China’s economic policy follows a random path
By Joe Zhang

China’s approach to foreign exchange, like many of the decisions of the country’s public authorities, could best be described as a banana-skin policy. That is to say: the government has no policy. It simply keeps doing the same thing for as long as possible, until it slips, suffers a nasty bruise, picks itself up and tries something else.

In the early 1980s, a US dollar bought you two renminbi. That was the fixed rate in the official market, anyway; the Chinese currency traded at about five to the dollar in the black market. Since then, Beijing has been forced by the black market to adapt, whenever the official rate falls out of line with the underground exchanges.

To maintain an overvalued exchange rate, China in the mid-1980s introduced a foreign exchange certificate to ration foreign currency. Only approved users would receive a ration. But FECs quickly took on a life of their own; unofficial trading of the certificate boomed. Black market prices fluctuated between 60 and 80 per cent of the official exchange rate. Even at the central bank, where I was working at the time, staff members had to go to the black market to buy dollars to pay tuition fees at foreign universities.

A black market for foreign exchange had existed ever since the 1950s. It only dried up in the mid-1990s, when the central bank drastically reduced the official value of the renminbi. Following that, FECs became worthless and the central bank stopped issuing them in 1995.

That Beijing had maintained an overvalued renminbi for half a century may come as a surprise to westerners who have grown accustomed to grumbling that an undervalued currency gives Chinese manufacturers an unfair advantage. Was the central bank deliberately punishing its own exporters and rewarding foreign businesses? That might have been the outcome but clearly it was not China’s intention.

The Chinese are masters of muddling through. They are firmly attached to the status quo, whatever that happens to be. Anyone accusing China of currency manipulation in the past decade is ignorant of the five that went before it. The renminbi now trades 30 per cent higher than its 1994 level. This did not happen by choice. It just happened.

This is not the only instance in which Chinese policy has followed a random path. A little over a decade ago, Beijing became alarmed about air pollution and the country’s dependence on imported oil. So it tried to introduce a fuel tax to discourage oil consumption. It was quietly withdrawn after noises were made about the levy’s impact on farm tractors, as well as general industry. Since then, no one has talked about the tax, although oil imports have kept rising and air pollution has worsened.

When a real estate crisis took hold three years ago, China experimented with a property tax in Chongqing and Shanghai. It was clear from the start that such a measure would test the government’s political will and administrative sophistication. Sure enough, the fanfare gave way to quiet forgetfulness.

For decades, water shortages have been growing challenges for China. But throughout that time water has been more or less free, and few people can conceive of having to pay for supplies. Politicians would rather undertake dangerous projects such as building river dams and south-to-north diversion pipelines than increase water tariffs. Clearly, true leadership and extraordinary statesmen are needed if such shortsightedness is to be overcome.

Since 1978, China’s economy has indeed grown dramatically, but its governance remains just as unsophisticated as before. Given the mounting challenges, banana-skin policies can only result in more painful slip-ups.
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The writer is author of 'Party Man, Company Man: Is China’s State Capitalism Doomed?'

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