

# China's Participation in Global Governance:

## Choosing an Exchange Rate Regime

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# 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



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# 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

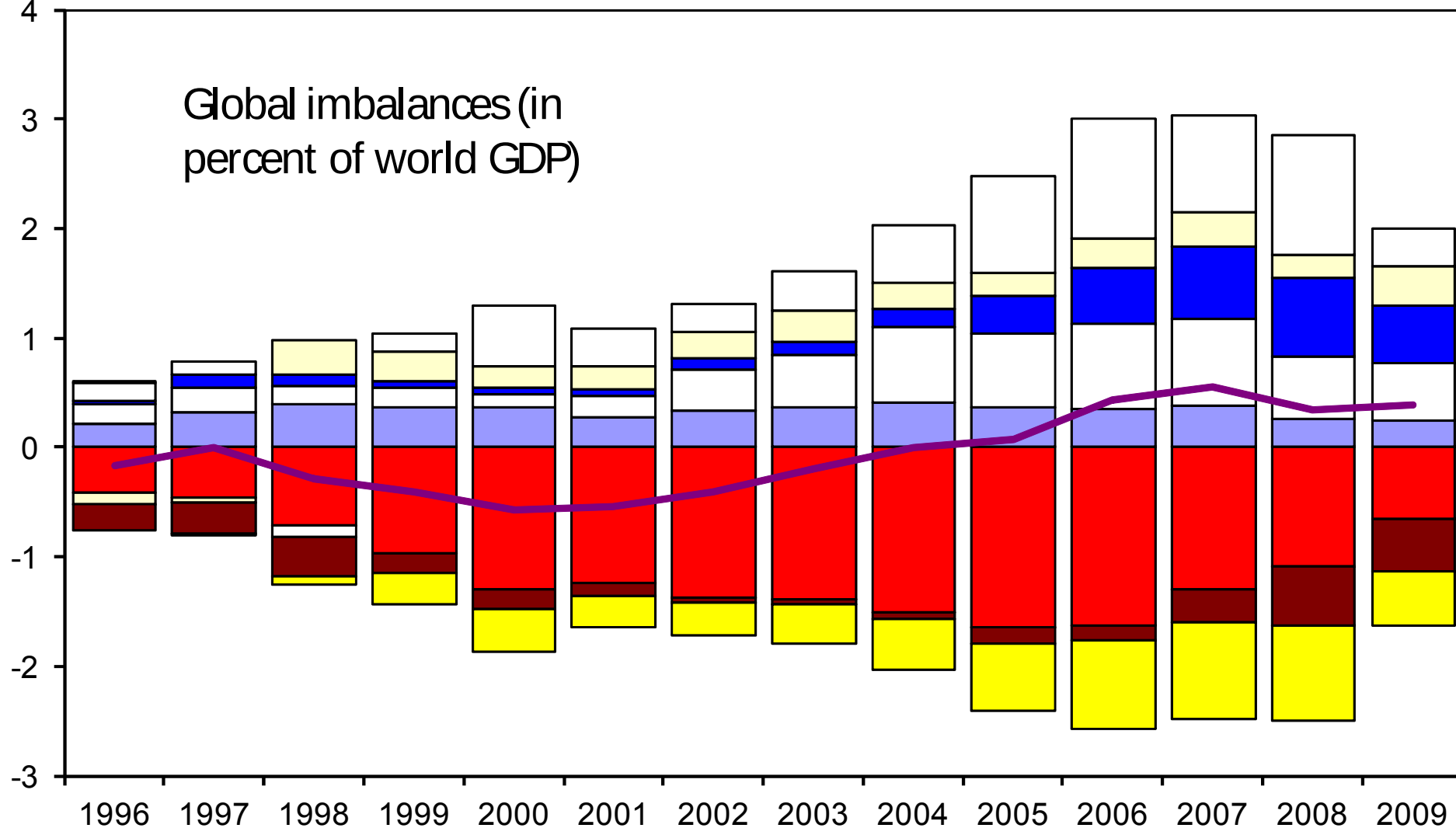
- Random event story? (Asian Financial Crisis)
- External pressure/politics story?
- Domestic politics story?
- The outcome is “overdetermined”. 😊



# 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)



- US
- CHN
- ROW
- JPN
- EMA
- Eur deficit
- Eur surplus
- OIL
- Discrepancy

# 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?





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# 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

Exchange Rate & Foreign Reserves

