

Forget Foreign Relations. Consider China
Strictly from the Viewpoint of Finance
C. Edward Chang, George S. Swales, Jr, and John S. Bowdidge

Introduction

Hjalmar Horace Greeley Schacht headed Germany's *Reichsbank* both before and after the coming of Adolf Hitler. His loyalty to *Der Führer* varied from time to time. He was indeed close to Hitler, so close that Schacht was placed on trial as a war criminal at Nürnberg after World War II. There are many legends regarding Schacht, some of which are hard to substantiate. One in the latter category goes as follows:

More than likely in the days around the Nürnberg Trials, someone asked Schacht about Hitler's immorality. Schacht according to the legend is said to have replied: "The only thing truly immoral about Hitler was his allowing a **deficit** in our Federal Budget!"

In somewhat the same spirit, the current study passes over the daily volume of news from the People's Republic of China and establishes a focus on matters of *Finance* related to that growing Giant!

A place to start is with the trade deficit the United States suffers with the People's Republic of China.

The Trade Deficit

As early as January 11, 2005, the U.S.-China Economic and Security Review Commission provided a quick historical sketch of the trade picture:

Using a methodology that determines the number of jobs needed to produce exports and imports, the EPI [Economic Policy Institute] study found that 1.5 million jobs were lost to lower-wage Chinese competition in the 14-year period between 1989 and 2003. During that time, the U.S. trade deficit with China rose **twenty-fold**, from \$6.2 billion to \$124 billion. It is expected to increase another 20 percent in 2004, to \$150 billion (Study Documents 2005 **bold emphasis** added by the current authors).

Over a year later, Jan Tromp of Amsterdam's *de Volksrant* provided an update. Tromp makes it clear that this trade imbalance is very clearly *desired* by the Chinese President for the good of his own nation. And understandably, for the American President this is a situation that cannot remain in place permanently:

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...het enorme handelsoverschot van China op Amerika B het gaat om 200 miljard dollar B zei Hu dat China de binnenlandse vraag wil stimuleren. Bush...noemde het handelsverschil tussen beide landen Aonhoudbaar@ (Tromp 2006) B ...the enormous trade surplus of China over America B a matter of 200 billion dollars B something that [President] Hu desires in order to stimulate his domestic economy. Bush [however] ...termed this trade imbalance between the two nations as Auntenable.@

Muriel Motte, a feature writer B apparently with a sense of humor B for the Paris daily *Le Figaro*, treated President Hu=s ever-present happy smile. Motte indicated that Hu=s happiness would not be appropriate at the April summit in Washington:

George Bush, son gouvernement et les élus du Congrès ne lui pardonneraient pas d=afficher publiquement son allégresse. Elle a coûté 200 milliards de dollars à l=Amérique en 2005, puisque tel est le montant du déficit commercial enregistré par les États-Unis vis-à-vis de la Chine (y compris Hongkong) (Motte 2006) B George Bush, his Government and those elected to Congress will not pardon the public display of his [Hu=s] happiness. It [that happiness] has cost America 200 billion dollars in 2005, since such is the mounting of the trade deficit registered by the United States vis-a-vis China (and including Hong Kong).

Although Muriel Motte of *Le Figaro* says Washington doesn=t want to see too much happiness by President Hu, a late 2005 article in Great Britain=s *The Economist* claims that Washington has not done enough to cut back on Hu=s happiness:

But the [Bush] administration has stood firm against a cacophony of demands for protection [from China imports]. [Those demands came all the way] from unions to manufacturing firms. It [the Bush administration] ignored John Kerry=s calls to get tougher on China during the 2004 campaign; it has refused (outside textiles) to impose safeguards against Chinese imports....and, despite all the rhetoric, no serious protectionist measure has made it out of Congress (Tensions 2005).

Are there some figures regarding these Chinese imports? Some *very early* statistics were provided by Pierre Haski and Laurent Mauriac for another Paris daily B *Libération* B way back in November of 2003:

*La Chine fabrique aujourd=hui 70% des jouets, 55% des appareils photo, 29% des téléviseurs, 24% des machines à laver, 16% des réfrigérateurs vendus dans le monde, selon un institut d=études chinois. Le plus souvent pour le compte de marques occidentales (Haski 2003) B China manufactures today 70 percent of toys, 55 percent of photo equipment, 29 percent of televisions, 24 percent of washing machines, 16 percent of refrigerators sold in the world, according to an institute of Chinese studies. Most often to the advantage of *Western* firms.*

We can assume that all of these numbers are much, much higher as 2006 closes. Why? Haski and Mauriac provide the answer:

Pour une raison simple: les salaires en Chine sont en moyenne sept à huit fois inférieurs aux standards occidentaux (Ibid.) B For a simple reason: wages in China are, on the average, seven to eight times below Western standards.

That A seven to eight times @ phrase as 2004 was dawning could contain even higher figures as 2006 is closing. Or maybe those figures could **go down!** It all depends on the relationship between the Chinese *Yuan* and the American *Dollar*.

The Chinese Yuan

Chris Isidore is a senior writer for *CNNMoney*. The opening paragraph of the Isidore report for July 21, 2005 made clear the role of the Chinese currency B the *Yuan* B in trade between the two major nations.

In a move that could trim the trade gap with the United States, China revalued its currency higher against the dollar Thursday and said it would no longer have the yuan tied to a fixed rate against the U.S. currency.... The statement said China will immediately value the currency at 8.11 yuan, down 2 percent from the 8.28 rate previously. It also said it will peg the yuan against a A market basket @ of numerous currencies (Isidore 2005).

We still do not see a *freely-floating* yuan; but it is more flexible than it was for well over a decade when locked into a firm relationship with the dollar. How well is the new plan working? Is the yuan increasing in value, thus robbing China of its ability to sell so cheaply to America? In spring of 2006, nearly a year after the new approach by Beijing, a short article in *Le Monde* glanced at the flexibility of China=s currency:

Théoriquement cette fourchette étroite permet une appréciation d=environ 6 % par mois.... en réalité, le flottement reste encore très contrôlé: la hausse contre dollar n=a été que de 1 % depuis le 22 juillet (Une 2006) B Theoretically this narrow range [of fluctuation] will permit an increase in value of about 6 percent per month.... In reality, the fluctuation remains very controlled: the rise against the dollar has not been more than 1 percent since July 22 [2005].

On March 29, 2006, the U.S. and the 25 members of the European Union made an appeal to Beijing, according to Germany=s *Handelsblatt*:

China steht unter internationalem Druck, den Wechselkurs des Yuan freizugeben. Vor allem USA und die EU werfen dem Land vor, sich durch den niedrigen Yuan-Kurs unfaire Wettbewerbsvorteile zu verschaffen (China steht 2006) B China remains under international pressure to give the Yuan free fluctuation. Above all, the USA and the European Union accused that country of gaining unfair advantage in world trade by keeping a low Yuan value.

Roughly two weeks later, Spain=s *El País* reported on a similar appeal:

Los ministros de Finanzas de los Veinticinco pidieron ayer a China un aumento gradual de

la flexibilidad del tipo de cambio de su moneda, el yuan (La UE 2006) B The Ministers of Finance of the Twenty-Five [EU nations] appealed to China yesterday to gradually increase the flexibility of the exchange rate of its currency, the Yuan.

When two more weeks had passed B we=re now at April 23, 2006 B an announcement came from the *other side!* Rex Nutting, writing in *MarketWatch*, quoted a key Beijing official:

Rather than monitoring the yuan, global financial institutions should watch the U.S. dollar, said Zhou Xiaochuan, the governor of the Peoples= Bank of China.... Zhou said the yuan could rise at a faster pace, but that=s not the Chinese way of economic reform (Nutting 2006).

In an apparent display of good international *sportsmanship*, an American Cabinet member stepped forward with an announcement on May 10, 2006, according to *Reuters*:

The Treasury Department ruled on Wednesday that China was not a currency manipulator but pledged to Aactively and frankly@ push Beijing toward faster exchange-rate flexibility that would let its yuan rise in value. Treasury Secretary John Snow said that currency values should be set on open markets and the decision not to cite China as a currency manipulator was based on a careful reading of the law (U.S. 2006).

Although Beijing gracefully received this news B so far as we know B the John Snow decision stirred up criticism here at home, according to *Associated Press* Economics Writer Martin Crutsinger:

ABy failing to designate China as a manipulator in this report...the United States comes off as a paper tiger unwilling to stand up for its domestic industrial sector,@ said Auggie Tantillo, executive director of the American Manufacturing Trade Action Coalition, which represents U.S. textile and clothing companies. ASecretary Snow has been consistently rolled by the Chinese government in his years-long but unsuccessful effort to get China to take action on its highly undervalued currency,@ said Kevin Kearns, president of the U.S. Business and Industry Council, which represents many medium and small-sized manufacturing companies (Crutsinger 2006).

Very, very interested in the U.S. trade deficit with China as well as in the dollar-yuan relationship is the well-known American firm known as Wal-Mart. We now consider why this is true.

The Role of Wal-Mart

It could be said that America=s giant retail chain Wal-Mart is a major contributor to America=s trade deficit with China. Jiang Jingling, writing way back in November of 2004 for *China Business Weekly*, thoroughly investigated the matter. But it was the *headline writer* for Jingling=s article who communicated most effectively, using the following words: AMost (70%) of Wal-Mart=s Products Are Produced in China@ (Jingling 2004).

A natural question to be asked is: How much of the U.S. trade deficit with China is the fault of Wal-Mart? Unfortunately, none of the key three entities—China, U.S., and Wal-Mart—issue daily statistics on the matter. Jingling's figures sum up the picture as of the **end of 2004**. At that time, here's how Jingling saw the picture:

Insiders point out Wal-Mart's imports from China have largely influenced the U.S. trade deficit in China, which is expected to reach \$150 billion this year.... The world's largest retailer, Wal-Mart Stores, Inc., says its inventory of stock produced in China is expected to hit \$18 billion (*Ibid.*).

That Wal-Mart figure is 12 percent of the U.S. 2004 trade deficit with China. Applying that 12 percent to the 2005 U.S. deficit of \$200 billion, the Wal-Mart figure could well be *at least* \$24 billion. And who is to say that the relationship will stay down at 12 percent?

The foreign press delights from time to time in considering Wal-Mart as an *independent nation!* For example, in the spring of 2006, the Paris newspaper *Le Monde* quoted an official of the People's Republic of China:

**Si Wal-Mart pouvait être considéré comme l'économie d'un pays, il serait le huitième partenaire de la Chine, devant la Russie et l'Australie, avait remarqué, il y a deux ans, Xu Jun, responsable de l'entreprise pour les relations extérieures (Wal-Mart a décidé 2006) B*
If Wal-Mart could be considered as the economy of a nation, it would be the Number Eight [trading] partner of China, coming in front of Russia and Australia, remarked Xu Jun, a [Chinese] official responsible for foreign commercial relations, two years ago.

Yes, Wal-Mart is a large volume importer of Chinese goods and a prominent contributor to America's trade deficit with the People's Republic of China. However, the executives at Wal-Mart engage in such tactics in order to fulfill a basic pillar of the longstanding philosophy of finance. That basic pillar has been described by Arthur J. Keown, *et al* in their excellent finance textbook:

In this text we designate the goal of the firm as *maximization of shareholder wealth*, by which we mean maximization of the price of the existing common stock. Not only does this benefit the shareholders of the company, but it also provides benefits to society as scarce resources are directed to their most productive use by businesses competing to create wealth (Keown, *et al.*, 2003, p. 4).

Within our specific China context, it could be said that for Wal-Mart to ignore the profit opportunities in that People's Republic would be a failure to accomplish *A*maximization of shareholder wealth.

To be successful in the act of *A*maximization of shareholder wealth, any firm needs to have sufficient funding easily available. It is being learned that the Federal Government of the United States is obtaining some of that *A*sufficient funding from what we could term a *loan office down the street!*

The Loan Office Down the Street

Quite early, Kevin Potvin identified the loan office down the street to which the U.S. has been turning. Potvin writes for *The Republic*, a publication which bills itself as Vancouver's Opinionated Newspaper. In their issue for December 23, 2004 to January 19, 2005, Potvin penned these words:

The Chinese government has been purchasing US treasury bills to keep US consumers flush with cash to buy Chinese goods.... Why, the Chinese minister of finance was asked, does China keep buying US treasury bills at the rate of **\$1 billion a day**? The reason, he said, is because, for the time being, China still needs US consumers to keep consuming (Potvin 2005 B **bold** emphasis added by the current authors).

In late 2005, Peter S. Goodman (with Eva Woo) wrote the following on that subject for *The Washington Post Foreign Service*:

China now holds more than \$700 billion in foreign exchange reserves B the second-largest reserves after Japan B with roughly one-third parked in U.S. Treasuries and another one-third in dollar-denominated assets such as corporate bonds.... (Goodman 2005).

On April 20, 2006, Teddy Davis and Dan Nechita of *ABC News* reported on Democratic U.S. Senator Evan Bayh of Indiana commenting on this very same issue:

As Bayh travels the country laying the groundwork for a presidential campaign, he tells audiences that the United States would stop turning a blind eye to China's reported Acurrency manipulation, illegal subsidies and intellectual property theft@ if the Chinese central bank did not hold so much U.S. debt.... Bayh worries that U.S. indebtedness to China has a harmful impact on the administration's ability to Atalk tough@ with China about foreign policy issues (Davis 2006).

And we note that Senator Bayh has referred also to Aintellectual property theft@ by China. We now take a **quick** glance at the **financial** aspect of that theft.

Intellectual Piracy

There has been plenty of talk for a long, long time about intellectual piracy in the People's Republic of China B and its financial implications. Joel Rothstein brought the matter up again via *Reuters* in the April 7, 2006 issue of *The Moscow Times*:

WASHINGTON B A group of U.S. legislators on Wednesday named China and Russia as the worst pirates of American movies, music and software and said Moscow should be denied World Trade Organization membership until it does more to end the theft. China and Russia together were responsible for **\$4 billion** in U.S. business losses in 2005 due to sales of illegal copies of copyrighted material, according to the Congressional International Anti-Privacy Caucus, a bipartisan group (Rothstein 2006 B **bold** emphasis added by the current

authors).

Just five days later, another Russian newspaper, *Lenta.Ru*, had an encouraging headline after a conference held in China and attended by U.S. Secretary of Commerce Carlos Gutierrez. The word was that China would strengthen its controls on intellectual piracy. It was good to have such an announcement made just *one week* before the Chinese President was to visit the White House.

That Presidential Summit B A Preview

In the middle of April, 2006, Chinese President Hu Jintao would be making his first ever visit to visit an American President in Washington. Many issues could have been discussed on Hu=s visit. Touching on some of them was the Paris daily *Le Monde* which at the same time wondered if anything truly worthwhile could be accomplished by such a Summit@:

Chine...accusée de manipuler sa monnaie et de gonfler ses dépenses militaires, l=heure n=est pas tout à fait à dérouler le tapis rouge pour Pékin, même si Washington aimerait bien obtenir un signal positif sur l=Iran (Chine 2006) B [Since] China is accused of manipulating its currency and of inflating its military expenses, this is not absolutely the moment to roll out the red carpet for Beijing, even if Washington would certainly love to get a positive signal [from Beijing] regarding Iran [and its nuclear threat].

That was a *French* view. A quick search of the *Asian* media provided a more complete and more serious view of this Hu visit to the White House. Here=s proof.

That Presidential Summit B China=sView

People=s Daily, available in several languages along with Chinese, is an official publication of the Central Committee of the Communist Party of the People=s Republic of China. *People=s Daily* quoted some significant and key passages from a speech by President Hu B delivered **not in Washington, D.C.** but rather in *Seattle* prior to Hu=s reaching the White House. Here=s an excellent excerpt chosen by *People=s Daily*:

AChina and the United States need to actively promote trade and investment liberalization and facilitation, remove trade barriers and work to help establish a multilateral trading system that is open, fair, equitable, transparent, non-exclusive and non-discriminatory,@ he said (Hu 2006).

Pueblo en línea is the Spanish translation of *People=s Daily*, and in its April 26, 2006 issue it saw the *Washington, D.C.* meeting as a very important opportunity for *pressure* to be exerted on China:

No se puede negar que lo que esperaban un sector de norteamericanos era aprovechar la visita de Hu para ejercer presión sobre China. Por ejemplo, exigieron que China potenciara la protección de la propiedad intelectual, se comprometiera a reducir el superávit comercial, y particularmente a elevar en grandes márgenes la apreciación del renminbi; y esperaban que China manifestara una actitud clara apoyando la tesis estadounidense para imponer

sanciones a Irán (Una 2006) B It cannot be denied that a certain sector of Americans look upon the Hu visit as a time to put pressure on China. For example, requiring that China strengthen the protection of intellectual property, reach a compromise to reduce the US balance-of-trade deficit, and particularly to greatly raise the value of the *renminbi* [Yuan]. And there is the hope that China will actively support the American idea of imposing sanctions against Iran.

It's almost as if the *People's Daily* editors had been getting their ideas by reading *this current study* by three American professors. That April 26 *People's Daily* identified **three** of the **four** finance topics treated by the current authors: intellectual piracy, trade deficit, and raising the value of the Yuan.

Down in Hong Kong, *South China Morning Post* published a key paragraph that was more than likely well received in Beijing:

Chinese President Hu Jintao made sure that Taiwan was near the top of the agenda during his summit with US President George W. Bush, and received reassurance from the US leader that the United States does not support Taiwan's independence (Bush and Hu 2006).

It was important that the President of China came to visit the President of the United States. However, somewhat surprisingly, the mass media of the Western World very clearly did not attach a great degree of importance to the Hu Jintao visit.

That Presidential Summit B The Western View

Germany's *Frankfurter Rundschau* quickly treated the visit in this manner: *AKühler Empfang für Chinas Führer. Für Peking ist es ein Staatsbesuch. Für Washington ist es keiner* (Kühler 2006), meaning: A cool reception for China's Leader. For Beijing it is a State Visit. For Washington it is not. Tom Baldwin, in Washington for *The Times* of London, told us of Hu's meal: AHe will, for example be offered only a >social lunch= during what the White House insists is merely >a visit=@ (Mccartney 2006).

Agnieszka Skietarska of *Reuters* and Poland's *Gazeta Wyborcza* summed up with: *ANic prześmowego jednak nie ustalili* (Skietarska 2006), meaning: ANothing crucial yet nothing settled. Harald Maass of *Frankfurter Rundschau* worded it *AErwartungen nicht erfüllen* (Maass 2006), meaning: AExpectations not fulfilled. Rome's *La Repubblica* assigned this headline to the event: *ALa visita del cinese Jintao negli Usa cordialità ma nessun risultato* (La visita 2006), meaning: AThe visit of the Chinese Jintao to the USA was cordial but without result.

Perhaps somewhat symbolizing what the Western press felt about the Hu visit is this April 21, 2006 report from Russia's *Lenta.Ru*, and we translate from the Russian Cyrillic: AVice-President Dick Cheney dozed off during a Hu Jintao press conference (Dik Cheini zadremal 2006).

Cheney denied that he was asleep, and we would like to accept that denial! But Cheney's

alleged *nap* clearly symbolizes a very clear fact. At least when Hu met Bush, the *finance* challenges addressed in the current study just did not make their way onto the official agenda.

Conclusion

The current study has attempted to focus strictly upon matters of finance in considering relations between the People=s Republic of China and the United States of America. Examined have been the huge U.S. trade deficit with China, the remaining low value of the Chinese *Yuan* in relation to the U.S. dollar, and the very active participation of Wal-Mart in relation to those two specific **finance** phenomena.

Also pointed out were two additional **finance** features: the very high level of purchasing of U.S. Treasury securities by the Government of China and a continuing piracy in China of American intellectual properties.

Perhaps at some point, a Chinese-American Presidential Summit Meeting could deal with these four **finance** challenges. So far as the Western media can determine, such a summit in April, 2006 did not touch on any of the foregoing topics. Maybe next time!

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