

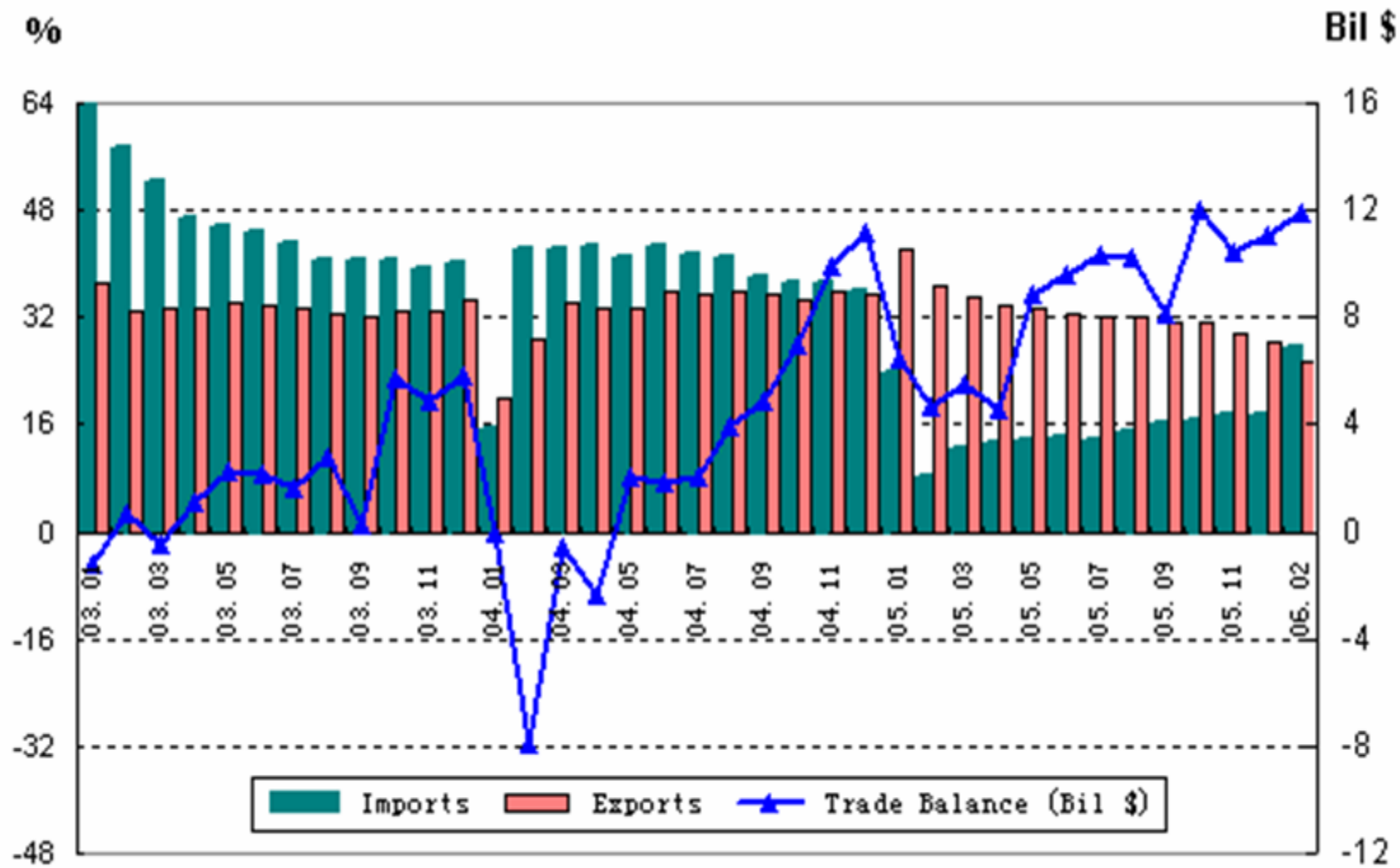
# Currency Asymmetry, Global Imbalance, and the Needed Reform of Global Monetary System

FAN Gang  
National Economic Research Institute  
China Reform Foundation

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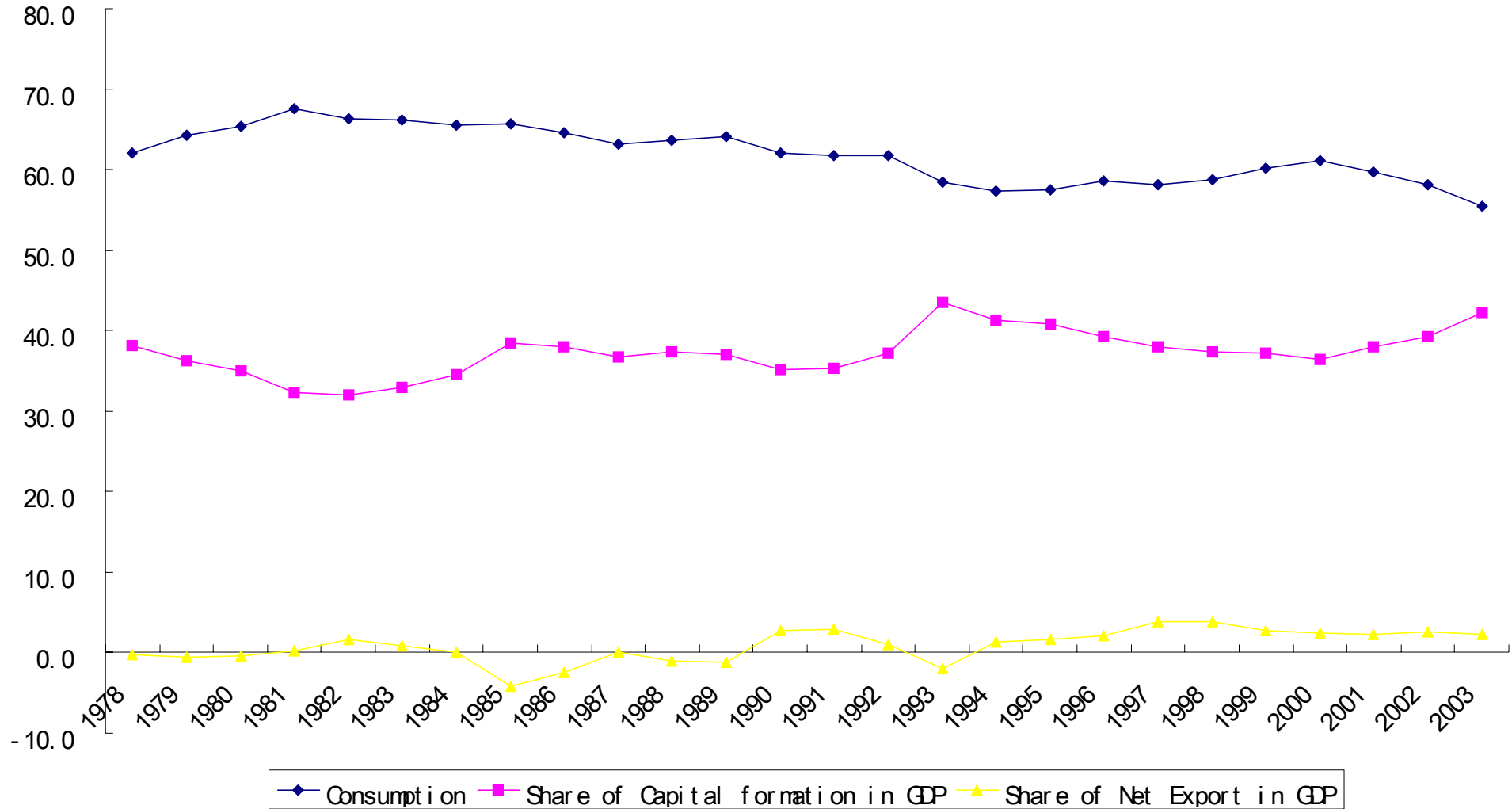
# 1. China's trade balance

- In most of past 27 years, including 2003-04 when revaluation pressures were already high, China's trade was basically balanced.
- 2005 was a special year of slow-down in aggregate demand, 5% of GDP as trade surplus was caused by slow-down (from 36% and 39% in 03-04 to 17.4% in 2005, while the growth exports also slowed down to 28% from previous years of 35%).

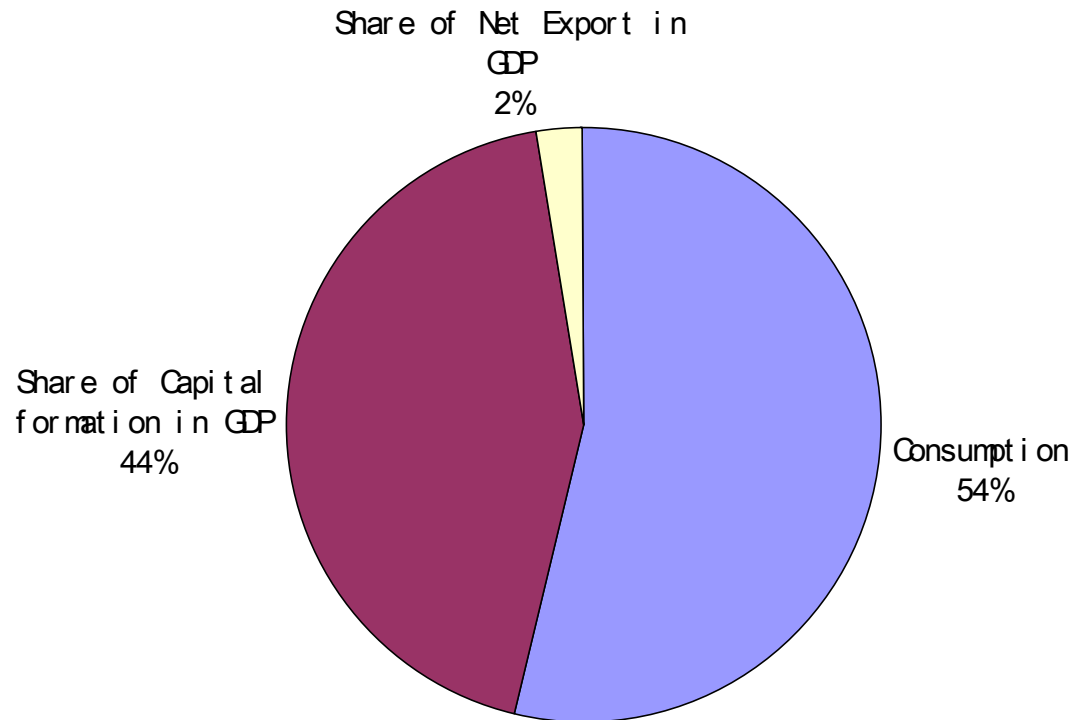


Source: China State Statistical Bureau

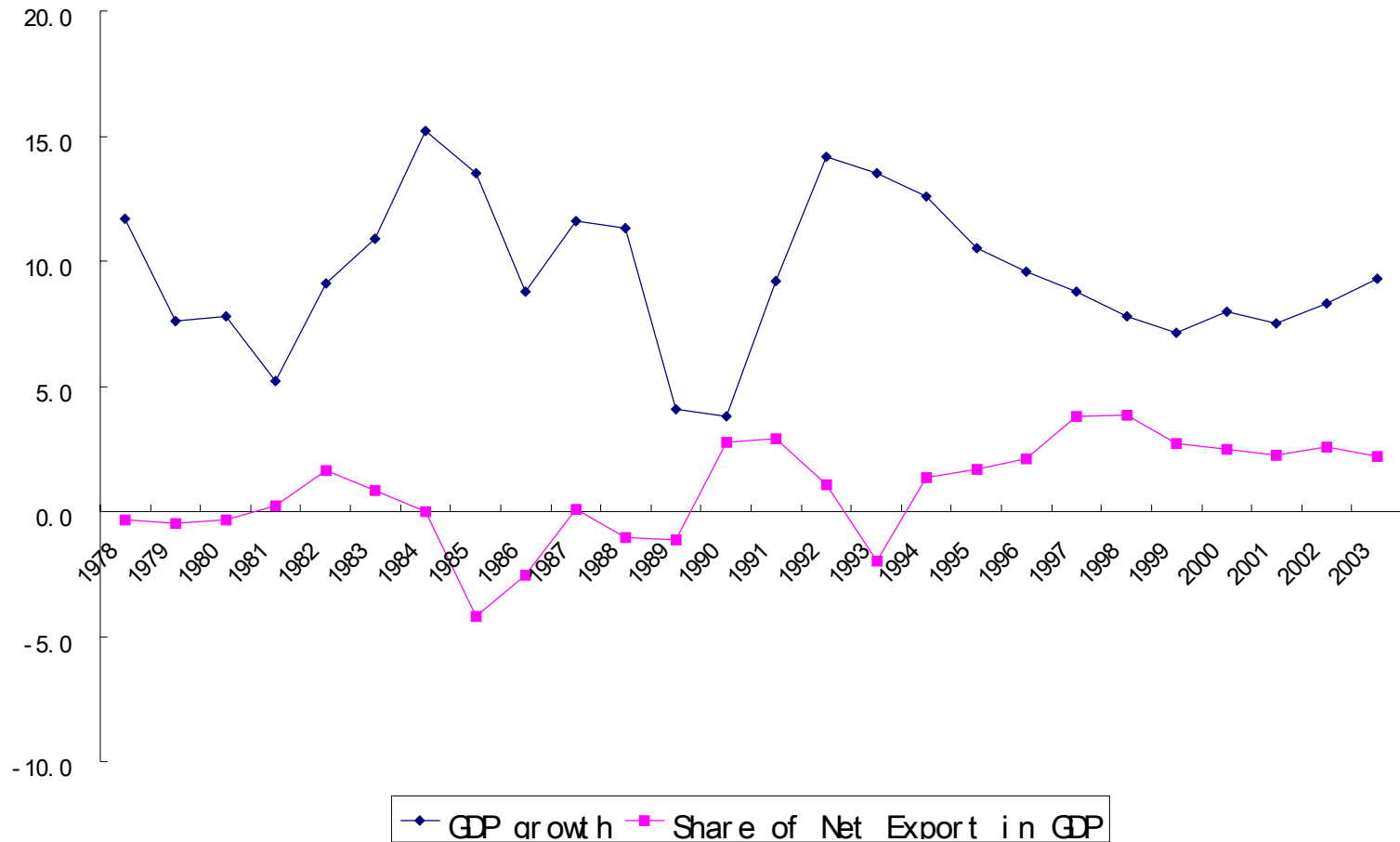
# The Composition of China's GDP



# GDP Composition, Chi na 2004



# And China's growth has been mainly dependent on domestic demand, not export

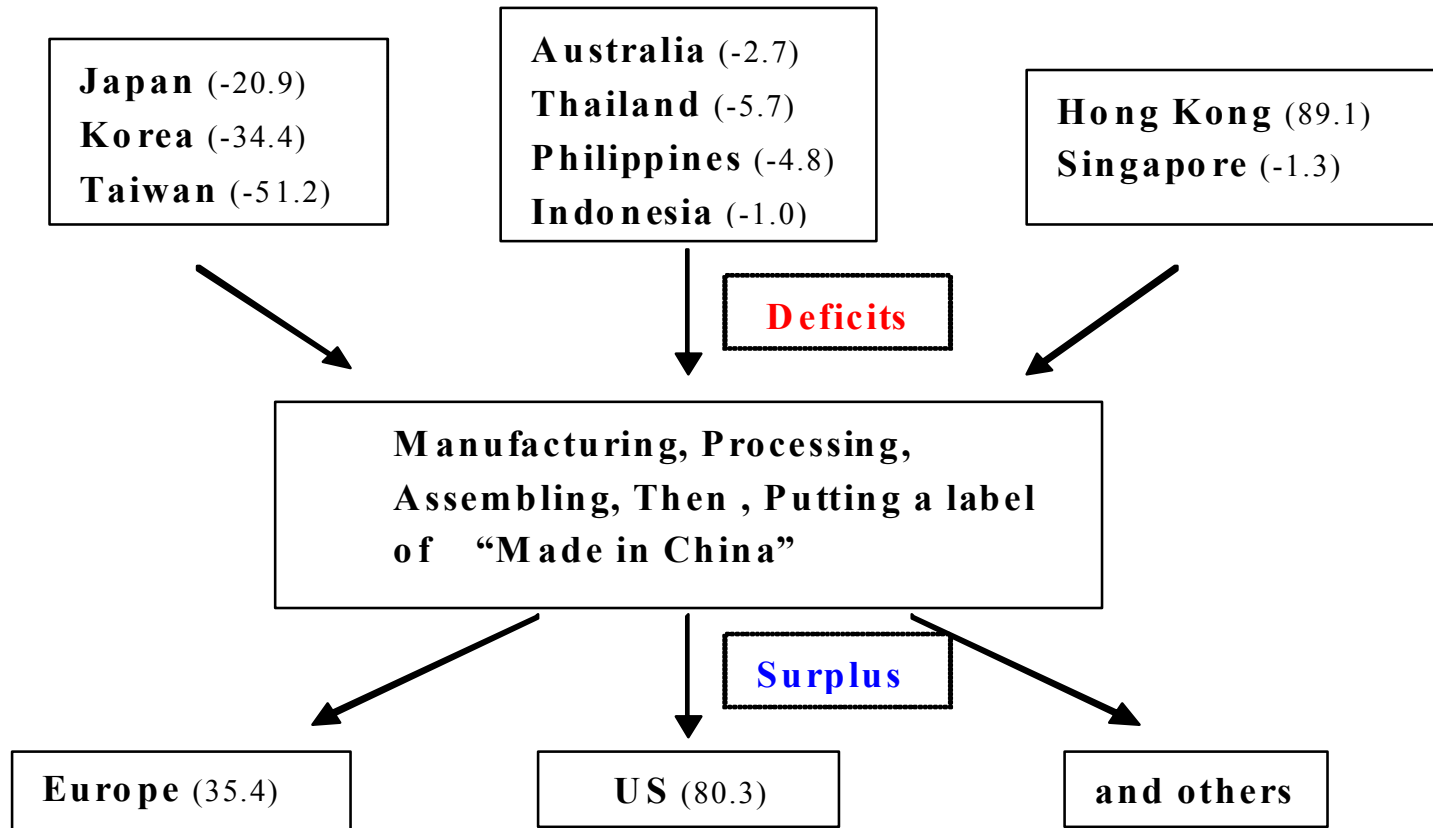


## 2. China-US trade imbalance

- The reason why China's trade was mostly balanced was that China imported a lot!
- But the only problem is that China mostly imported from other economies, particularly in Asia, but not the US;
- That is where the China-US imbalance stands.

# China's "Trade Map"

Graph 5: Illustrated Triangle Trade Relations – China's Bilateral Balance in 2004 (\$ Billion)



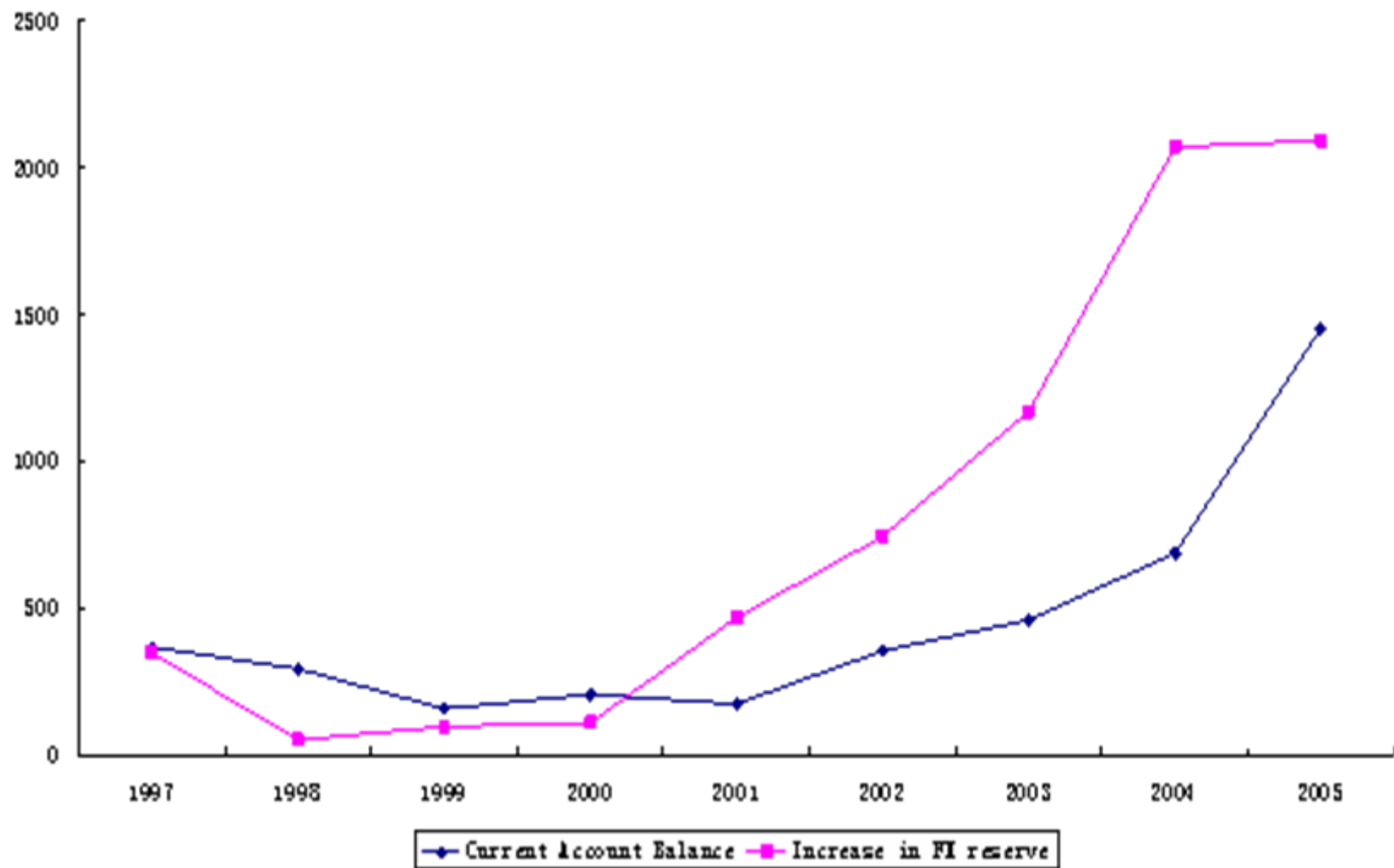


### 3. What is behind China's the large fx reserves

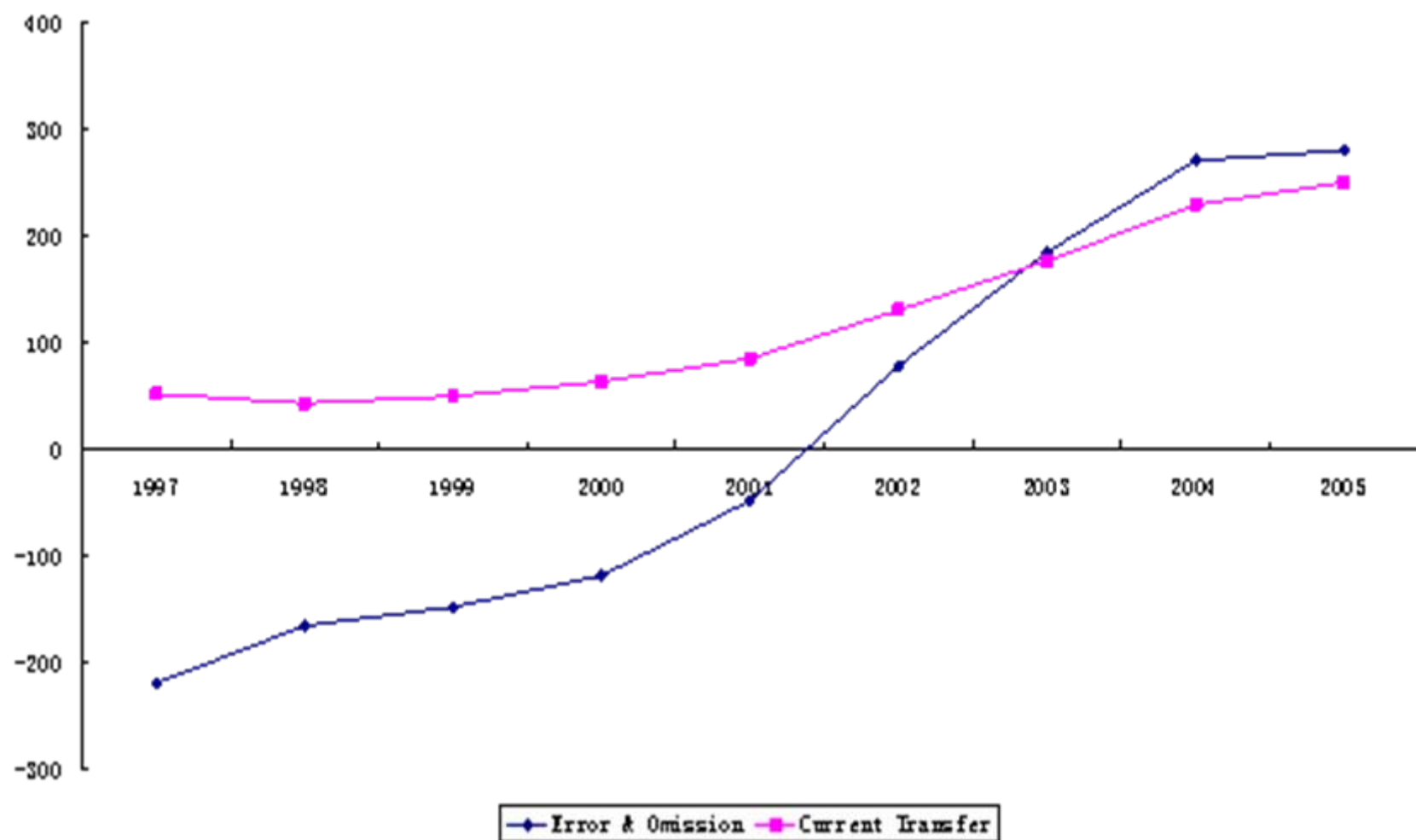
In 2004, China had only US\$30 billion current account surplus, but got US\$200 billion increase in foreign exchange reserves. Where the difference came from?

-- Capital inflows (with speculations), or others' savings or previous savings, not the savings from Chinese!

## China's Current Account Balance and FX Reserve Increase



## Speculations: E&M, and Current Transfer



# 4. Savings vs. spending

- Chinese save a lot, but they spend a lot too, may not on consumption, but on domestic investment (even over-spending in 2003-04), and increase the demand for commodities on global market.
- Domestic savings on domestic investment does not contribute to global imbalance!

Total national savings =  $S + (X-M)$   
= domestic savings + current account surplus

Net national savings =  $(S-I) + (X-M)$   
= current account surplus + part of net private  
capital outflows (equivalent to  $S-I$ )

- China's current account surplus cannot explain the \$600 billion US deficits.
- And China's revaluation will not be a solution to US deficits and the global imbalance:
  - How much to revalue? 200% or 500% to be enough?
  - How many times? 50% + 50% + 50% +.....?
- The real issue is the persistent tendency of devaluation of USD. But why?

## 5. Global Currency Asymmetry: the US vs. all others

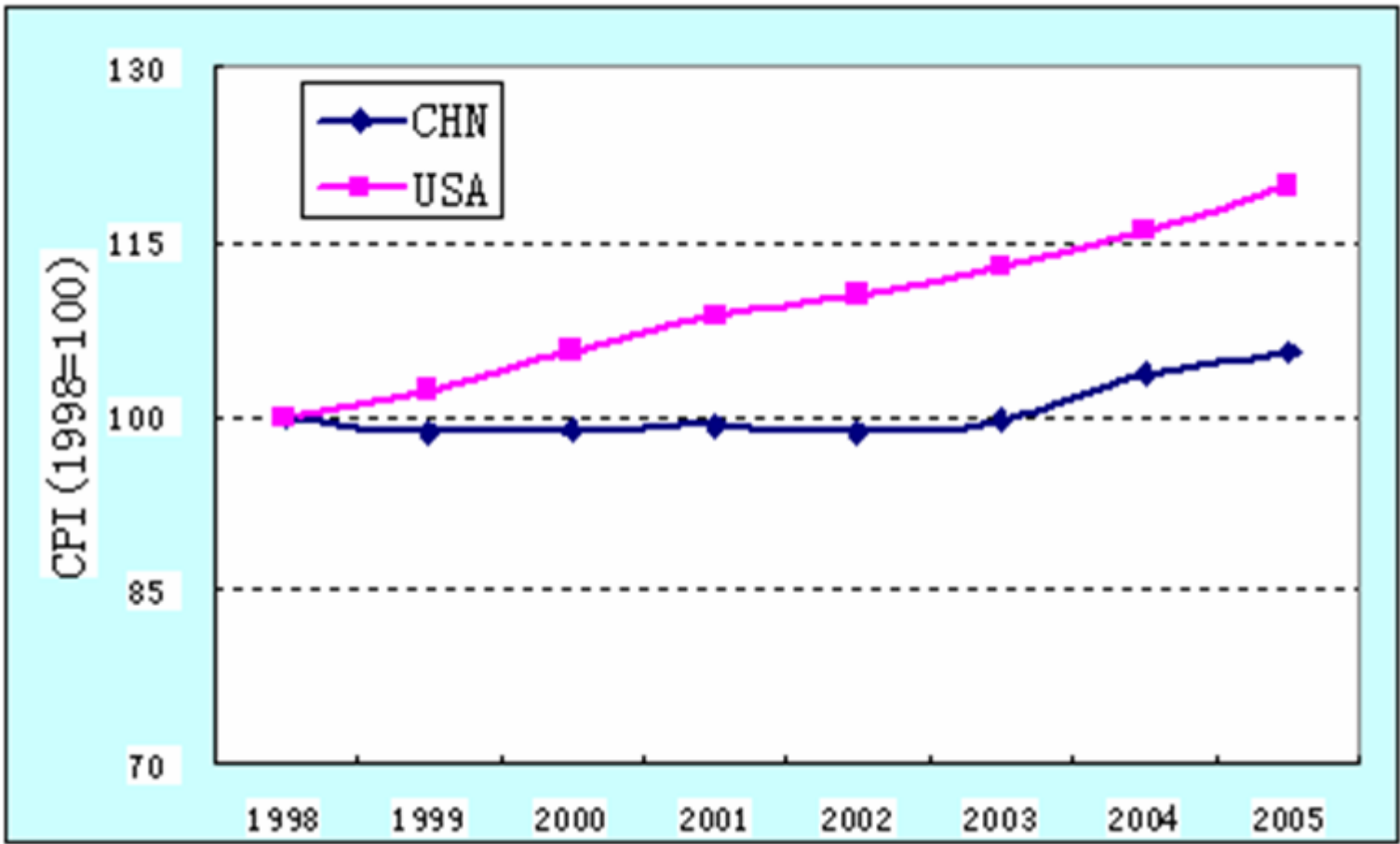
- The US issues its own currency which also serves as the international currency; and the rest of the countries of the world which only issue their own respective currencies for domestic use and accept the US dollar in international transactions.
- USD is a private good in terms of national interests, but serves as a global public good (people pay seigniorage as the appreciation for the good service);
- While everyone else must face all negative consequences of excessive liquidity and budget deficits, the US can spread risks all over the world since over 50% of USD is circulating outside US;
- While everyone else must face all negative consequences of devaluation, the US only gains from it.

# Illustration: Asymmetry and the USD devaluation tendency

|                 | US               | Any other country |
|-----------------|------------------|-------------------|
| Foreign Assets  | Up               | Up                |
| Domestic Assets | <b>Unchanged</b> | <b>Down</b>       |



Table Inflation in US and China

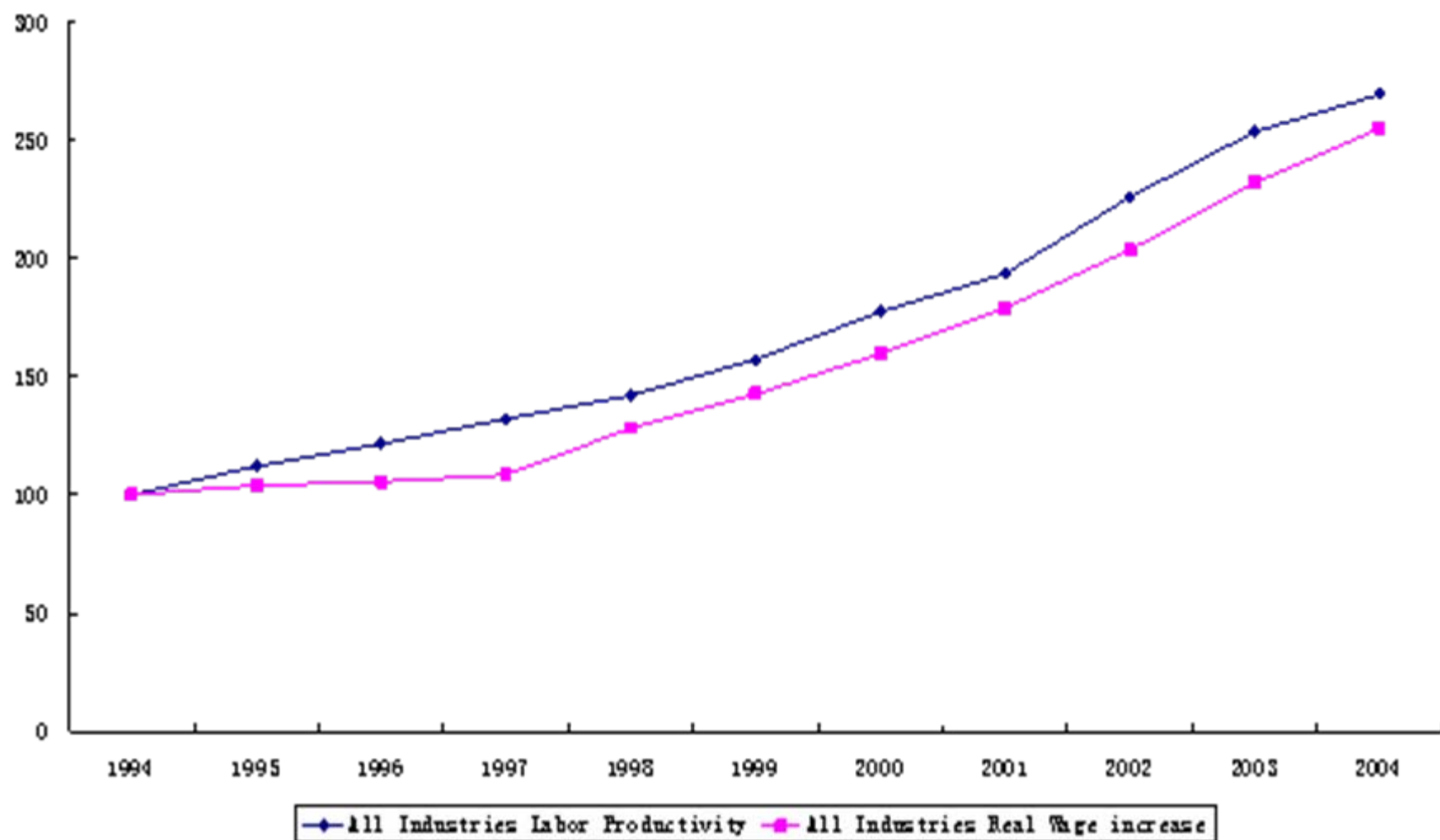


Source: IFS

## 6. China's responsibility and RMB regime

- The currency disequilibrium is mainly due to the present system with USD as the international currency, and the persistent tendency of devaluation of USD since Nixon shock in 1970s and Plaza Accord in 1980s.
- China's "guilt" is that the wage has been growing less than labor productivity (about 1% per year), due to too many poor rural laborers with 1 dollar per day come to compete for better paid jobs.

## China's Real Wage and Labor Productivity Changes



# China's managed floating regime

-- is a right system in the senses of

1. It makes China possible to pay its own duty to reduce the disequilibrium and imbalance (gradual revaluation according the wage/productivity relationship);
2. It makes China possible to prevent it from taking too much burden which should be shared by others (think otherwise under free floating regime).

## 7. Needed reform of global monetary system to remove the Asymmetry

- More other reserve currencies (EURO, ACU....)?
- Back to Gold? the gift of Mother Nature, but too rigid.
- Go to something like “Bankor” (Keynes, 1944), a true modern global public goods independent of any particular nation? Transaction cost too is high?

Easy to imagine,

Hard to break through.