China’s Participation in Global Governance:
Choosing an Exchange Rate Regime

Alternative XR Regimes

• Currency Union
• Hard Peg
• Adjustable Peg
• Managed Float
• Freely flexible
Overview

• 1) Central Questions, Key Assumptions

• 2) Methodology

• 3) 3 Decision Points: 1997, 2005, 2010

• 4) Conclusions
Central Questions & Assumptions

• What explains China’s choice of exchange rate regime? (Internal politics, external politics, random events?)

• GGOs (IMF, WTO, BIS, G20 etc) – do they mediate the political conflicts?

• Does the story change systematically over time?
Methodology

• Three Decision Points: 1997, 2005, 2010

• Search for the best causal story for each event (make them compete against each other)

• Test: “Preponderance of the evidence”
1997: China Chooses a Hard Peg

• Random event story? (Asian Financial Crisis)

• External pressure/politics story?

• Domestic politics story?

• The outcome is “overdetermined”.
2005: From Hard Peg to Adjustable Peg

• Random event: emergence of large, persistent global trade imbalances

• (My nice data set merits a two-minute detour.)
Global imbalances (in percent of world GDP)
2005: From Hard Peg to Adjustable Peg

- Random event: emergence of global trade imbalances
- External pressure – US Congress
- GGO story: Tutelage, adoption of ‘international norms’
- Internal turf battles – POBC loses out to MOF – leads to ‘window-dressing' reform
2010: Return to an Adjustable Peg

• External Pressure?
• But China’s economic growth makes her political position considerably stronger now
Indicators of China’s Growing Economic Strength

• PCGDP: from 10% to 23% of US level

• GDP: from 47% of US to 99.4% (2010)

• Share of World Exports: 9.7% (Rank=1)

• Share of World Forex Holdings: 33%

• ($T 3.20)
2010: Return to an Adjustable Peg

• External Pressure?

• GGO mediation?

• But China is now becoming a rule-making participant.

• (Zhu Min: Managing Director in Waiting?)
Min Zhu: Deputy Managing Director of the IMF

Former Deputy Director of the PBOC

Princeton MPA; Johns Hopkins PhD
2010: Return to an Adjustable Peg

• External Pressure?

• GGO mediation? New IMF measures
• But China is now becoming a rule-making participant.

• (Zhu Min: Managing Director in Waiting?)

• Internal story: Continued Financial Repression?
July 2008: Repeg to the Dollar

• Response to hot money inflows?

• Anticipating the September crash?

• An appreciating dollar carries the RMB with it (23% in 6 months following July 08)
Strategy should remain flexible—there will be unanticipated events—but with a roadmap:

1. A stronger exchange rate
2. Rethinking the monetary framework
3. Improved regulation and supervision
4. Market development
5. Liberalizing interest rates
6. Opening up the capital account
There is a need for currency appreciation to...

- Reduce the scale of BOP inflows
- Lower FX intervention
- Have the flexibility to use reserve requirements not merely as a sterilization tool
- Greater scope for an independent monetary policy