the British pound brought disastrous results to the world economy.

During World War II, the United States inherited the British Empire’s hegemonic position. Although America was in a far different situation than the British Empire, it still failed to break through the boom and bust cycle of hegemony. From 1918 to the 1960s, the United States was in a dominant position in the capitalist world due to its economic strength. The Bretton Woods period represents the peak of US hegemony. However, the Cold War, launched by the United States after World War II, caused the eventual collapse of the US economy by leading it down the dysfunctional developmental path of the military-industrial complex. In order to feed its vast war machine, American had to buy large quantities of goods from abroad. This placed huge financial strains on the country and put America at a disadvantage



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in the economic competition with its capitalist allies, especially West Germany. Thus the US developed a long-term trade deficit and went from being a creditor nation to a debtor nation. The three dollar crises that occurred at the beginning of the 1960s and 1970s reflected the conflict of interest between Western creditor and debtor countries. These conflicts were concentrated expressions of the billions of dollars that countries held, dollars that were not convertible at the official parity in the United States, nor could they be used to buy gold on the market.

On August 15, 1971, when the United States announced that it was abandoning the gold standard, $61 billion in liquidity claims held by foreigners permanently lost the right to exchange for gold from the United States. This means that the United States actually refused to settle its foreign debt. This deadbeat behavior in contravention of market principles showed that the economic hegemony of the United States was in decline. However, after the collapse of the Bretton Woods system, the dollar continued, and still continues, to serve as the global currency. The fact that the dollar remains the dominant currency is one of the most curious spectacles in the history of world currency. It is incredible that the dollar has retained its dominant position over the past 40 years. Since this position has been retained on the basis of non-economic factors, Paul Krugman has referred to the US dollar as an "emperor with no clothes."

The US dollar had been on the verge of collapse in the early 1960s, when the global supply of dollars far exceeded demand. The United States could have resolved the problem by decreasing the supply, but it could not bear the serious consequences of such an act: the loss of military superiority in the Cold War. The only viable option was to manipulate the currency. Through manipulation of the dollar and US Treasury Bonds, the United States forced the surplus countries that held large amounts of dollars to buy US Treasuries, which caused dollars to flow back into the US, thereby reducing the supply of dollars on the world financial market. When the dollar flows out of the US to foreign countries, the US obtains substantive goods, services and assets from those countries, and foreign countries obtain US dollars. When dollars flow back to the US from purchases of US Treasury Bonds by foreign countries, those countries purchase the opportunity to gain income with no risk. This is how the United States controls the turnover of dollars in the world. With these tactics, the US benefits from stabilization of the external value of the dollar and access to ultra-low interest loans from dollar surplus countries.

"Under the blessing of almighty God, we are completing this career on behalf of mutual and common benefit."[1] Even though by the early 1970s the dollar was disconnected from gold, it did not meet the same doom that the British pound met during the Empire's decline. The ability of the US to trade dollars for debt plays the key role in preserving the dollar's hegemony. It has allowed the dollar to completely replace the world monetary functions of gold. The dollar's status as world currency



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depends neither on support from gold nor superior economic strength. Gold itself has been completely non-monetized. Today, the world currency is no longer gold, nor a value symbol representing gold; it is a purely paper currency and a sovereign currency to boot—the sovereign currency of the United States.

The reason why the United States is able to manipulate the dollar by exchanging "dollars for debt" is that its superior military strength allows it to threaten the survival of other sovereign countries. All countries and regions in the world are within the reach of the US military and often feel its threat. No other dominant country in history has had such tremendous military strength, and today there is no other country that can rival it. However, the strong must always have a weakness, and the weak will always have strengths. Although the United States has the strongest military, it still has the fatal weakness of being too heavily dependent on the continuation of the US dollar's status as the world currency. The smooth operation of the American war machine depends on the vast resources that America uses the dollar to acquire. If the dollar ever loses its status as the international reserve currency, can the engine of the war machine continue to run? Perhaps supplying its aircraft carriers will become a problem, for Hong Kong no longer accepts the US dollar as a means of payment.

The economic foundation of the dollar had already collapsed in the early 1970s. The reason why it is still a major world currency is because America still has a strong military. This seems like a circular argument, but it is an objective fact that the US dollar and the American military survive through a symbiotic relationship. For any country in the world, rejecting the dollar means war with the US. Saddam Hussein's refusal to use US dollars in oil trading resulted in the invasion of Iraq. Even improper use of the dollar can mean war. "After 1972, when Saudi Arabia and Iran proposed to begin buying U.S. companies with petrodollars, U.S. officials said that this would be considered an act of war. OPEC was told that it could set the price of oil at whatever level it wanted, as long as it used its earnings to buy American government bonds."[2] It is difficult for anyone with common sense to understand this imperialist gangster logic.

Instead of resorting to imperialist aggression, America needs to find legitimate ways to earn dollars. Even if dollars do not flow back to the United States through normal trade channels, that is no reason for America to sell the physical assets of US companies in order to recycle the dollars. If that is allowed to happen, the physical assets of the United States will disappear faster than the presses can print Treasury Bonds. Once America's physical assets are sold out, what kinds of things can the United States produce to earn dollars? If America has no competitive products and services to offer, then dollars will become nothing but piles of waste paper that pollute the global environment, and American supremacy will come tumbling



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down. Given these prospects, one can see why America regards refusal to use the dollar as an act of war.

Since the late 1970s, the central position of the American dollar in the international monetary system has been based on force. This non-economic monetary standard with its anti-market implications is the consequence of the US government's blatant manipulation of the dollar. The manipulation of the US dollar and the currencies of other countries has been an American "patent and privilege" for a long time. Thus American politicians and scholars customarily view countries that fight against American dollar hegemony as "currency manipulators," and they advocate surcharges on goods from these countries. Every six months, the US Treasury releases a list of countries it has labeled as "currency manipulators" when in fact the United States is the world's largest currency manipulator. In truth, America bites the hands that feed it.

## The Managed Floating Exchange Rate System Effectively Counters US Currency Manipulation

Under the international monetary system of the "Dollar-Force" standard, the US government's manipulation of dollars creates "tidal effects" in which dollars flow into countries like a flood and flow out like an ebb tide. The speculative behavior of some US hedge funds exacerbates these "tidal effects." It is difficult for countries whose exchange rates are decided by the market to bear the impacts of these forces. As a result, since the 1970s financial and economic crises have become so frequent and severe that there was a Great Recession in 2007–09. Developed countries often take measures such as intervention or joint intervention to deal with the tidal effects of the US dollar, while the developing countries try to cope by "pegging" their currencies to the dollar.

Since 1994, when the RMB exchange rate system was reformed, China has gradually instituted a managed floating exchange rate system. While this exchange rate system requires constant maintenance and improvement, practice has shown that it is well adapted to the requirements of economic development in China and conducive to the health of the East Asian economies, as well as to global economic and financial stability. During the Asian financial crisis of 1997–98, China's insistence on a managed floating exchange rate system kept the RMB exchange rate stable. This diffused the impact of the crisis on China's economy to a considerable extent. Competitive devaluations among East Asian countries were avoided, which created favorable conditions for the Southeast Asian countries to pull out of the crisis. At that time, the US government strongly urged the Chinese government to stabilize the RMB exchange rate. The US treated the absence of RMB



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exchange rate depreciation as an important defense line for stopping the impact of the Asian crisis on the United States.

During the global economic and financial crisis triggered by the US subprime mortgage crisis in 2007–09, American's anti-crisis policy caused the US dollar to flood the globe and resulted in continuous depreciation. China's managed floating exchange rate system effectively mitigated the impact of the depreciatory flood of US dollars on the Chinese economy and financial system, thereby successfully preventing America's attempt to foist the crisis onto China. On March 15, 2010, more than 130 members of the US Congress signed a joint letter to the Secretary of the US Treasury and the Secretary of Commerce demanding that China be labeled a currency manipulator and urging the US government to use all available means to force China to cease manipulating its currency. Confronted with a managed floating exchange rate system, the world's largest currency manipulator finds it hard to bully China and consequently turns to aggressive political tactics.

US imperialist hatchet man and Nobel laureate, Paul Krugman, has joined the crusade against China's exchange rate policy. He believes that "China, by engineering an unwarranted trade surplus, is in effect imposing an anti-stimulus on these economies, which they can't offset." "China's policy of keeping its currency, the renminbi, undervalued has become a significant drag on global economic recovery. Something must be done."[3] In Krugman's opinion, China is a currency manipulator which must repent by allowing its currency to float freely on the foreign exchange market. However, Krugman's recent views on the RMB are completely different from those expressed in his book, *Exchange Rate Instability* (1989). In that book, Krugman says: "For most of my professional career, I believed that freely floating exchange rates represented the best system available… I have now changed my mind. Based on the view I now have of how floating rates work in practice, I am now an advocate of an eventual return to a system of more or less fixed rates subject to discretionary adjustment… This change of mind results from two observations. The first is that the delinking of exchange rates and trade that seems to be occurring as a result of exchange-rate volatility is an argument against allowing such volatility on a routine basis." Next, "financial markets are not to be trusted; they can drive the exchange rate far away from a sensible value, doing real harm in the process." So, "in effect, I am arguing that the exchange rate is too important a price to be left wholly at the mercy of the exchange markets."[4]

China's current exchange rate policy is actually one that can be adjusted accordingly and fixed relatively, which Krugman claims is the best practice. And practice has proven that China's current exchange rate policy is not only beneficial to the country itself, it also brings economic benefits to other countries, including the United States. With such a well-established RMB exchange rate regime, why



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should the Chinese government give it up and hand the RMB over to the foreign exchange market, a move with which even Krugman would disagree?

Objectively speaking, it is the US government that manipulates the exchange rate of the dollar and controls other countries' currencies through dollar hegemony. By contrast, the current RMB exchange rate regime is a system of highly effective counter-hegemonic exchange rate management. We believe that the Chinese government will not succumb to pressure from the US to change its current exchange rate policy. On the RMB exchange rate issue, the guilty America government dared not play the game of the thief who cries "stop thief!," so George W. Bush also dared not openly label China as a currency manipulator. We are sure that the Obama administration does not have the courage to publicly declare China a currency manipulator. Krugman, however, said what the US government wanted to say but could not. This shows that Krugman has given up his integrity as a scholar in order to uphold the reactionary interests of a fading hegemonic country.

Former US Vice-President, Walter Mondale, holds the view that "China has never manipulated the RMB exchange rate. In the past decade, the great effort to keep the RMB exchange rate stable not only maintains the long-term stable development of the Chinese economy, but also makes a great contribution to the world economic and financial system. It is unfair and unreasonable for the USA to accuse China of manipulating the RMB exchange rate. Only by maintaining the stability of the RMB exchange rate, is it possible for the Chinese economy to recover quickly and contribute to the world economic recovery from the crisis. In order to recover from the global economic crisis, not only should the RMB exchange be stable, but also coordination between the countries of the world should be enhanced; actions should be taken immediately to stabilize world exchange rates, especially the Euro and U.S. dollar, and eventually to return to the fixed exchange system."[5] Nobel laureate Joseph Stiglitz opines that "The crisis has confused right and wrong for all." While the American government focuses on unemployment, "the majority of Americans do not understand the principle of comparative advantage…and can hardly understand that their comparative advantage in many fields of manufacture is being lost. If China (or any other country) begins surpassing the USA, they attribute it to unfair trade: manipulating exchange rates, or government subsidies, or selling products below production cost, etc."[6]

Recently, using his status as a Nobel laureate in Economics, Krugman has served as spokesman for American politicians who are trying to provoke a currency war with China. He has echoed their claims that "the world economy was suppressed because China brought down the RMB exchange rate artificially and aggravated the problems of other countries in the world"; he has insisted that a 25 percent surcharge be placed on Chinese goods, in order to force China to reform its currency. This



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irrational proposition shows that US politicians, and their intellectual puppets like Krugman, will not hesitate to sacrifice the interests of China and other countries in order to pull America out of the economic crisis. A British *Daily Telegraph* article called Krugman's declaration a threat to the world economy. And UNCTAD warned in a recent policy brief: "the view that China should release the RMB exchange rate and should face the kind of impact that Japan confronted due to the appreciation of the yen ignores the importance of the internal and external stability of China for the region and the world."[7]

It is rarely acknowledged by US propagandists that since July 2005, the Chinese government has allowed the RMB exchange rate to appreciate by more than 30 percent. It has done this not because of US pressure, but from its own judgment of what will best serve the global economy and China's economic reform. The 30 percent appreciation is very close to what America has been asking for anyway. So, why do American politicians continue to call China a "currency manipulator" and demand that the RMB be allowed to appreciate? The crux of the matter is that the Americans are the real currency manipulators. Force-based dollar hegemony, which is non-economic and against market principles, means that America can issue dollars at will and without any international constraints. Since the outbreak of the US subprime crisis in August 2007, the Federal Reserve has been issuing huge amounts of dollars, which has caused the dollar to fall. Thus, the speed of RMB appreciation lags far behind the speed of dollar depreciation and cannot possibly be synchronized with the declining value of the US dollar. Clearly, the problem originates in the United States, not China.

If China caves in to American pressure, it is bound to become the "second Japan." The Plaza Accord in 1985, by which America forced Japan's currency to appreciate, bogged down Japan in a 20-year depression. As long as the international monetary system of force-based dollar hegemony is not reformed, dollars manipulated by the US government will continue to devalue, and politicians in the United States will keep using the false charge of "currency manipulation" to pressure China to raise its currency. China's only goal is the stable development of the national and global economy, which will improve the RMB exchange rate formation mechanism. The battle between China and the US over the RMB exchange rate will continue. We venture to assert that no matter who becomes President of the United States, they will not have the courage to formally declare China a currency manipulator. Despite the high interdependence of the Sino-US economic relationship, China will resolutely safeguard its national sovereignty, security, and development interests and will never yield to any external pressure. If the United States provokes an exchange rate and trade war, the losses to the US will surely outweigh any gains.



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## Conclusion

A stable RMB exchange rate is needed for the economic development of China, of East Asia, and the whole world. The assumption behind the RMB exchange rate manipulation charge leveled against China is that when America starts to control dollars in order to transfer its domestic economic problems overseas, China should take no counter measures and just accept RMB exchange rate instability, in effect allowing the US to transfer its economic problems to China. Otherwise, China will be classified as a currency manipulator. As we all know, in order to wipe away the stain of "currency manipulation," Japan had to pay the price of 20 years of economic stagnation. Obviously, there is a great difference between China and Japan. China will never let itself become a "second Japan" that swallows bitter pills like the Plaza Accord.

## Notes

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