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CHINA

Stop Calling China a Currency Manipulator

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By William Pesek a A

Christine Lagarde's people say China's currency is no longer undervalued. Jacob Lew's argue it still is. There's a lot at stake in the debate: The yuan can't gain status as a global currency reserve if China is thought to be manipulating its value. So who should we believe, the head of the International Monetary Fund or the U.S. Treasury Secretary?

It's worth asking Ben Bernanke. Now that the former Federal Reserve chairman is in the private sector, he can say what he really thinks -- and, as he pointed out in a recent speech in Seoul, it's not wise to ignore political factors when managing the rise of the Chinese economy. Bernanke argued that if Washington had heeded IMF requests to allow China to play a larger role in global institutions, Beijing wouldn't now be creating the $100 billion Asian Infrastructure Investment Bank, which threatens to undermine the existing global financial system.

It's worth extending Bernanke's point to the yuan debate. Japan's yen is down 30 percent since late 2012 (hitting a 12-year low this week) while the yuan has risen during the same period. So the IMF has good reason to contradict America's assessment and bolster China’s case for reserve currency status. But there are two further reasons why the IMF must stand firm, no matter what U.S. officials and lawmakers say.

First, China might go it alone. As Bernanke points out, the West is playing hardball with Beijing at its own risk. The AIIB is already diminishing the relevance of the World Bank and Asian Development Bank. What's to keep Beijing, flush with $3.7 trillion of reserves, from now opening its own bailout fund for governments facing balance-of-payments shortfalls? China proposed a similar idea during the region's 1997 economic crisis. Although the idea died a quick death at that time amid fears the IMF and U.S. Treasury would lose influence, it might attract more interest now -- especially if China promises to demand less austerity from needy countries like Greece.

"If the IMF were to sidestep the explicitly stated desire of China’s government," says Eswar Prasad of Cornell University in Ithaca, New York, "it would create more bad blood in an already contentious relationship regarding currency matters." He worries it would "crystallize emerging market policymakers’ concerns that the IMF remains an institution run by and for the benefit of advanced economies." That would encourage nations to rally around Beijing's alternative lending institutions, and could deal a fatal blow to the post-World War II global financial architecture.

Second, Chinese economic reform is accelerating. Bernanke is right that the yuan has a ways to go before it can become a major reserve player. But a new Swift study shows the yuan is Asia's most-active currency for payments to China and Hong Kong and number five globally. Convertible or not, the yuan is too big to ignore. In that sense, its inclusion in the IMF's special drawing rights system -- along with the dollar, euro, yen and pound -- is a matter of when, not if.

Moreover, the makers of China's monetary policy are committed to economic reform -- and their efforts are forcing change on the entirety of the Chinese government. Central bank Governor Zhou Xiaochuan is a disciple of Zhu Rongji, the former premier (1998-2003) who did more than any leader since Deng Xiaoping to internationalize China's economy. Zhou's lobbying of the IMF on behalf of the yuan has forced the Communist Party to commit to financial reform. The effectiveness of Zhu's strategy was evident during China's 2001 entry into the World Trade Organization, which eventually pried the nation open to foreign investment and competition. Zhou's plans for a freer yuan would curb the party's influence over the economy, and force transparency on the financial system and state-owned enterprises.

"Its importance is as a tool to build political support for China’s financial and capital account liberalization," says David Loevinger, former U.S. Treasury Department senior coordinator for China affairs.

Serious people can disagree about what the real value of the yuan should be (and Lagarde and Lew certainly do). And with a U.S. presidential election approaching, it's a safe bet China's commitment to economic fair play will be a big subject of discussion in the year ahead. But let's not treat China as a minor player in this drama. The world's second-biggest economy is run by a government with loads of cash, vast ambitions and lots of options. As Washington learned the hard way with AIIB, it's better to make room for China than give it reason to walk alone.

To contact the author on this story:
Willie Pesek at wpesek@bloomberg.net

To contact the editor on this story:
Cameron Abadi at cabadi2@bloomberg.net