

'Flowers and criticism': The political economy of the renminbi debate

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ABSTRACT

Since 2003 China has faced increasing pressure, especially from the US and Japan, to revalue the renminbi. In July 2005 China responded by announcing a small revaluation and a switch from a dollar peg to a tightly managed float against a currency basket. The mainstream economic debate, which we briefly review, has focused on whether, and to what extent, the renminbi is undervalued. From a political economy perspective, however, the more interesting question is why China has been so reluctant to significantly revalue the renminbi especially since it was keen to prove itself a 'responsible member of the international community' by not devaluing in the wake of the Asian financial crisis in 1997–1998. We argue that this can be explained by three factors. These are, firstly, the diminished ability of China's policy-makers to use the export tax rebate policy to mitigate the effects of a revaluation. Secondly, there are differences in the regional context between the two time periods. Thirdly, in the international game of 'problem assignment', China refuses to accept that the US trade deficit is its 'problem'.

KEYWORDS

Exchange rates; renminbi; China; international adjustment

I. INTRODUCTION

During the 1997 Asian financial crisis, China stood up to pressure for keeping the Renminbi (RMB) from devaluing, and thus won praises from various countries around the world. In 2003, China is faced with international pressure demanding the appreciation of the RMB (People's Currency), which is as strong as the previous one and even more difficult to resist. The present difference is: there are no more fresh flowers and applause, China has become the object of criticisms from the United States and Japan. (*People's Daily*, 23 July 2003)

During 2003 and 2004 the clamour accusing China of 'manipulating' the renminbi-dollar exchange rate reached a crescendo. Seen against a backdrop of a huge US balance of trade deficit and an electoral year in the US with 'outsourcing' a major debating point, this is perhaps not surprising. Economic studies have sought to measure whether, and the extent to which, the renminbi is undervalued. Perhaps again unsurprisingly, a wide variety of estimates can be found as we document in Section I later. In the US Senate, legislation was proposed that would have placed a 27.5% tariff on Chinese imports to offset China's alleged 'manipulation'; the tariff rate being the average of three estimates of the undervaluation of the renminbi offered to a congressional committee. (Eichengreen, 2004). The G-7, to which China is now an invited guest, has also used its meetings to voice its concern over China's exchange rate policies. Post-election debate in the United States has continued unabated with the US Treasury reporting in May 2005 that without a 'substantial alteration' in trends, China's policies would soon meet the criteria for classification as a 'currency manipulator' under the US Omnibus Trade and Competitiveness Act of 1988.

Faced with this pressure, China held firm, highlighted international (mainly United States) economists who supported the fixed rate, before eventually agreeing to a joint statement with the United States in late September 2004 which indicated China's intention to introduce a flexible exchange rate system (see *New York Times* October 1 2004).² China did not, however, indicate a date by which this intention might be realized. Indeed, shortly after the announcement Li Ruogu, deputy governor of the People's Bank, reportedly remarked that 'China has an 8,000-year history ... A decade is truly a short period' (*The Economist*, October 4 2004). Nevertheless, China did suddenly announce in July 2005 that it would change its exchange rate policy. This change resulted in a small revaluation of the renminbi against the US dollar of 2% and a switch from a fixed rate against the US dollar to a tightly managed float against a basket of currencies.³

The 'debate' over the appropriate level of the renminbi-dollar exchange raises an interesting political economy question, namely, why did China maintain its de facto dollar peg in the Asian crisis in 1997–1998 in order to win international support but has stood firm in the face of international pressure to revalue since 2003 with only a modest revaluation occurring in 2005? In short, why did China play the role of 'responsible' member of the international community in 1997–1998 but refuse to move in the face of later international criticism? We argue that China's reluctance to revalue despite the strength of international pressure to do so can be explained by three factors. The first is that China's export-tax rebate policy has lost much of its ability to be used as a policy tool to mitigate the impacts of a revaluation. Secondly, the regional context has changed enabling China to maintain regional support and maintain its exchange rate regime. Thirdly, we argue that in the international game of 'problem assignment', China has refused

to accept that the US trade deficit is its problem. This latter factor sheds light on how adjustments take place in the international political economy and which countries bear the burdens of these adjustments. It exposes the tensions within the international system between the United States, unique in its ability to 'burden shift' because of the role that the dollar plays as an international currency, and an increasingly powerful China following developmentalist policies. Each of these three factors is discussed in the sections which follow the brief review of the conventional debate.

II. IS THE RENMINBI UNDERVALUED? A BRIEF REVIEW OF THE CONVENTIONAL DEBATE

The trends which have propelled the value of the renminbi to the forefront of discussions on international monetary arrangements are summarized in Tables 1–3. They show the US trade balances with the China and with the rest of the world, the dollar/renminbi exchange rate and the level of China's international reserves.

While there is agreement on most of these trends, there is less agreement on what their implications are.⁴ The question which has attracted the most attention in is whether the renminbi is undervalued and whether any such undervaluation is the result of currency 'manipulation' and therefore in violation of IMF rules.

Table 1 US Current Account Balance and Balance of Trade with China 1990–2004 (US\$ billions)

Year	Current account ^a	Trade deficit with China ^b
1990	-78.97	-10.4
1991	3.75	-12.7
1992	-48.01	-18.3
1993	-81.99	-22.8
1994	-117.68	-29.5
1995	-105.22	-33.8
1996	-117.20	-39.5
1997	-135.98	-49.7
1998	-209.56	-56.9
1999	-296.82	-68.7
2000	-413.45	-83.8
2001	-385.70	-83.1
2002	-473.94	-103.1
2003	-530.67	-124.1
2004	-631.27	-147.7

Source: ^aInternational Monetary Fund, World Economic Outlook Database, September 2004.

^bUS Census Bureau, <http://www.census.gov/foreign-trade/balance/c5700.html#questions>.

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Table 2 Renminbi/US dollar exchange rate 1990–2004

Year	Renminbi per US dollar
1990 ^a	5.2220
1991 ^a	5.4340
1992 ^a	5.7158
1993 ^a	5.8000
1994	8.4462
1995	8.3174
1996	8.2982
1997	8.2798
1998	8.2787
1999	8.2795
2000	8.2774
2001	8.2768
2002	8.2773
2003	8.2767
2004 ^b	8.2765

Source: Statistical Yearbook for Asia and the Pacific, United Nations.

^aDuring this period, there was an official exchange rate and a swap market rate. The exchange rate shown here is the official rate. For details of the gap between the official and the market rate see Lin and Schramm (2003).

^bEnd of year rate. See <http://www.pbc.gov.cn/diaochaotongji/tongjishuju/gofile.asp?file=2004S5.htm>.

Table 3 China's international reserves 1990–2004 (US\$ billions)

Year	Foreign exchange reserves
1990	28.594
1991	42.664
1992	19.443
1993	21.299
1994	51.620
1995	73.579
1996	105.029
1997	139.890
1998	144.959
1999	154.675
2000	165.574
2001	212.165
2002	286.407
2003	403.251
2004 ^a	609.932

Source: IMF, International Financial Statistics.

^aData from the People's Bank of China. See <http://www.pbc.gov.cn/diaochaotongji/tongjishuju/gofile.asp?file=2004S5.htm>.

This debate has been carried out mostly by economists and policy-makers in the United States and in China. It has been a debate which has not been restricted to academic papers but has also been prominent in the op-ed pages of the 'respectable' press in the United States as well as on the front pages of the official newspapers in China.

To start with the main question, estimating whether the renminbi is undervalued or not is a complicated and contested exercise and a range of answers has been given. This reflects not only a number of different methodologies being employed but also a theoretical issue of what constitutes an 'equilibrium exchange rate' in an economy with pervasive capital controls. If, for example, the renminbi is calculated to be undervalued at present, would this still be the case if capital controls were removed? Would capital outflows then ensue which exceed current capital inflows? If this was the case, then any present undervaluation could be argued to be 'temporary' rather than 'fundamental'. Differences in the assessment of renminbi 'undervaluation' depend in part, therefore, on differing assessments of temporary and fundamental factors.

As an example of the current debate, consider Goldstein and Lardy (2003a,b) who argue that the renminbi is between 15 and 25% undervalued. This estimate was repeated in testimony by Goldstein (2003) in Congressional hearings. This figure was obtained in two ways, both described by Goldstein (2004: 3) as 'back-of-the-envelope' estimates. The first was by 'solving a trade model for the appreciation of the RMB that would produce equilibrium in China's overall balance of payments' while the second was a rather vaguer approach which sought to measure 'the appreciation of the RMB that would make a fair contribution to the reduction in global payment imbalances, especially the reduction of the US current account deficit to a more 'sustainable' level'. Both approaches supported the 15–25% undervaluation estimate. However, as Goldstein (2004: 16) makes clear, this estimate depends critically on the assumption that capital controls are kept in place.

Goldstein (2004) further argues that this undervaluation represents 'manipulation' and hence contrary to IMF rules. While China's reserves have been increasing for a decade, the increase in reserves since 2002 suggest to Goldstein that China has been intervening in the foreign exchange market to maintain—'manipulate'—the value of the renminbi at an undervalued rate (2004: 18).

Other approaches, using purchasing power parity (PPP) measures, have reached contradictory conclusions.⁵ Thus, Frankel (2004) concludes that the yuan was undervalued by around 35% in 2000. Preeg (2003: 270) estimates an undervaluation 'probably on the order of 40%'. In contrast, Yang and Bajeux-Besnainou (2004), also using PPP measures, conclude that there is no convincing evidence of undervaluation of the renminbi.⁶

While Goldstein (2004: 18) cites China foreign exchange reserves build up as evidence of 'currency manipulation', Yang and Bajoux-Besnainou (2004: 19) attribute the increase in international reserves to capital inflows resulting from 'a few key non-market driven factors (such as control on capital outflows and preferential treatment of foreign investment)' rather than as a sign of currency manipulation.

Empirical studies have been supplemented by comments by a number of prominent economists who have argued that the renminbi is not undervalued. For example, US economists McKinnon and Mundell have argued that the renminbi is not undervalued and that China should not change its exchange rate peg to the dollar. McKinnon argues that the level of renminbi reflects China's fundamentals and that the problem of the US current account deficit has much more to do with the US policies than with China (see *China Daily*, 31 May 2004). In a different vein, for Stiglitz it is the instability of global financial markets that makes floating the exchange rate a potentially destabilizing force for both the Chinese and global economies.

The views of McKinnon, Mundell and Stiglitz as well as private sector economists such as Stephen Roach (chief economist at Morgan Stanley), Fred Wu (at Goldman Sachs Asia) Gerard Lyons (at Standard Charter Bank) all of whom have, at some point over the 2003–2004 period, defended China's exchange rate peg were prominently reported in the Chinese press to bolster the official position. Chinese economists have typically favoured the official position arguing that the RMB is not over-valued. Although there has been only a small nominal appreciation of the renminbi against the US dollar over the past ten years, Yang *et al.* (2003) among others, note a much larger real effective appreciation to justify this no undervaluation conclusion.⁷

The Western opponents of a change in the value of the renminbi or of exchange rate regime have tended to focus on the problems that such changes would bring to the Chinese economy in terms of potential exchange rate volatility and a fall in employment growth.⁸ In contrast, although much of the research done by proponents of a change in the exchange rate and/or the exchange rate regime is stimulated by an interest in the fairness of China's policies, most continue by stressing that a change in the present system is in China's best interests.

A second question in the debate, therefore, has been, regardless of whether the renminbi is undervalued at present, what type of exchange rate system should China have over the longer term?

Here Goldstein and Lardy (2003b) argue for a two-step process for moving to a managed float which would benefit China and her trading partners.⁹ Their argument that exchange rate flexibility should precede capital account liberalization is also supported by Prasad *et al.* (2005). Frankel (2004) argues that China's undervaluation is causing domestic inflationary pressures and a further build up of low interest bearing reserves is neither

desirable nor necessary for China. An appreciation would ease the inflationary pressures although Frankel too supports some kind of intermediate exchange rate regime such as a target zone. This type of intermediate exchange rate approach is also supported by Williamson, Feng and Willett (n.d.).¹⁰ As Willett points out, these writers all argue that there are a good many possibilities between the status quo and the rapid move to a float and capital account liberalization which US Treasury Secretary John Snow and other G-7 officials have urged China to adopt.

The extent to which any revaluation would ease the US trade deficit also remains an issue in dispute. In general, the prospects for a large reduction in the bilateral United States–China trade deficit from a revaluation of the renminbi are held in check by factors such as the high import content of Chinese manufactured exports and the high proportion of Chinese manufactured exporters accounted for by multinational companies (see Bottelier, 2004: 22–23, and *The Economist* 2005).¹¹ Furthermore, the impact of a renminbi revaluation on the overall US trade deficit is likely to be minimized by the fact that the United States no longer produces many of the goods which it imports from China and therefore will have to turn to higher cost suppliers.

This review has highlighted the range of methodologies used and estimates made of the extent of the renminbi's undervaluation. The review has also highlighted the wide range of views over where China should go from here. Implicit in almost all of the discussion is that we know where 'here' is, namely, a fixed nominal rate against the US dollar (rigidly so at least until July 2005). In the next section, we provide a brief history of China's exchange rate policies since 1978 and suggest that there is, in fact, more uncertainty about where 'here' is than has been evident in much of the debate surveyed earlier. This arises because of the flexibility which China has retained in exchange rate policy by the continuing use of export tax rebates. These rebates indicate the continuing relevance of developmentalist objectives in Chinese policy but their budgetary implications also provide us with one part of the explanation of why China did not devalue during the Asian financial crisis but has resisted the pressures to substantially revalue since 2003. The export tax rebate and the unconventional nature of China's peg are discussed in the next section.

III. CHINA'S UNCONVENTIONAL DOLLAR PEG, DEVELOPMENTALISM AND EXPORT TAX REBATES

The usual interpretation of China's exchange rate policy is that during the 1980s a dual exchange rate system operated followed by exchange rate unification in 1994 and a fixed exchange rate against the US dollar from 1995 onwards. There was therefore a change in exchange rate regime in the mid-1990s. This can readily be seen from Table 2.

The period since 1995 has provided a starting point for the current renminbi debate, namely, a fixed rate against the US dollar.¹² It should also be noted that this is nominal peg; given the higher inflation rates in China than in the United States since 1995 there has been a real appreciation of the renminbi of around 20% (although the choice of base year affects the sign and size of this measure (see Bottelier 2004). But, this aside, is it accurate to classify China's exchange rate regime as a 'conventional peg' and was there a discrete change in policy in the mid-1990s as Table 2 suggests?

In this section, we argue that in fact China's exchange rate regime is more complicated than at first appears and that in both the pre- and post-1995 periods there is an element of continuity in the developmentalist/productivist approach that has been taken. The continuity in China's exchange rate policies, the regime change in Table 2 notwithstanding, arises because of the use of VAT rebates for exporters. This has important implications for explaining China's policies towards devaluation in 1997 and revaluation in 2003 as well as for understanding the differences in the interests of the United States and China arising from differences in developmental status. These two implications are critical to a political economy analysis of the renminbi debate although they are typically ignored in the conventional economic approaches.

A brief history of China's exchange rate policies since 1978 is necessary.¹³ In 1981 China adopted a quasi-dual exchange rate system. Under this system, the official rate of 1.5 RMB/US\$ was used for all transactions carried out with the Bank of China by all Chinese and foreign companies with the exception of those Chinese companies engaged in foreign trade. For these latter companies, an Internal Settlement Rate of 2.8 RMB/US\$ was used. As China re-entered the world market, a lower exchange rate for exporters was needed to stimulate exports and correct for the overvaluation which had occurred in the years of central planning. The official exchange rate was gradually devalued over the following four years. However, this system was abandoned in 1985 after pressure from the IMF which regarded the Internal Settlement Rate as a de facto dual exchange rate system but which it, the IMF, had not sanctioned.

In 1985 China introduced, this time with IMF approval, a foreign currency swap market (administered by the Foreign Exchange Adjustment Centres) which served as a de facto dual exchange rate regime. The role of the swap market was to act as a clearing house for enterprises with excess demand for, or supply of, foreign exchange where the exchange rate was determined (more or less) by market forces. As enterprises were increasingly allowed to retain a percentage of their foreign exchange earnings, the swap markets became increasingly important. Between 1985 and 1993, the swap markets expanded in number and in size as foreign exchange retention rates were increased and more enterprises were permitted to use the

swap centres. The bands within which currency trading was allowed were widened and finally, more or less, abandoned. By 1993, the swap market was handling approximately 80% of China's foreign trade transactions. The exchange rate set in the swap market was much lower than the official rate. The latter was devalued four times between 1985 and 1990 as a result.

The dual exchange rate system effectively secured a devaluation for exporters but one which was differentially applied because of sectoral variations in foreign exchange retention rates. Thus, some exporters were able to take much greater advantage of the implicit devaluation than others because of the differential retention rates. As a general rule, those sectors such as manufacturing which had the highest foreign exchange retention rates enjoyed the fastest rates of export growth (see Boke, 1996: 78). It is perhaps more accurate to describe China's foreign exchange rate policy during this period as one of multiple exchange rates.¹⁴

In 1994, the exchange rate was unified with the official rate being devalued in line with the market-based swap rate. The retention system was abolished at the same time. This policy change occurred as the gap between the swap rate and the official rate became increasingly large. China had entered a new cycle of reform in late 1992 as a result of Deng Xiaoping's southern tour and unification of the exchange rate was a part of this reform cycle. While the unification of the exchange rate marks a clear policy change, it was accompanied by a move towards the adoption of a *de facto* dollar peg. This did not happen immediately and, in fact, the renminbi appreciated slightly in 1994 before the implicit peg took over.

It is important to realize that the unification of the exchange rate and the abolition of the differential foreign exchange retention system did not mark the end of the broader developmentalist approach. Rather, it continued in the form of differential and variable VAT rebates for exporters. The tax rebate system has been noted by several authors as an alternative to exchange rate changes in the current debate. However, a systematic account of its operation over time is required to fully appreciate its importance.¹⁵

China introduced a policy of export-tax rebates in 1985. The policy was based on returning to exporters of specified goods an amount equal to the sum of the value-added tax and the consumption tax which were levied before exporting, so that exports were tax-free. This is, of course, an export promotion policy although one which does not contravene international trade rules since it is based on tax rebates on inputs used by exporters rather than direct export subsidies.

The export-tax rebate policy has two main phases, the first from 1985 to 1993 and the second after 1994. During the first phase, the tax rebate applied only to a limited number of commodities, and the total amount of the rebate was relatively modest. In 1985 it amounted to RMB 1.98 billion and the accumulated rebate during the nine years of the first phase was approximately RMB 138.8 billion. During this period, the foreign exchange

Table 4 Total export-tax rebates (RMB billions)
1994–2004

Year	Total rebate
1994	45.02
1995	54.87
1996	82.77
1997	43.27
1998	43.63
1999	62.71
2000	81.00
2001	107.15
2002	125.94
2003	203.90
2004	219.59

Source: State Administration of Taxation website
<http://www.chinatax.gov.cn/data.jsp>.

swap centres were also in operation and there were multiple exchange rates, as explained earlier.

However, when the exchange rate was unified in 1994, the export-tax rebate system was greatly expanded to ensure that exporters continued to receive preferential treatment. In 1994, the export-tax rebate was set at 17% (13% for agriculture goods) the same rate as the value added tax. The total rebate in this one year was RMB 45 billion as shown in Table 4.

During this second phase, the export-tax rebate has been varied—upwards and downwards—in response to China's changing external environment. In effect, the rigidity of a fixed nominal exchange rate has been partially circumvented by flexibility in the application of the export-tax rebate system. For example, in 1995, the export tax rebate rate was adjusted downwards twice. The rate for agricultural goods was reduced to 3%, while the rates for manufactured goods which used agricultural raw materials was reduced from 13% to 10% and for manufactured goods which did not use agricultural inputs was reduced from 17% to 14%. In 1996, the tax rebate rate was adjusted downwards again. However, because of 'tax inertia' these reductions in the rebate rate were not immediately reflected in the total amount of the rebate paid out and it reached RMB 82.8 billion in 1996. The effects of the tax rebate rate reductions were reflected more clearly in the falling total rebates for 1997 and 1998.

The export tax rebate therefore enabled China to preserve some implicit exchange rate flexibility as part of a broader developmentalist/productivist policy framework.¹⁶ This flexibility was to prove important in enabling China to respond to the Asian financial crisis without a formal devaluation of the renminbi. Instead, China reversed the downward trend of the export-tax rebate rate. In 1998, export growth rate fell to

only 0.5%. In 1999 the export tax rebate rate was adjusted upwards four times to reach an average rate of approximately 14.75%.¹⁷ For example, in January of 1999, the government raised the rate of the export tax rebate to 5% for agriculture goods, 11% for chemical goods, toys, and plastic products, 13% for agriculture machinery, textiles, shoes, watches and clocks, iron and steel, and cement 17% for machinery, electronic products, and transportation equipment. Between 1999 and 2002, the rate continued to move up reaching an average rate of 15.6% in 2002 and the total rebate reaching RMB 125.8 billion.

Having weathered the storm of the Asian financial crisis further adjustments were then made in October 2003, when the rebate rate for some goods was reduced. For example, with some exceptions, the rebate rates for all exported goods that were subject to 17% and 15% rebates were reduced to 13% and 11%, respectively. Agricultural products remained at 5% and those goods that used agricultural products as raw materials remained at 13%.

The characterization of China's exchange rate as a conventional peg therefore needs to be modified to take account of the role played by a variable export-tax rebate system which has been a significant source of flexibility. The total rebate in 2004, for example, amounted to 4.5% of the total export value for that year. Furthermore, the differential rebate rate has continued the developmentalist/productivist policies which were clearly evident under the dual exchange rate system which operated in various forms between 1981 and 1993.

The flexibility which the export tax rebate system offered allowed China to make adjustments in the wake of the Asian financial crisis but without having to resort to a devaluation. It might be asked, therefore, why China has been so reticent to revalue since 2003 when it could presumably accommodate international pressures and at the same time preserve its competitiveness by increasing export tax rebate rates. This would indeed be a possibility if the export tax rebate system was working smoothly. However, it was not largely because of its cost to the central government.¹⁸ In fact, not all of the export-tax rebates have been paid. At the end of 2002, the un-retained accumulated amount of the rebate was RMB 247.7 billion. By the end of 2003, this amount was expected to exceed RMB 340 billion or more than 40% of the entire amount of the export-tax rebate that was owed by the government between 1985 and 2002. The central government has been unable to fund the scheme because of its expense which, as Cui (2003: 344) calculates, 'consumed more than one-fifth to one-third of the central government's total expenditure' between 1991 and 1997 and has continued to increase since.

To address the budgetary problem, the October 2003 tax rebate rate reductions were accompanied by an announcement that the central government would also change responsibility for the payment of the export-tax

rebate. Specifically, it was announced that existing rebate arrears would be paid by the central government but that in future rebates would be paid by both the central government (75%) and by the local government (25%).¹⁹ Thus, at exactly the same time that international pressure was building to revalue the renminbi, a revaluation which could have been offset by an increase in the export tax rebate rate, government authorities were actively seeking ways in which to reduce the burden of this system. The flexibility which this system offered to policy makers in 1997 had disappeared by 2003 under the weight of its budgetary expense.

There were also other complications which resulted from China's accession to the WTO in 2001. The export tax rebate system is not in contravention of WTO rules provided that it is applied equally to all exporters. This has, however, become an issue. The intention of the rebate policy was to assist Chinese firms in exporting as part of an export promotion strategy aimed at increasing the exports of Chinese firms. Under WTO rules these rebates must be offered to foreign-owned exporting firms as well, a request which many have made. China is obliged to extend the rebate scheme to them but, given that foreign investors already receive other tax incentives, China has been reluctant to do so. Thus, the ability of China's policy-makers to continue to use what Wade (2003) has termed 'development space' in pursuit of its own developmental objectives has been restricted; the export tax rebate provides another example of WTO rules limiting such space and another reason why China did not use this policy as a way of responding to international pressure to revalue the renminbi. This was not the only reason, however, and the changed regional context and the political economy of 'problem assignment' are also important explanatory factors to which we now turn.

IV. THE CHANGING REGIONAL CONTEXT

It is clear why 'international pressures' should be in the direction of not devaluing the renminbi in 1997–1998 but in the direction of revaluing the renminbi since 2003. Changing regional dynamics help to explain why China would acquiesce to the pressures in 1997–1998 but not post-2003. First, consider the Asian crisis period. Following the crises in Thailand, Malaysia, Indonesia, the Philippines, and South Korea, China came under pressure to maintain its exchange rate. There was no prospect of a sustained attack on the renminbi but rather a fear that China would devalue in order to maintain its export competitiveness. China maintained the value of renminbi but this role in stabilizing the Asian regional economy was not immediately recognized or appreciated by the United States or the IMF (see Bowles, 2002). However, this role was eventually recognized and China's leaders made what they could of their 'responsible' behaviour in contrast to Japan's 'irresponsible' policy of allowing the yen to depreciate thereby

undermining the prospects for recovery in the crisis-affected countries (see Bowles, 2002, for review). The policy of maintaining the value of the renminbi therefore enabled China to play the role of a responsible regional leader and hoped for greater influence on the world stage.

The policy of not devaluing the renminbi also had advantages closer to home. For one, the non-devaluation policy provided a confidence boost for Hong Kong, newly returned to China, and for its dollar peg in the face of speculative pressures. In terms of the domestic economy, the weakness of the financial system has been pinpointed as a reason for the non-devaluation policy (see Lardy, 1998). Capital flight was already a problem.²⁰ With a sea of non-performing loans, state-owned banks could be severely tested by any withdrawal of funds in anticipation of a devaluation and/or any possible increases in enterprise debts as a result of an increase in their foreign currency liabilities following from any devaluation.

The non-devaluation policy did, however, have its costs. With neighbouring competitors depreciating their currencies, China's export growth slumped to 0.5% in 1998. This affected employment growth at a critical time when China was also engaged in a major restructuring of state-owned enterprises. With the leadership concerned with social stability, the employment imperative was addressed by a massive public spending program on infrastructure.

Summarising these interests and considerations, Wang (2003: 160) concludes that 'on economic grounds there were reasons for China to devalue the RMB, especially in light of its impact on the real economy. However, there were also reasons to avoid devaluation, mostly out of consideration of its impact on the financial side of the economy. Overall, the economics were ambiguous and indeterminate. The decisive forces underlying China's policy choice were political'.

The political factors which Wang identifies as decisive were legitimacy (in the form of the government not having to devalue and face accusations of mismanagement) and international image. In terms of international image, Wang (2003: 162), in line with the discussion earlier, points to Chinese policymakers' desire for China to appear as a 'responsible great power'.²¹

The same ambiguity in the economic arguments can be found in the post-2003 debate; those sectors and industries which stood to gain from a devaluation in the earlier period are now favoured by a policy of no revaluation. However, the fact that those interests were not dominant in the earlier period but appear to have been well-served in the later period does not necessarily mean that these actors have become more powerful in the intervening period. More likely is that political factors are again decisive but that the political calculus has changed.

If political factors, in particular the desire to appear as a 'responsible great power' explain why China did not devalue the renminbi in 1997–1998, what has happened to the desire for international respectability in

the revaluation debate since 2003? There are two important points here. One concerns the changing dynamics of power relations between China, the United States, Japan and ASEAN and the second concerns the causes of the current global imbalances.

In terms of the first factor, paradoxically, the pressures from the United States and Japan for China to act 'responsibly' have resulted in reactions in China to hold firm against this pressure. The hectoring style of the United States and Japan means that China's image, domestically and in the region, is best served by standing up to this pressure. With Japanese newspapers portraying the pressure to revalue as an 'international encirclement net' that is being tightened on the Chinese leadership, the response has been to resist. (Anon, 2003)

Furthermore, China's overtures towards ASEAN in terms of negotiating a free trade deal with this group, served to lessen any wider regional pressures. For example, Foon (2002) documents that 'at the Asean Finance Ministers' meeting in August [2002], Malaysia's Finance Minister II Jamaludin Jargis said: "My colleagues and I agree that concerns on diversion of FDI, competition in export markets and a loss of market share are far outweighed by the opportunities in China's domestic market"'.

The ASEAN countries might have been expected to have some sympathies with China since the latter resisted the temptation to devalue in the wake of the Asian crisis, thereby aiding the affected ASEAN countries. Furthermore, ASEAN countries held external speculators responsible for their exchange rate crises and external pressure was also identified as causing problems for China. At the ASEAN+3 meetings in November 2004, Chinese Premier Wen Jiabao argued that 'whether the RMB is revalued or not is an important economic decision. China will never revalue its currency under external pressure. China will consider revaluing its currency only in the right time. If the international society continues to speculate about RMB appreciation, it is impossible for this policy (revaluation) to be implemented'.²² Standing firm in the face of 'international speculation' from whatever source might also be expected to elicit sympathy from ASEAN countries.

However, whether such sympathies would have amounted to much is open to question; the prospect of a free trade deal with China was, however, of sufficient lure to overshadow any adverse effects that ASEAN countries felt by China not revaluing the renminbi. It is also worth noting that China and ASEAN had, in fact, been engaged in more broad-based forms of cooperation as well. Van Ness (2004/05: 41) argues that 'Beijing followed the establishment of the 'ASEAN+3' ... with the establishment of 'ASEAN+1' (the ASEAN countries and China alone)'. Furthermore, he points out (2004/2005: 42) that 'in October 2003, China signed the ASEAN Treaty of Amity and Cooperation (the first non-ASEAN country to do so), and negotiated a 'strategic partnership for peace and prosperity' with the

ten ASEAN member countries'. The result of this broad-based diplomatic activity was that China was able to garner the support of the ASEAN countries for its position, leaving Japan isolated in the region as the only critic of China's policy. China has therefore been able to simultaneously maintain its fixed exchange rate and its regional position.

In terms of the second factor, the Asian crisis was a clear 'crisis' and its 'victims' easily identifiable. In the case of the renminbi debate since 2003, however, there is no such 'crisis' but rather 'global imbalances'. Neither is it clear who the 'victim' is and who should be aided. In other words, how 'global imbalances' are reduced is a matter for international political economy. Here China does not accept that it should be subject to the same role in finding solutions to 'global imbalances' that was played by Japan in 1985 and by South Korea in 1989. This points to the third factor which explains the differences between China's policy response in the Asian crisis period and since 2003.

V. WHOSE PROBLEM? THE INTERNATIONAL POLITICAL ECONOMY OF 'PROBLEM ASSIGNMENT' AND 'SHARING THE BURDEN' OF ADJUSTMENT

In the original conception of the Bretton Woods Agreement, it was envisioned that equal responsibility would fall upon creditor and debtor countries to correct imbalances in global trade. However, this vision was not realized and typically it has been the deficit countries which have borne the burden of adjustment to restore equilibrium. The adjustment by deficit countries has been through a combination of expenditure switching policies, such as devaluation, which increase exports and decrease imports, and more socially costly expenditure reducing policies which drive down the demand for imports by cutting government spending and imposing 'monetary and fiscal discipline' on countries. This has been the standard fare of structural adjustment programs, for example, as they have been applied to developing and transition economies for the past couple of decades.

This was also the policy framework used by the IMF in the wake of the Asian financial crisis. Then the crisis countries, with the exception of Malaysia which eschewed IMF advice and imposed capital controls, were subject to policies which led to deflation and imposed painful economic and social costs. The deflationary impact of the measures adopted were clearly shown by the fact that external balance was restored almost exclusively through a reduction in imports and very little increase in exports (see Bowles, 2002). One of the responses to the crisis has been for all countries in the region to build up their dollar reserves to protect themselves from future currency crises and avoid further doses of IMF medicine (see Stiglitz, 2003). Indeed, China is not alone in amassing large foreign reserves.

As Marshall (2004) notes, Asian countries' foreign exchange reserves now stand at over US\$ 2 trillion, a threefold increase since 1997.²³

The exception to this pattern of the burden of adjustment falling most heavily on deficit countries has been the United States. It has been able to use its superpower status and its position as the supplier of the international reserve currency to escape severe domestic adjustments of the expenditure reducing type in the face of a poor trading performance. The United States has been able to rely on expenditure switching to a much greater extent by forcing other countries to allow a devaluation of the dollar, a move which the United States is uniquely able to absorb since it borrows in its own currency; the United States has 'no fear of floating' since it repays debt in its own currency. The United States stimulates its own exports through depreciation but minimizes the need for expenditure reducing measures. Rather, other countries are asked to accept that their dollar reserves are worth less and their economies are less competitive. It is for this reason that political pressure is typically needed to persuade other countries to allow the dollar to depreciate against their currencies. This much was evident in the decision of the Nixon administration to remove convertibility in 1971 and to devalue the dollar in 1973. Faced with a weak dollar as a result of a trade deficit and domestic inflation, Treasury Secretary at the time, John Connolly, famously remarked that 'the dollar is our currency and your problem'.

Reflecting on these events and their relevance for the present period, Hufbauer and Yong (2004: 5–6) write that 'circumstances in that era were vastly different from those today, but history suggests that—by breaking enough crockery in the trade arena—the United States can force other countries to alter their exchange rate systems'. No crockery had to be broken when the United States successfully engineered changes in Japan's and South Korea's exchange rate levels in 1985 and in 1989, respectively, in response to bilateral trade deficits with the United States.

These historical parallels have not been lost on China. Many Chinese academics and policymakers view the 1985 appreciation of the yen as part of the Plaza Accord as being directly responsible for the emergence of the bubble economy which burst in 1989 and ushered in a recession from which Japan has yet to recover (see Anon, 2003). While the United States entered its longest post-war growth period in the 1990s, Japan had by far its worst post-war growth decade. Chinese analysts point to the rapid appreciation of the yen/depreciation in the dollar in 1985 as a powerful explanatory variable in explaining these outcomes. Chen (2003), for example, argues that by forcing an appreciation on Japan as a result of its 'financial hegemonism', the United States was able to obtain ten years of economic prosperity. Now, he argues, China is being faced with pressures to revalue as a result of the new financial hegemonism of the United States and Japan.

Table 5 China's current account balance 1990–2004
(US\$ billions)

Year	Current account balance (US\$ billions)	Current account balance as a percentage of GDP
1990	11.99	3.1
1991	13.27	3.3
1992	6.40	1.3
1993	–11.90	–2.0
1994	7.66	1.4
1995	1.62	0.2
1996	7.24	0.9
1997	36.96	3.8
1998	31.47	3.3
1999	15.67	1.6
2000	20.52	1.9
2001	17.41	1.5
2002	35.42	2.8
2003	45.88	3.2
2004	70.00	4.2

Source: International Monetary Fund, World Economic Outlook Database, April 2005.

China has therefore shown a reluctance to acquiesce to United States and Japanese demands for a revaluation. Indeed, they do not accept that 'global imbalances' are 'China's problem'. This view is supported within China with the argument being that the large trade surplus with the United States is due the latter's economic structure rather than China's exchange rate policies. Indeed, the fact that China's overall balance of trade surplus for most of the past 10–15 years has been relatively small (see Table 5), and in large deficit with Japan, is used as evidence that it is the US economy that is exceptional and that China's currency is not generally undervalued.²⁴

In the view of some Chinese academics and policy-makers, 'global imbalances' are the problem of the United States and of Japan as well, a problem which they are trying to force upon China. For example, Wu (2003) argues that Japan is now pushing for a renminbi revaluation because its own policies have left it in a liquidity trap from which it cannot escape; reducing the competitiveness of other countries through currency changes is the only policy it has left.

Western commentators have weighed in with references to Connolly's 1971 remark. For example, Stiglitz informed a Shanghai conference that 'It is an American problem, not a Chinese problem'.²⁵ The large tax cuts of successive administrations, the record low savings rates in the United States and the budget deficits under the Bush administration are to blame for US trade performance. For Stiglitz (2003), therefore, the trade deficit has more to do with US domestic economic mismanagement, and the current

pressure on China is similar to that which was applied to Japan in the early 1980s. One European Central Bank official, commenting on the 'global imbalances' and China's role has been quoted as saying that 'It may be our problem, but it's their currency'.²⁶ Seen in this light, the renminbi debate has been in large part about how much of the adjustment to this 'problem' will be undertaken by a change in US policies and how much by a change in policies in China and other countries.

The current impasse can be seen as a game of 'problem assignment'; whoever blinks first will have to assume responsibility for the problem and bear the associated costs. At present, the United States, Japan, China and also Europe are engaged in the game of attempting to assign the problem to one of their number. China's July 2005 change in policy is economically of limited significance in solving the problem of global imbalances since the revaluation of the yuan against the dollar is small (2%). Politically, the change does not represent an acceptance by China that the imbalances are its problem. However, again politically, the switch from a dollar to a weighted currency basket is more significant as an attempt to dilute the pressure which emanates from a dollar peg; with the renminbi no longer exclusively tied to the dollar, the United States may find it harder to target China's policies.²⁷

All of this should not be taken to mean that future changes in China's exchange rate system will not occur. Should inflationary pressures become more difficult to control with the sterilization of foreign exchange inflows a major contributing factor then further revaluations may occur. Restrictions on capital account outflows were already eased slightly in 2002 and 2003 and again in 2005 in response to a perceived need to enable Chinese firms to internationalise by setting up production overseas. Furthermore, there has been widespread discussion among Chinese economists about the long run future of exchange rate policy. A review of leading academic articles on the subject suggests that the majority of economists believe that a flexible rate regime is preferable.²⁸ China will gradually open its banking, insurance and securities markets under the terms of its WTO accession and the separate bilateral United States–China agreement. The key question for Chinese economists is the relationship between these financial liberalization measures, other possible future capital market openings and the reform of the exchange rate system.²⁹ The issues which have attracted attention are how fast each of these reforms should take place and what should be their sequencing. Many economists have argued against any rapid changes and believe that the reform of the exchange rate system and the opening up of capital markets should proceed simultaneously and gradually, where the latter, in an echo of Li Ruogo's timetable, is interpreted as implying a 20–30-year process.

The main opposition to this position has come from those who argue that China's growing regional and world power may lead eventually to

the renminbi becoming an international currency. Internationalisation of the renminbi required, it was argued, a stable exchange rate against the US dollar (see, for example, Shi, 2003).³⁰ The case for a long run peg is therefore premised on the desire of China to become a 'financial hegemon' itself.

Further changes in China's exchange rate regime are therefore likely. The main issue is whether reform (or not) of the exchange rate mechanism is dictated by Chinese policy-makers assessments of the economy's needs or based on the pressures brought to bear by other states. That is, the issue is whether China will continue to find the 'development space' to determine the pace and direction of its own exchange rate policy or whether the interests of other countries will predominate. As our analysis in Section III showed, China has continued to pursue developmentalist objectives in its exchange rate policies since 1981, the change in exchange rate regime in 1995 notwithstanding. International pressures may be tied to the US electoral cycle and it might be argued that the current pressures for renminbi appreciation have not yet reached the level of those which were applied to Japan in 1984, for example.³¹ However, international pressures may be enduring and have showed no sign of abating in 2005. In this vein, Nakagawa (2004: 6) argues that 'for the US the current round of discussion on revaluation of the yuan can be viewed as a preparatory skirmish for future currency negotiations with China, in which the US is throwing some powerful initial jabs'.³²

VI. CONCLUSION

The debate on the 'undervaluation' of the renminbi and what to do about it has occupied much op-ed space and received attention from Western economists and policy-makers. We can summarise the academic side of the debate as follows: there is no consensus on whether, and to what extent, the renminbi is undervalued or whether the exchange rate is being 'manipulated'. There is also no consensus on whether China should keep its fixed rate or move to a more flexible exchange rate regime. There is a fair measure of agreement among those who believe that China should move to a more flexible regime that the US administration's policy of urging an immediate free float and capital account opening is not the best way of proceeding. There is also a fair degree of agreement among all participants in the debate that a revaluation of the renminbi will not, in the absence of any other measures, lead to a dramatic reduction in the US current account deficit.

This debate has largely taken for granted that China operates a 'conventional peg'. In Section III, we argued that the move from the dual exchange rate system which China operated between 1981 and 1993 and the unified exchange rate system which has occurred since 1994 contains some continuities as well as some changes. In terms of the similarities, the incentives

given to exporters (especially manufactured exports) under the dual exchange rate system was continued through an expanded export-tax rebate scheme. This continued the developmentalist/productivist orientation of exchange rate policy introduced in the reform era. The export-tax rebate rate has been varied since 1994 to respond to external trading conditions. In particular, increasing the export tax rebate system in 1999 provided China with some implicit exchange rate flexibility even though China stood firmly behind an official 'no devaluation' policy. This stance received regional and (belated) international recognition, a factor of importance to the Chinese leadership. However, the growing budgetary burden of the export tax rebate system, together with concerns over its extension to foreign multinationals in line with WTO rules, meant that the leadership was unwilling (or unable) to use the system to accommodate international pressures to revalue in the period since 2003. In any case, there were also other reasons why China has held firm in the face of these pressures.

In the post-2003 period, contrary to the situation in 1997–1998, China did not believe that revaluing the renminbi would lead to any greater role in regional or international affairs but rather be seen as a sign of weakness under international pressure. The regional context had changed.

China is also resisting the pressures to 'share the burden' of adjustment required by the huge US trade deficits. While the burden of adjustment typically falls most heavily on deficit countries, this has not been the usual case for the United States which has been able to use its predominant international position to shift the adjustment burden onto others. The United States was successful in this respect with both the dollar/yen agreement with Japan in 1985 and the dollar/won negotiations with South Korea in 1989. While the United States clearly, and relatively easily, won the first two rounds in its confrontation with successful East Asian developmental states it has had considerably more trouble in round three with China since 2003. China responded with a small revaluation against the US dollar in 2005 and a switch to a tightly managed float against a currency basket. This is a relatively minor shift in economic terms but perhaps important in diffusing US political pressures. What happens next in the renminbi debate will be one indicator of whether the US position of global dominance will remain undisputed or whether it will be challenged by an increasingly assertive China.

NOTES

- 1 We are grateful for Brian MacLean and Eric Helleiner for providing us with very useful comments. We also appreciate the insightful comments of two referees of the journal. Paul Bowles acknowledges funding from SSHRC.
- 2 This was announced in China as a 'managed flexible exchange rate system' (*you guan li de ling huo hui lu zhi du*) indicating that the government would

continue to play an intervening role. See http://informationtimes.dayoo.com/gb/content/2004-10/03/content_1753086.htm

- 3 On July 21, 2005, the People's Bank of China made a public announcement on reforming the renminbi exchange rate regime. The Bank announced that: (1) starting from July 21, 2005, China would reform the exchange rate regime by moving to a 'managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies'; (2) the Bank would announce the closing price of a foreign currency such as US dollar against the renminbi in the inter-bank foreign exchange market after the closing of the market on each working day, and would make it the central parity for trading against the renminbi on the following working day; (3) the US dollar/renminbi exchange rate would be adjusted to 8.11 yuan per US dollar effective immediately; and (4) the daily trading price of the US dollar against renminbi in the inter-bank foreign exchange market would continue to be allowed to float within a band of $\pm 0.3\%$ around the central parity published by the People's Bank.

It should be noted with respect to point (4) that the band limits are the same as those which were used prior to the announcement. However, previously this band was set around a fixed rate against the US dollar. After the announcement, the band was set around a rate which itself may move on a day-to-day basis. Thus, the new exchange rate regime is best regarded as a tightly managed float. The renminbi is also allowed to float against other major currencies in the currency basket but the bands for these currencies have not been announced. With respect to the currency basket used, Zhou Xiaochuan, the governor of the People's Bank, raised this issue in his speech at the Inauguration Ceremony of the People's Bank of Shanghai Head Office on August 10, 2005. According to Zhou, the selection of the basket currencies and the determination of the weights assigned to these currencies gives due consideration to countries' standing as China's trading partners. Thus, the US dollar, Euro, Japanese yen, and Korean won are the major currencies of the basket. However, information on the exact weight of each foreign currency in the basket has not been publicly announced. See <http://www.pbc.gov.cn/> for details.

- 4 We say 'most' because there is a substantial discrepancy between the bilateral United States–China trade balance reported by the two countries. For example, in 2002 the United States reported a US\$ 103 billion bilateral trade deficit while China reported only a US\$ 42.7 billion bilateral trade surplus. See Yang and Bajoux-Besnainou (2004: 12) for further details. The discrepancy arises in large part because of differences in the ways in which re-exports from Hong Kong are counted. See also (Bottelier, 2004).
- 5 However, see Bosworth (2004), who argues that PPP measures provide 'very weak guidance as to the appropriate exchange rate for low income countries'.
- 6 See also Funke and Rahn (2004: 28) who 'find compelling evidence that the renminbi is not substantially undervalued'.
- 7 However, there are arguments to the contrary. See, for example, the study by Zhang and Li (2003) which uses a PPP approach to argue that the renminbi is undervalued.
- 8 The range of interests affected by an exchange rate revaluation will be discussed further in Section IV.
- 9 The first step involves an immediate appreciation of the renminbi of 15–25% and a switch from a dollar to a basket peg with relatively wide margins (plus or minus 5–7% being suggested). Capital controls on outflows would, however, remain in the short run.

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- 10 This is also supported by Eichengreen (2004: 5) even though he believes that the current exchange rate undervaluation is a modest 5–10%.
- 11 Even some of the harshest critics of China's policies do not anticipate that revaluation of the renminbi alone would eliminate the US balance of trade deficit. Preeg (2003: 270), for example, estimates that currency manipulation by China, Japan and other 'likely manipulators', principally South Korea and Taiwan, accounts for around US\$100 billion of the US trade deficit. That would still leave a deficit three to four times that amount remaining.
- 12 As an example, Hufbauer and Yong (2004: 4) write that 'since 1995, China has fixed the renminbi at about 8.28 to the dollar'. The IMF did not change its classification of China's exchange rate regime to a 'conventional peg' (see Lin and Schramm, 2003: 247) until April 1999. However, this marks a change in reporting with IMF officials using their discretion to classify exchange rate regimes rather than simply using national governments' own classifications as they had previously.
- 13 The next four paragraphs are based upon material provided in Boke (1996) and Lin and Schramm (2003).
- 14 The IMF's official classification of China's regime after 1987 was 'other managed float'.
- 15 The discussion which follows is based government documents available at <http://www.chinatax.gov.cn>. Our discussion here, based on these sources, is consistent with that provided by Cui (2003) whose analysis focuses particularly on the 1995–1999 period.
- 16 For a broader discussion of the importance of developmentalist objectives in Asian countries' exchange rate policies see Dooley *et al.* (2004).
- 17 The average figures quoted here are drawn from government documents. However, it is not clear from the documents how this average was computed and whether it is a simple or a weighted average.
- 18 Rebate fraud was also a problem.
- 19 This returns China to the pre-1994 system when there was also a central-provincial government sharing of the export tax rebate costs. See Cui (2003: 346).
- 20 Despite trade surpluses during the 1990s, China's reserves increased by much less indicating that (largely illegal) capital flight was taking place on a significant scale. Yu (2000: 183) argued, for example, that 'in 1998, while China's international balance of payments was several hundred billion in surplus, China's official foreign exchange reserves increased by only US\$5 billion. Where has the rest of the money gone? Precise information is not available. According to some estimates, US\$ 20–40 billion has left the country. How could this happen? The government recently sent a number of investigating teams around the country to find out what was going on out there'. Until very recently, therefore, the expectation was of a depreciation with attendant capital flight. The situation since 2000, with an expectation of an appreciation and attendant 'hot' capital inflows is a relatively new phenomenon. Trade surpluses have been common to both periods.
- 21 This reason is also discussed by Bowles (2002) although here the emphasis is on China's failure to achieve this status in the eyes of the United States that is identified as the reason for China's subsequent backing of regional initiatives.
- 22 Quoted in the Chinese language newspaper, *International Finance*, 30 November, 2004.
- 23 Marshall (2004) provides the follow quote by Ifzal Ali, chief economist at the Asian Development Bank, to explain the reasons behind this huge increase:

- 'Politicians with a survival instinct vowed never again to be forced into a position where they had to deal with IMF. For them, large dollar reserves were a firewall to guard against this. It became an obsession'.
- 24 The current account surplus measured as a percentage of China's GDP has, however, risen rapidly since 2001. IMF predictions indicate that it will fall slightly in 2005 to 4.1% of GDP and to 4.0% in 2006. These are, economically speaking, substantial surpluses.
- 25 Benjamin Morgan, 'China vows to maintain yuan stability as HSBC, Stiglitz backs Beijing', *AFP*, 17 September 2003.
- 26 Quoted in Liang (2003).
- 27 China's switch to a currency basket will also likely change the composition of China's international reserve holdings. This, along with other changes in the Middle East over the pricing of oil, may have implications for the role of the dollar as the international reserve currency. This issue, while important and interesting, is not pursued further here.
- 28 This statement is based on a review of articles in the 2003 and 2004 issues of the Chinese language journals *China Money*, *World Economic Research*, *International Economic Review*, *Economic Review*, *The Banker*, *Finance Survey*, *World Economy*, *Shanghai Finance*, *Commercial Research* and *Modern Management Science*. For examples of articles in support of a flexible exchange rate in the longer term see Ding (2003), Li (2003), Zhang (2003) and Editor (2003).
- 29 As documented in Section II, this issue has also been debated in the Western literature.
- 30 There are doubts about the strength of this argument; the euro and the yen are both international currencies but neither are pegged against the dollar.
- 31 Measuring pressures for exchange rate appreciation is largely subjective. However, if it is believed that pressures today on China are less than those on Japan in the pre-Plaza period there are a number of factors which might explain this. Firstly, the manufacturing sector in the United States was more directly affected by Japanese exports in the mid-1980s than it is by China's exports now since many of the goods exported by China are no longer produced in the United States anyway. Furthermore, US multinationals investing in China have no incentive to see their costs rise there (see 'Who Wants The Yuan To Rise? Why multinationals aren't joining the US campaign', *Business Week*, March 7, 2005: 37). Secondly, in 1985 the US balance of trade deficit with Japan accounted for approximately 38% of its total trade deficit; in 2004, the trade deficit with China accounted for only 23% of the total deficit. To some extent, therefore, it was easier to pinpoint Japan as the source of US trade imbalances in the mid-1980s than it is to do likewise with China currently. We are grateful to Eric Helleiner and Brian MacLean for bringing these points to our attention.
- 32 After analyzing the dollar's movements over the past, he continues by suggesting that 'assuming the dollar's recovery follows the same 15-year cycle as in the past, serious moves for revaluation of the yuan will be made between 2010 and 2020'. Perhaps this timetable gives China's policy-makers as much 'development space' as they need.

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