



China, the Reluctant Monetary Power

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There is an acute need for ambitious multilateral responses to the systemic crisis of international currency and finance. But does such a crisis not constitute an inevitable transition for allowing the redistribution of power and responsibility among declining and emerging powers? A multipolar world needs a strong multilateral base so as to make it economically more fair and effective and geopolitically more stable. China's option will be decisive. The world is waiting for China.

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Introduction

The decisive contribution¹ prepared for the Cannes G20 Summit by the prominent “Palais Royal” Group led by Michel Camdessus, Alexandre Lamfalussy and the sorely missed Tommaso Padoa-Schioppa, will provide world leaders with a robust and clear framework for guiding International Monetary System (IMS) reform when the time is ripe.

But the conditions for a reshuffle are not there yet despite the acute need for ambitious multilateral responses to the systemic crisis of international currency and finance. But does such a crisis not constitute an inevitable transition for allowing the redistribution of power and responsibility among declining and emerging powers? Things must settle first. The three major economies - the US, China and EU - must focus on their homework and put their houses in order before going back to the drawing board to design a new badly needed IMS. America must substitute the dollar emission with taxes. Europe must turn the eurozone into an effective political entity and China has the immense task of consolidating and expanding further its recent achievements in terms of growth and of raising its people out of poverty. Yet since the transition in progress is fraught with dangers for the stability of the world, cooperation among the “Big Three” is critical.

Let us here focus on the rising role of China, which holds the key of moving from the current pre-multipolar monetary system to an effective multipolar one; and then from there possibly towards an SDR-based truly multilateral monetary system. But prior to this let us clarify China’s present monetary regime. The Chinese Yuan, once pegged to the dollar (1997-2005), moved afterwards towards a managed floating exchange rate regime² through the combination of a daily 0.5% fluctuation margin against a basket of currencies (euro, yen, dollar and a few other minor currencies) and retaining the possibility of parity adjustments. The exchange rate is *de facto* targeted according to political (the need to accommodate US pressures) and economic considerations (the balance between keeping inflation under check and retaining a competitiveness margin). Hence the capital account is not liberalised. Moreover its liberalisation would require first more progress in the financial market reform³.

Let us see now how China found its way through the successive transformations of the IMS.

Double-edged dysfunctions of Bretton Woods I and II

The post-World War II period saw the setting up of the first ever multilateral economic governance system – Bretton Woods (BW) -, which aimed at efficiency and equity through international and domestic policies. It rested upon three pillars: first trade, second currency and finance, and third norm-setting in various areas such labour, health, environment, technical standards, intellectual protection, etc.

¹ “*Reform of the IMS; a cooperative approach for the 21st Century*” delivered to the French Presidency of the G20 on the 18th of January 2011.

² W. M. Morrison and M. Labonte, “China’s Currency: An Analysis of the Economic Issues”, *Report for Congress*, (3 August 2011), p. 2.

³ “...the RMB...has significant handicaps in the short term, due to the limited openness and development of China’s financial markets, as well as to a weaker policy record, but it has strong governance underpinnings. Provided financial reforms are carried out in China, it could gradually become a major challenger, and ultimately the main challenger to the dollar...” W. Dobson & P. Masson, “Will the Renminbi become a World Currency?”, University of Toronto, IIB paper No. 10, (March 2008) in A. Bénassy-Quéré and J.P. Ferry, *What International Monetary System for a Fast-changing World Economy?*, (Brussels: Bruegel, 2011), p. 19. See also: C. Thimann, “Global roles of currencies”, ECB working paper No. 1031, (March 2009). “China has clearly signalled its intent to see its currency acquire international status” see C. Yin-Wong, Ma Guonan, & R.N. McCauley, “Renminbising China’s Foreign Assets”, *CESifo working paper No. 3009*, April.

Such a system would deliver global public goods and control over externalities and spill-overs, contributing to the convergence of policies and outcomes among participating countries. The International Monetary System (IMS), a major foundation of the new multilateral order went through a series of successes and failures.

The current IMS – let us call it Bretton Woods II (created after the breaking up of Bretton Woods I in August 1971 because of the decoupling of the dollar from gold) – is going through an ultimate transition whose end, a Bretton Woods III, is not yet in view; meanwhile it is gradually shifting from a dollar-based to a multipolar currency system.

Bretton Woods I was both an experiment in multilateral governance with the International Monetary Fund (IMF) and the World Bank (WB), and the consecration of the USA as the Western hegemon. It brought together an exclusive club of mostly Western and Northern States with close characteristics: a comparable level of development and, most of them, like-minded countries with regard to the tenets of the market economy. It marked a definitive break with the Gold Standard since currency convertibility was based on fixed but adjustable exchange rates pegged also to gold but through the dollar and last but not least, allowing capital controls. The IMF provided the institutional framework for the IMS and ensured assistance to countries in need. Policy-wise, the IMS rested on two pillars: trade liberalisation through GATT negotiations, and domestic full employment policies. For this reason, it received the appellation of “embedded liberalism” which amounted to “the multilateralising” of Roosevelt’s New Deal which in Europe took the form of the Welfare State.

Bretton Woods I indeed proved a success which culminated in the “Glorious Thirties”. But its growth and welfare achievements mostly benefitted Western advanced economies that succeeded in retaining the three main benefits attached to the colonial and later post-colonial rent: low commodities and energy prices, a monopoly over manufacturing and captive markets for their exports. Today the rise of China and of the BRICS is definitely putting an end to the post-colonial rent. This is a sea change for Western economies confronted with manufacturing outsourcing and off-shoring and with new terms of trade with commodity producers.

For its huge benefits, the BW system has gradually revealed three major drawbacks. First, it aggravated the North-South income gap despite the granting by the North of multi- and bi-lateral aid and of trade preferences. In the eighties and nineties, the Washington Consensus-based conditionality which was impressed by the IMF on indebted developing countries did not cure their ailment. Second, it allowed the USA as the ultimate issuer of the reserve-currency, to emit huge amounts of dollars beyond their gold stock, fuelling world inflation, and triggering two oil shocks in return. Third, the abrupt end of the gold exchange standard so clearly analysed and predicted by Triffin, and the shift to floating rates and capital liberalisation, opened an era of monetary and financial instability. But as odd as it may sound, the new “non-system” did not diminish but rather strengthened the hegemony of the dollar as a means of payment and as a reserve currency, hinting at the fictitious character of the link between the dollar and gold during the preceding decades.

The fault-lines of the BW IMS entailed two interesting side consequences which changed the balance of the world economic system. On the one hand it provided an effective mechanism for defence burden-sharing between the USA and its allies. On the other hand it eventually encouraged heterodox

development strategies by the “Asian tigers” and later China, which exploited to the full the American excess of investment over savings.

Bretton-Woods as a Security System for the West

Bretton Woods I was highly dysfunctional from an economic standpoint because of the exorbitant privilege of the dollar. But it proved advantageous from a geopolitical standpoint by allowing the USA to dodge the “guns and butter” dilemma, i.e. first and foremost, in the case of the Vietnam War and the Great Society social programmes through the sixties. The USA was dispensed to raise taxes, because they could then monetise the fiscal deficit through issuing more of the international currency. The dollar-based IMS - be it BW I or BW II - put the USA at a strategic advantage in the armament race with the USSR: it was eventually the pharaonic Star Wars project that broke the back of the Soviet economy. The dollar system proved therefore an implicit way for the USA to share the defence burden with its economic partners, mainly the EU and Japan. As the last resort security provider for the West, the USA was indeed de facto granted the right to manage the international currency according to their economic needs and strategic priorities. This implicit consensus still prevails today: the EU is more prompt to lecture China on the undervaluation of the Yuan than to raise the matter of the depreciating dollar with Washington. Yet, the USA is not anymore a 100% reliable strategic partner for Europe: its superiority, although still very high, is dwindling and its concern for Europe is fading away as geopolitical stakes move eastwards.

The Blessed American Structural Deficit

A second severe dysfunction of the IMS lies in the gradual emergence of structural imbalances which appeared first in America as a result of an excess of consumption over savings and a lax monetary policy by the international reserve-currency issuer. But, the huge anomaly of the richest country going into heavy external debt had its positive counterpart. China, building up on the “flying geese pattern” initiated by Japan and the Asian tigers in East Asia, took advantage of US households’ profligacy. Through heterodox policies from a Western vantage, which eventually proved the only gate of access into the advanced countries club, China succeeded in inserting its natural comparative advantage (cheap disciplined labour) into the global output chain. China started off its modernisation from the modest level of “the world powerhouse”. In this capacity, it supplied the US market with cheap imports that protected real wages from the relative stagnation of nominal wages, while keeping inflation under check. In parallel China steadily piled up huge current surpluses as a counterpart to the US’ structural deficit. In order not to appreciate its currency accordingly, China turned into the bank of the US Treasury buying scores of T-bonds and keeping thereby long-term rates on US public bonds at a lower level. Its foreign reserves amount today to \$3 trillion, providing China with a formidable leverage for promoting its geopolitical and business interests.

On the one hand, it grants China an insurance policy from the US Treasury against protectionism from the Congress. Then it also allows China to make more loans to developing countries than the World Bank. Also it puts China today in a position of contributing to the rescue of the eurozone – although in a cautious manner – while suggesting in return the attribution of Market Economy Status before the 2016 World Trade Organisation (WTO) deadline. But first and foremost, it shelters China from the type of IMF interference as imposed on some of China’s neighbours during the 1997-1998 Asian crisis, which was reminiscent for China of the infamous Western and Japanese concession regimes imposed on it between 1843 and World War II.

On the other hand, these huge forex reserves fuel a sovereign fund which allows Chinese operators to buy strategic economic assets for market, resource and technology access. The sovereign fund is a key tool in China's strategy for upgrading the quality of its production capacities and for deepening its industrial and technology base. Thanks to its formidable economic war chest, China has freed itself from the grip of the West over its domestic model: not a minor achievement.

Is China's remarkable competitiveness mainly due to the manipulation of its currency? Only at the margin say Sylvain Plasschaert⁴ and Michel Aglietta and Françoise Lemoine⁵. Such was the huge competitiveness advance achieved by China through a unique growth differential between, on the one hand, productivity gains obtained through technology transfers, and, on the other hand, the limited rise of real wages until the very last years, which saw huge increases in salaries in the Eastern coastal area. Yet China's nominal exchange rate policy carries a cost which I shall analyse later.

China: Twice a Hybrid

Let us rather concentrate on the peculiarity of the Chinese miracle in order to explain the leadership preference for retaining control over currency and finance.

Capitalist and Communist

How did this huge country, relatively poor in natural resources and unusually exposed to natural disasters, emerge as a giant in a matter of two generations through two contrasted major sequences between 1949 and today? Mao's reign until his death in 1976, for the terrible mistakes of the Great Leap Forward and the Cultural Revolution, secured the triple foundation for an economic launching pad: infrastructure, heavy industry and education. Then Deng Xiaoping built up on a long-term vision and through empirical implementation a hybrid economic regime characterised by a unique capacity to anticipate, to reform and to modernise. On the one hand, China, following on the tracks of Japan and the Asian Tigers, has played the card of promoting industrialisation by attracting FDI and pushing manufactured exports towards advanced countries' markets; this is the market capitalism side of Deng's great design. On the other hand, the one party system allowed for political stability, long-term planning, infrastructures and higher education on a massive scale, and the pursuit of an effective industrial policy first through State Owned Enterprises (SOEs), and later through their privatisation. But the State retained first and foremost an effective control over finance – both savings and investment.

The joining of the WTO in 2001 provided a strong base for market oriented institutional reforms made compatible with the multilateral trading system. But it restricted drastically the discretionary power of the CCP which then focused on retaining its grip over finance, a key tool for conducting the industrialisation from the world powerhouse stage towards the status of a fully-fledged advanced economy with a high technology level.

⁴ See on this question the in-depth study conducted by Sylvain Plasschaert in several recent publications.

⁵ "...Le taux de change yuan/dollar a peu d'impact sur les déséquilibres de balances de paiements; la meilleure manière de les réduire est une hausse des salaires en Chine et la remontée du taux d'épargne des ménages américains." In *L'économie mondiale 2011*, (Paris: Coll. Repères, 2010), p. 46.

Emerging and Developing

This is deemed by Beijing all the more necessary because China is also a hybrid in another way: it combines the strength of an emerging economy of the size of Germany and the burden of a developing country the size of Africa. The gap between East and West, North and South within China is not the only challenge China has to face: social inequalities have exploded even if the poor have seen their predicament seriously improved; environmental degradation is a serious issue as is the safety of energy and commodity supplies. Climbing up the technology ladder so as to break through the glass ceiling of the middle income country level, is the most serious long-term challenge for China's legitimate economic and strategic ambitions.

Finance as a Source of Discretionary Power

This double hybrid character justifies China preserving an effective policy margin both in order to strengthen its economic unity through inter-regional convergence and to keep the ultimate power monopoly of the CCP. Key to this policy space is the discretionary power secured by the hold over the currency management and over finance allocation, through capital account controls and the Yuan exchange rate policy.

China is today confronted with a set of complex trade-offs with regard to its financial and monetary strategy, which is conducted in a very sophisticated and pragmatic way. Yet nobody can guess if and when China will eventually opt for a substantially more market-driven system, which implies the suppression of capital controls, the full convertibility of the Yuan and a higher degree of opening up to foreign operators. This option is the prerequisite for China to engage in the reform of the IMS, starting off with the inclusion of the Yuan on a par with the dollar, the euro and the Yen in a revamped and rebalanced Special Drawing Rights (SDR).

China is first and foremost anxious to protect its economy from the vagaries of global finance which have led, through the collapse of Lehman Brothers on 9/15 2008, to a major sovereign debt and banking crisis in several countries. Particularly hit by the crisis is the USA and the Eurozone with huge consequences for the monetary policies of those countries, and their severe impact on the dollar and euro exchange rates in opposite directions.

Domestic Interests First, Multilateralism Second

China's ambitions focus on its domestic interests and concerns. They do not encompass the will to put its imprint on the world. In that sense, China, although imperial in a way, is not an imperialist power.

Its huge population, the difficult natural conditions prevailing in most of its large territory and the fast growth dynamics triggered-off by the CCP-led reforms, make China exceptionally difficult to govern. Incidentally the magnitude of the challenge calls for some humility from observers.

China's internal consensus is vital for the pursuit of the Chinese miracle. It rests upon three major principles: unity, independence and political stability.

Based on these tenets, the Chinese leadership's priorities are: first, fast growth and job creation which represent the main source of output legitimacy for the Communist Party. Yet, growth needs to be

qualified according to the core concepts of the 12th five-year plan: on the one hand, it should shift from managed mercantilism to domestic consumption and green investment, on the other, it should remain high enough to absorb rural migrants on the labour market, but also become more stable inflation-wise, more equitable and more sustainable.

Second, it is the CCP's power monopoly which allows and requires a certain scope of discretionary power, aimed at shaping up the economy and in particular the industrial structures, and at allowing for a strong networking through CCP members across industry, finance and government.

Thirdly, China as a global power has so far limited its ambitions to interact "in harmony" with third countries. This means first behaving vis-à-vis its neighbours in a manner which is not dissimilar, neither to the US one within its backyard with its hub and spokes trade policy and dollar-zone within the Western Hemisphere, nor to the EU with its web of association agreements and euro-pegging within its Southern and Eastern neighbourhood. Clearly China is providing the trade and currency anchorage for the whole region and is playing the responsible hegemon for ASEAN, Mongolia and perhaps someday for Central Asia. Second, China wants to deal on an equal footing with other global players such as the USA and Europe or rising States such as the other members of the BRICS. China is legitimately keen to ensure effective access to their markets as well to natural resources wherever they are located in Africa, Central Asia, Latin America or the Middle East. A Blue Navy might be presently in the making to ensure the safety of maritime routes. With regard to multilateral relations, China is not for the time being willing to accept more obligations than those contracted with its entry into the WTO⁶, be it for climate or for currency and financial matters. China makes huge strides in these areas, but at its own initiative and its own pace. It approves of multilateralism, but will engage more only when it is ready and when its bargaining position is strengthened by the relative decline of the two other global players. Both of these players are confronted with the severe consequences of Western capitalism's systemic crisis, which will sharpen the growth differential between China and the West.

The Systemic Crisis of Western capitalism

How does one recognise a systemic crisis? Three symptoms are revealing: first, Western market capitalism has presently lost its capacity to deliver growth which is both its *raison d'être* and its main source of social legitimacy. Second, orthodox policies for stimulating growth through global demand do not work anymore: neither the monetary policy caught in the liquidity trap, nor the fiscal policy as massive nor brutal deficit cuts have a deflationary impact on global demand while explicit competitive devaluations remain excluded by the dangerous prospect of a currency war. Thirdly, heterodox policies are being tried but they actually change the very features of the system: bailing out banks or helping the car industry because they are "too big to fail", substituting moral hazard for managers' and shareholders'

⁶ China is a pragmatic player in international economic matters. Interests prevail over principled stances. But is this only true for China? Where the rule exists, China applies it, but it is not keen to accept new commitments that would limit its margin for action. China has joined the WTO after protracted negotiations (1987-2001) which left it caught in vast and coercive obligations, in particularly subject to the lowest industrial tariffs imposed on a newcomer, and a drastic reshuffling of domestic law amounting to a legal revolution. Partly it was the price to pay for consolidating its rising status of trade power, partly it was the way the leadership tied itself to the mast for overcoming internal opposition from special interests. Since it joined it has achieved an impeccable record as a WTO Member, but it resists accepting further obligations – i.e. with regard to public procurements – as playing a leading role, commensurate with its weight, in the Doha Round, and certainly not more than the USA. With regard to other pillars of the international economic order, China is either reticent to switch from unilateral to multilateral options, e.g. for carbon emissions, or very cautious about substituting a new order for the existing loose one such as in monetary and financial affairs.

patrimonial responsibility; ECB buying long-term bonds from failing States and negotiating austerity programmes with governments bypassing EFSF procedures; quantitative easing on a massive scale and, in the case of the USA, committing to zero interest rates for 2 years (until 2013) fuel the risk of real estate and stock exchange bubbles in emerging economies, starting with China.

These stop-gap policies make sense: in emergency situations of the present magnitude, problem solving should prevail over ideological considerations. Yet it is important to realise that these policy choices change the very nature of our economic system, going back to a new role for the State not only as a regulator but as an industrial and financial actor with the inherent risk of competition distortion and protectionism. Moreover, while the crisis aggravates the West's relative decline, these heterodox policies might complicate governance convergence among Western countries and within the G20. In particular unilateral quantitative easing can be perceived as beggar-thy-neighbour tactics. Uncooperative policies from major players would set new hurdles to the task of reforming the IMS. But is China ready for an IMS aggiornamento?

China's Monetary and Financial Dynamics

One should always consider the dynamics at work in any aspect of China's development. A static view does not do justice to China's sheer complexity; this is particularly true with regard to monetary and financial matters which are key to the Chinese development model and to the power of the State as controlled by the CCP. The balance of power between merchants and the Emperor must ultimately tilt towards the polity in the Confucian conception, which in this respect fits in with a truly democratic vision of Western society which the excessive weight of finance has recently damaged.

China is walking on a narrow path of trade-offs between market liberalisation and State control.

Firstly, China wants growth to continue and exports still to play a driving role although less bearing: competitiveness through the control of the nominal exchange rate is therefore deemed crucial. It wants also to influence the allocation of finance to the SOEs and to the private sector, including sometimes foreign companies themselves: finance allocation is a critical tool of industrial policy, as corporate taxation is, with its myriad of tax loopholes, in Europe and in America. But the control of finance through personal connections within the triangle State-finance-firms is also a powerful tool of governance which strengthens the influence of the CCP and therefore consolidates its de facto monopoly power. Such control indeed allows for coherence between the macro-economic policy carried out by the central government, and the meso-and micro-economic decisions taken at the province and the firm level. Such interventionism carries a twin cost: on the one hand the loss of efficiency through competition distortion and on the other the risks of cronyism and corruption entailed by collusion among public and private operators. To the first objection one can answer back that externalities such as the regional impact of major investment decisions or its technological spill-over effects must be taken into account by the authorities. About the risk of corruption, very real indeed, it is fair to say that the system pays extreme attention to severe corruption which can be sanctioned by capital punishment, the harshest law in any country for this sort of crime. Contrary to perceptions in the West, Communist ethics are still very alive in China and the CCP implements from within very coercive rules and procedures for assessing the performances of its members endowed with economic responsibilities through board membership in banks or large companies.

Secondly, China realises very well that keeping inflation under check is key for the stability of the economy and for its external competitiveness. From this standpoint, an appreciation of the Renminbi (RMB) resulting either from market mechanisms or from political decisions would ease the control of imported inflation. Monetary policy would also be more independent and more effective, if the People's Bank of China was not under the constraint of sterilising foreign reserves still on the rise. This is all the more true since the internationalisation of the Yuan is under way through different legal and grey channels.

Thirdly, the RMB internationalisation remains experimental and tentative⁷, but the experiment is not a timid one and it is probably irreversible. It obviously paves the way for the full liberalisation of the capital account and thereby for the convertibility of the Yuan. The pilot programme explores several avenues: trade invoicing and settlement in RMB for selected mainland traders with their counterparts anywhere in the world; creation of a RMB sovereign bond market in Hong Kong; currency swaps with several neighbouring countries⁸; authorisation to offshore RMB funds to participate in the mainland interbank bond market.

As a result, the expansion of cross-border RMB saps capital controls by making possible arbitrage between onshore and offshore markets.

The internationalisation of the Yuan offers therefore a twin benefit to China but with adverse consequences as well: capturing a share of the seigniorage generated by the status of transaction and reserve currency, on the one hand; and the supply of an anchorage for the whole of East-Asia with Japan and Korea staying apart, on the other hand.

But such internationalisation, although gradual and experimental, calls for further financial market reforms as a prerequisite to the full liberalisation of the capital account and the full convertibility of the Yuan and its likely appreciation. The risk of a swing from under-valuation towards over-appreciation exists indeed, especially as the sovereign debt crisis rages in Europe whilst the FED, the ECB and the Bank of Japan (BoJ) are practicing either quantitative easing, or near-zero interest rates or both. The inflow of that money will then severely indent China's competitiveness and financial stability – the bubble risk already present - at a time when financial reforms will have to go on to make room for foreign operators and to accommodate new market pressures.

This is why China's future intentions remain uncertain. As Jianxiong He and Zhengxin Zhang put it in a comment in an IMF China report, 'a subtle difference was that the (IMF) staff preferred a clear reform sequence and road map, while our authorities believe that, although it is important to have a clear direction and an integrated and coordinated approach to reform design, predetermined timing, sequencing, and pace could complicate and even slow down implementation. Flexibility to unforeseen shocks is critical.'⁹

⁷ See: Yung Chul Pak & Chi-Young Song, "Renminbi Internationalization: Prospects and Implications for Economic Integration in East Asia", *Asian Economic Papers*, Vol. 10, No. (Fall, 2011), pp. 42-72.

⁸ Starting with the Chiang Mai bilateral swap arrangements of 2000 and culminating today in the ASEAN+3 Chiang Mai Initiative (CMI) launched on 24 March 2010 and setting up a forex pool of \$120 billion.

⁹ Jianxiong He, Executive Director for People's Republic of China and Zhengxin Zhang, Senior Advisor to the Executive Director, July 15, 2011 IMF country report n°11/192.

Meanwhile progress is made towards more liberalisation coupled with better regulation and supervision. The IMF last country report on China lists its recent achievements in the financial sector reforms with regard to bank commercialisation (risk management, bad loans and bank recapitalisation), regulatory and supervisory infrastructure with regard to insurance and financial clusters such as Shanghai. There is a consensus that with bad loans (15% of GDP in 1999) lodged in bad banks, the financial sector of China is now rather healthy and, along with capital controls, has kept China's financial markets out of the instability caused by the Western financial crisis. Uncertainty about local government debt and small banks remains an issue of concern.

China's Options: Between a Multicurrency and a Multilateral IMS

Despite its focus on its domestic agenda, China, in the words of François Godement¹⁰, is obsessed with strategic culture, the balance of power and geopolitical shifts. But China is in no hurry. Its bold long-term vision is indeed restrained by its innate pragmatism. It will therefore wait for the right circumstances for engaging in the rebuilding of a world monetary system based on a revamped SDR, made up of a basket of representative currencies. Meanwhile, China will not take on new multilateral commitments beyond those it has to the WTO. China joined the WTO under the US' and EU's conditions. But the new IMS will be set up in due time on China's terms. For China retains an ancient mistrust of the West and will decide upon the design of the system only after balancing the advantages and costs. In particular China will resist changing the RMB regime as long as there persists the threat of dollar depreciation, which is seen by Beijing both as an asset spoliation and an attack on Chinese competitiveness.

There is though an inherent limit to the gradualist method of shifting from an administrative to a market system chosen by China: once you are too advanced on the route towards the new regime, the costs of retaining controls start outweighing the benefits because controls lose their watertight nature while you do not enjoy yet the full benefits of market mechanisms. Such grey systems become less efficient, more vulnerable to inflation and more exposed to competition distortion and corruption.

Surreptitiously the inner strength of RMB internationalisation dynamics prevails over internal policy objectives and the system loses its effectiveness by lack of coherence. Yet when the external conditions are unstable as they are presently, a half-baked regime retains the advantage of somehow insulating the domestic market from the shocks from the global market.

Yet China will not be able to wait indefinitely until the conditions are right especially if the recession continues in the West. The current de facto multi-currency monetary system can move in two contrasting directions: either it will shape up an integrated multilateral system eventually based on a new SDR, with a collegial direction led by the three major players – US, EU, China – as the core of a G20 plus; or it will shift towards the setting up of continental trading and monetary blocs with the risk of their drifting apart because the multilateral governance framework would be too weak. Regionalism and multilateralism are not necessarily at odds, but one model will eventually supersede the other, and the final outcome will be a matter of political will. A multipolar world needs a strong multilateral base so as to make it economically more fair and effective and geopolitically more stable. China's option will be decisive. The world is waiting for China.

¹⁰ François Godement, "Redbacks for Greenbacks: The Internationalisation of the Renminbi", *Asian Centre/ECFR*, (November 2010).

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