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THE BATTLE CONTINUES

Relevant for: International Relations | Topic: World Trade, WTO and issues involved

On Monday, the US formally labeled China a currency manipulator after Beijing allowed its currency to fall to an 11-year low — below the psychological mark of 7 per dollar. This comes after US president Donald Trump accused China of weakening its currency to create an unfair trade advantage. Though the decision to label China is largely symbolic — it will be followed up by consultations between the US Treasury and China — it marks an escalation in the ongoing trade war. These developments suggest a hardening of positions between the warring parties, belying expectations of a resolution.

To be labeled a currency manipulator, a country is measured, and seen to have failed, on three parameters — its current account surplus, trade surplus with the US, and interventions in the currency market. Despite the US Treasury's charge against China, the allegation of currency manipulation today is weak at best. As economists at the Peterson Institute For International Economics have pointed out: "China was by far the largest currency manipulator between 2003-12. It reversed that practice in 2015-16." In fact, in its External Sector Report released last month, even the International Monetary Fund noted that China's external assessment is moving from "moderately stronger to broadly in line". But though China has said that the "devaluation reflects pressure on the exchange rate stemming from the US decision" and that it has "refused to engage in competitive devaluation", other countries which compete with China might follow suit — weakening their currencies in order to maintain their competitiveness — triggering off a currency war.

In India, too, some have argued in favour of a weak currency — going by the RBI's real effective exchange rate (REER), the currency is overvalued. But at the current juncture it may be prudent to avoid getting caught in these wars. Instead, the focus should be on addressing the deeper structural issues that affect export competitiveness. Resolving issues regarding taxation and tax administration, reducing policy uncertainty, carrying out reforms to boost exports, especially of labour intensive sectors, and creating conditions for greater integration with global supply chains, should be the pressing concern of the government.

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