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Currency Asymmetry, Global Imbalances, and Rethinking of the International Currency System

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The US dollar has been volatile and in repeated decline in recent decades as well as recent years, and many observers expect it to collapse sooner or later. The central importance of the dollar is due to the fact that, in addition to being the US currency, over half of all dollar bills in circulation are held outside of US borders, and almost half of the US Treasury bonds are held as reserves by foreign central banks. The US dollar is supposed to be the anchor that stabilises the global currency market, but today it is a major source of instability.

What is the background for this instability? The US fiscal deficits have been running high again under the Bush administration, up to almost 3 percent of GDP. The current account deficit was about 7 percent of GDP in 2005, and more volatility is widely expected. The situation is challenging for the central banks of Japan, China, Korea, Taiwan and Singapore, which collectively hold for about \$1.14 trillion in US Treasury bonds as part of their reserves. The moment that they reduce their purchases, the value of the dollar slips. Yet, the more they buy, the more they are exposed to a potential free fall of the US dollar.

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understandably not very familiar with either the complicated currency issues or the domestic politics in any other country, but also by many economists and business strategists. They have said that the current “global imbalance” and currency instability came about because the Chinese did not revalue the renminbi (RMB).¹

How much revaluation of the RMB would remove the US deficits of \$700 billion, or at least the US-China trade deficit of \$200 billion (including Hong Kong)? 500 percent or 1000 percent? Of course, no one would ask for a revaluation of that magnitude now. Normally, smart people say 30-50 percent, with the unsaid intention to blame-then-suggest again another 30-50 percent after some initial moves, then the third, and the fourth...

This does not seem to be a new phenomenon at all. It has been all too familiar before and since the “Nixon shock” in the early 1970s, and in the 1980s with the “Plaza Accord”. The convenient targets to blame were the “gold standard”, the Deutsche Mark, and the Japanese yen. Now it is turn for the Chinese renminbi (RMB). So the question is, what are the real causes of the global imbalance and currency instability?

In this chapter, we first look at what is really going on with the Chinese economy and the trade balance. We try to identify the sources of the current imbalance, and then, as a concluding remark, think again about the possibilities of reforming the global currency system.

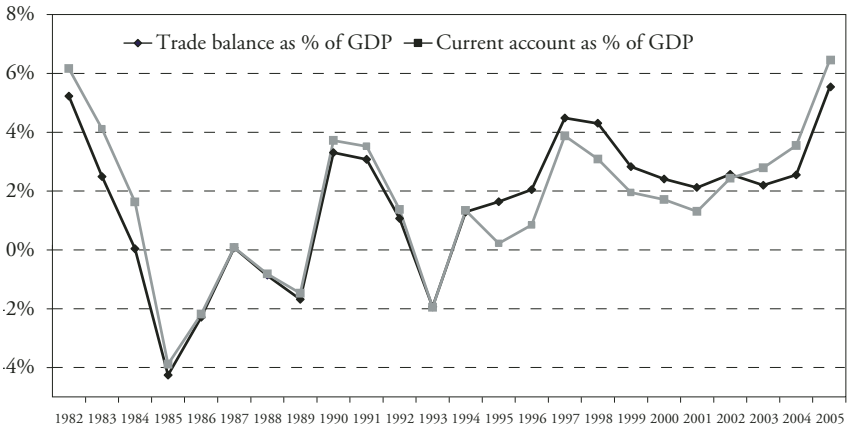
1 China’s Trade Has Been Mostly Balanced in the Past 28 Years!

In 2005, China registered a record high trade surplus of \$101 billion and a current account surplus of \$146 billion, or about 5 percent of GDP.² Even though it could result in placing China in a position to

¹ *Newsweek*, C. Fred Bergsten, “Clash of the Titans”, April 24, 2006.

² The trade surplus increased by almost 300% in one year, compared to the \$30 billion trade surplus in 2004. This extraordinary rise could also be misleading – it could include some speculative capital movements under the trade pricing mechanism, as exported goods may be priced higher and imported goods may be priced lower when capital control is in place but people want to speculate on the revaluation of RMB. See a recent report in *Business Week* by Stephen Green “China’s Trade Surplus May Be an Illusion”. The article claimed that “Our numbers show that China’s trade surplus could have been as small as \$35 billion in 2005. Trade could have disguised some \$67 billion of non-trade capital inflows. We made a long list of assumptions to get to this number, and we are not claiming that it is absolutely accurate. But it does give a hint as to the potential scale of these

Figure 1 China's Trade Balance* and Current Account Balance
(in percent of GDP)



Note:

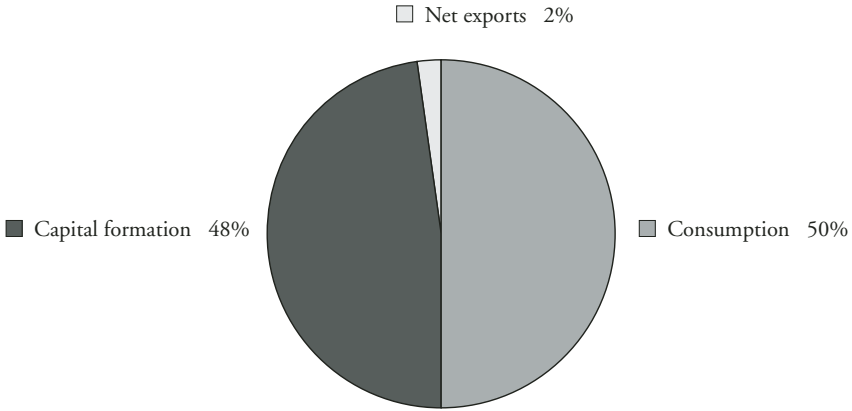
* "Trade balance" = commodity trade + service trade.

Source: China State Administration of Foreign Currency, 1999-2006.

receive more blame, we should look into the situation in more detail. On many counts, 2005 was a special year for China since it was facing a slowdown in aggregate demand after the overheating in the previous 2 years. This is evident from the fact that the growth rate of imports was 17.4 percent in 2005, sharply down from almost 36 percent in 2004 and 39 percent in 2003, while the growth of exports also slowed down to 28 percent from previous years of 35 percent.

foreign currency inflows." I could question the scale of the problem, but even if the number would be cut by half, it would be a serious problem. In the first half of 2006, this "factor of disguised capital inflow" became a "must" in explaining the statistics, otherwise we would be not able to put things together: during these 6 months, the investment growth accelerated to 31%, consumption growth also accelerated to 13.6% in real terms; meanwhile, on the other side of the national income account identity, the current account surplus accelerated to almost 7% of GDP (annualised) from previous year's 6.7%. Only capital inflow through trade channels (by overinvoicing exports, underinvoicing imports, or making the advanced financial transaction for imports, etc.) can make the accounting equation to hold. This may also explain why the figures of the current account and capital account switched suddenly in such a dramatic way as contributors to the growth of foreign exchange reserves (see Figure 4).

Figure 2 China's Composition of GDP, 2004
(in percent of GDP)



Source: China's Statistic Yearbook, State Bureau of Statistics, 2005.

Except for 2005 (and maybe 2006, if our expectation is correct that China will be in a slowdown phase for a while after the overheating), in most of the past 27 years, China's trade was more or less balanced, with small surpluses in some years and small deficits in others. Take 2004 as an example. In this year, since it had already been under fierce pressures for a revaluation, China only registered a surplus of about \$30 billion, or about 2 percent of GDP (see Figure 2). The previous record high trade surplus of \$43 billion occurred in 1998 when China was in a slowdown and deflation period, and everybody in the world was guessing when China would devalue while the US government was pressing China not to do so.

2 China's Trade Imbalance With the US and the New Supply Chain in Asia

Why did China get its trade balanced? Because China not only exported, but it also imported, and it imported a lot! In most years, China's imports grew by double digits, and during 2003-2004, China's imports grew by almost 40 percent per year!

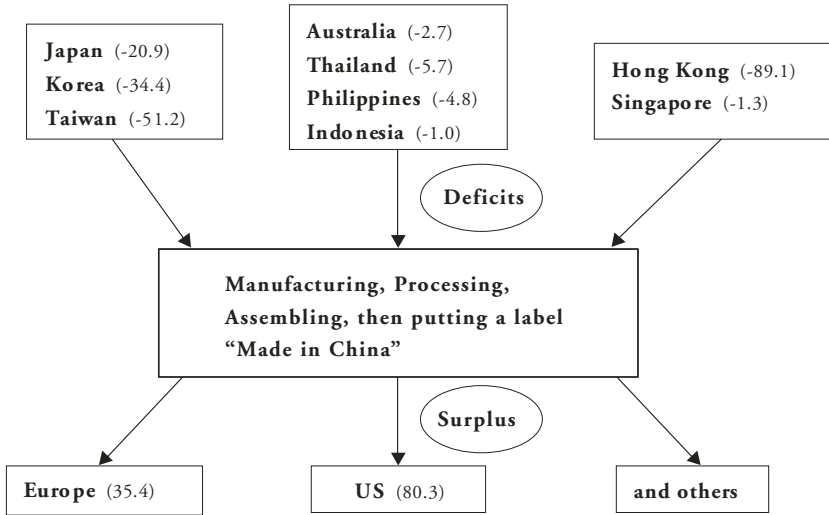
Table 1 Trade Balance between China and its Neighbouring Economies
(in billions of dollars)

	1999	2000	2001	2002	2003	2004	2005
Taiwan, China	-15.6	-20.5	-22.3	-31.5	-40.4	-51.2	-58.1
Korea	-9.4	-11.9	-10.9	-13.0	-23.0	-34.4	-41.7
Japan	-1.4	0.1	2.2	-5.0	-14.7	-20.9	-16.5
Malaysia	-1.9	-2.9	-3.0	-4.3	-7.9	-10.1	-9.5
Thailand	-1.4	-2.1	-2.4	-2.6	-5.0	-5.7	-6.2
Russia	-2.7	-3.5	-5.3	-4.9	-3.7	-3.0	-2.7
Philippine	0.5	-0.2	-0.3	-1.2	-3.2	-4.8	-8.2
Singapore	0.4	0.7	0.7	-0.1	-1.6	-1.3	0.1
Indonesia	-1.3	-1.3	-1.1	-1.1	-1.3	-1.0	-0.1
India	0.3	0.2	0.2	0.4	-0.9	-1.8	-0.8
Brunei	0.0	-0.1	-0.1	-0.2	-0.3	-0.2	-0.2
Mongolia	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2
Lao	0.0	0.0	0.1	0.0	0.1	0.1	0.1
Myanmar	0.3	0.4	0.4	0.6	0.7	0.7	0.7
Pakistan	0.2	0.2	0.2	0.7	1.3	1.9	2.6
Bangladesh	0.7	0.9	0.9	1.0	1.3	1.8	2.3
Vietnam	0.6	0.6	0.8	1.0	1.7	1.8	3.1
Hong Kong, China	30.0	35.1	37.1	47.7	65.2	89.1	112.3
Total	-0.7	-4.5	-2.9	-12.5	-31.8	-39.2	-23.0
of which:							
total deficits	-33.8	-42.7	-45.4	-58.9	-102.1	-134.6	-144.2
total surplus	33.0	38.2	42.5	46.4	70.3	95.4	121.2
World	292.3	241.1	225.5	304.3	254.7	31.9	101.9

Source: United Nations, WTO, PC-TAS; The Ministry of Commerce of PRC.

Figure 3 Triangle Trade Relations-China’s Bilateral Balance in 2004

(in billions of dollars)



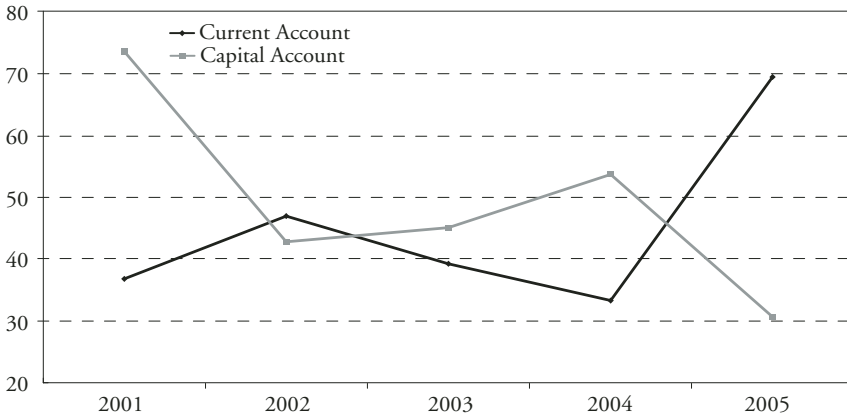
Source: China’s State Administration of Foreign Currency and Ministry of Commerce, 2006.

But why did China still run large trade surpluses with the US, if China imported a lot? The only problem here is that China imported a lot, but not from the US. China imported from the rest of the world – by large margins, particularly from Asian economies.

Table 1 shows how China ran trade deficits with almost all Asian economies except Hong Kong, which has been a major trade outlet of the Mainland. What happened in Asia was a newly emerged production and supply chain with China as a centre of assembling and manufacturing. Figure 3 shows how it actually worked, and how many things with a label “Made in China” are actually “Made in Asia”. This is also reflected in the fact that more than 50 percent of China’s exports are from “reprocess manufacture sectors” of which the value-added in China only counts for 10-20 percent of the total price.

What Figure 3 does not show is another relationship – over 50 percent of China’s exports are produced in China by foreign companies, including US companies. This fact is also relevant to the currency issues we are discussing because one of the factors that determines the currency balance is the labour cost, which is one of the major considerations for foreign investors or outsourcing companies.

Figure 4 Structure of Foreign Exchange Reserve Increase
(Growth in percent)



Source: China State Administration of Foreign Currency, 1999-2006.

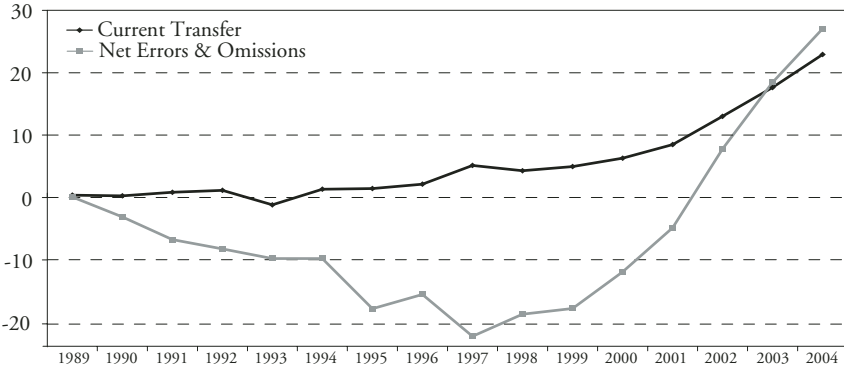
3 Where Did China's Large Foreign Exchange Reserves Come From?

One of the striking phenomena in middle of the global imbalance problem is the surge of foreign exchange reserves in China. It increased by more than \$200 billion per year for the years of 2003, 2004, and 2005.

Take 2004 as an example. In this year alone, China's foreign exchange reserves increased by \$210 billion. This of course included the current account surplus of \$68.9 billion. But the rest (i.e. capital account plus the item called "errors & omissions" which is also part of capital flows), as much as \$137.7 billion, were from capital inflows! The capital which had been accumulated in other countries, including \$50 billion FDI (suppose it all came in cash and bought goods in the Chinese domestic market), and \$20 billion in the increases of foreign debt and foreign security investment, and other inflows came into the economy through various channels motivated by the speculation on RMB revaluation.

For example, the "errors & omissions" item in China's capital account went from negative (outflow) to positive (inflow) in 2001 as the "market sentiment" went from RMB devaluation to revaluation, and has increased steadily ever since. Also, we can see that the item "current transfer" in the current account, which includes the remittances between family members or movements between personal bank accounts, increased more rapidly after 2001.

Figure 5 Current Transfer and Errors & Omissions, China
(in billions of dollars)



Source: China State Administration of Foreign Currency, 1999-2006.

This situation changed a bit in 2005 because almost 50 percent of the increase in foreign exchange reserves can be explained by current account surplus. Capital inflows reduced to \$100 billion, due to calmed expectation-speculation on RMB revaluation, particularly after China's foreign exchange regime was changed back to "managed floating".

The fundamental issue here is that the foreign exchange reserves in one country may not be all its own national savings, but may be the capital inflows from other countries driven by some market forces including speculation.

4 National Savings and Global Imbalance

The so-called global imbalance is often interpreted as the result of Chinese oversaving and American overspending. There might be overspending in the United States, but it does not necessarily follow that there is Chinese oversaving in the sense of international balance of payments.

The Chinese do save a lot, often up to 40 percent of GDP. But as a nation, it spends a lot too – it may not spend much on consumption (only less than 60 percent of GDP in recent years), but it invests up to or even more than 40 percent of its GDP in industrial capacities, housing, and public infrastructures.

Therefore, as a nation, China buys a lot in the international market, of course not in the way of consumer goods, but a lot of investment

goods. As a result, China has pushed up resource or commodity prices on the international market in recent years.

This means that China's high saving rate may have little to do with the global imbalance – it saves, but it spends the savings in domestic investments! Sometimes China overspends too – during 2003-2004, it over-invested and therefore the economy was overheated. Moreover, China registered trade deficits for almost 11 months during this period of time!

What is really relevant to the global imbalance problem is not the total savings of the nation, but what we may call the “net savings” reflected in the current account surplus (if any).

It is also important to remember (from the previous section) that the net national savings is not equal to the total increase of foreign exchange reserves – increase in reserves includes the capital inflows which may be the result of foreign savings (or the wealth which was saved before). Only those parts contributed by the current account surplus are national net savings related to the international imbalance.

From this point of view, China did not have much net national savings in recent years, normally only less than \$30-40 billion per year. But then, the large scale of global imbalances measured by the US trade deficits of up to \$600-700 billion per year should be explained by the sum of current account surpluses of economies everywhere, some of them (including almost all economies in Asia) also run a surplus against China!

From this perspective, we can see the following:

1. If the US wants to blame someone for its trade deficits, it should blame everyone who has some surplus, and therefore “contributes” to the matter directly (as having a surplus against the US) or indirectly (through countries which have a surplus with the US);
2. If the US wants someone to revalue its currency in order to help to reduce US deficits, it should ask everyone who has a surplus.

However, here comes the problem: if you want everyone to revalue its currency, it actually just shows that the real problem is not in others' currencies, but in yours! *The real question we should ask is not why China's RMB has not revaluated, but why the US dollar has always had the tendency of devaluation against everyone else since the 1960s.* First we had the devaluation against the gold standard or against all other currencies in the 1970s (the Nixon Shock), then the devaluation against the Deutsche Mark and Japanese yen in the 1980s, and now the Chinese RMB.

5 The “Currency Asymmetry” and the Persistent Tendency of US Dollar Devaluation

Many have said again and again in the past 40 years that under the present “US dollar standard” global currency system, global financial stability depends on the “good behaviour” of the United States or the good monetary policy of the Fed.³ However, analyses show that the fundamental problem is not in US policies, but in the global currency system itself which makes the US follow a certain behaviour pattern. It is a very “old” issue, dating from the 1960s, but we may still need to pay some attention to it or we may fail to identify the real source of the imbalance.

The breakdown of the Bretton Woods system and the de-linking of the US dollar from the gold standard in 1971 created a global currency system without a “neutral standard” (such as gold) other than a national currency (i.e. the US dollar).⁴ From then on, the world had got a major “asymmetry”, as it divided all nations into two categories: the nation which issues its own currency that serves at the same time as international currency (the US), and the nations which only issue their own currency and use the US dollar in international financial markets.

On one hand, this arrangement of “currency asymmetry” has its positive effects. The US is the largest and strongest economy with the most efficient financial markets in the world. The world financial system needs someone strong enough to play the role of anchor against the torrents. Unstable economies, such as developing countries, would like to hold some commonly trusted assets to increase their credibility in the international financial market. In some sense, Japan and China, which are the two largest foreign exchange reserves holders, do not finance the US debts, they are paying, to a certain extent, the seigniorage of the US by using the US dollar as their security against their own weakness in the economic and financial system, either in the form of asset bubbles (Japan), or non-performing loans in the domestic banking sectors (Japan and China), or massive underemployment of the rural

³ As pointed out most recently by Clyde Prestowitz: “When President Nixon announced the end of the dollar’s link to gold and created today’s dollar standard, he effectively made the global financial system dependent on America’s good behaviour.” (Prestowitz, 2005, p. 169).

⁴ The world has never faced such a situation before. Even when the British sterling was the *de facto* global currency, it was pegged to gold.

labour force in the process of economic transformation (China). And it is seen as convenient to have a national currency (the dollar) serve these purposes since it may be cheaper than if the international public goods such as an international currency would be provided by an expensive international bureaucracy, presuming that the US would be a good anchor.

On the other hand, such a currency asymmetry can have negative consequences. A government of any country has the right to print more money to stimulate domestic demand when growth is weak. But it has to bear its negative consequences such as inflation and financial instability within the country. Financial crises occurred because irresponsible domestic policies led to high fiscal deficits and current account deficits (or “twin deficits”). However, the country that prints international money may face fewer penalties – along with the about 50 percent of total printed papers and 50 percent of US dollar denominated financial assets used or held by all other economies,⁵ the financial risks spread over or externalised to other corners of the world. As a result, it seems that no matter how large the US fiscal deficits are, no matter how loose the monetary policies become and how much the excessive liquidity provided are, the US is not likely to run into financial crisis like anyone else in the world would. This may delude, if not “corrupt”, people and policymakers in the “anchor country”, as they may not see it as “their problem” that they run high deficits and print more money when the bad consequences become the “others’ problem”. Therefore, such a system would naturally result in the persistent fiscal deficits and/or overprovision of liquidity that we have seen in the US since the 1960s. From this perspective, the US twin deficits problem is not even a policy issue; it is an institutional issue – not of the US domestic institutions, but of the international financial institutional arrangement! In some sense, the US is subject to a kind of “soft-budget constraint”, and this external condition “softens” the domestic policy disciplines and results in excessive liquidity to both the domestic market and the world.

Meanwhile, whether they are aware or not, other countries may face greater financial risks. The huge stock of (over-supplied) financial assets denominated in US dollars moves around knocking down the doors of developing countries that still have fragile domestic systems and are incapable of handling the risks that the liberalised financial market and

⁵ See United States Department of the Treasury (2003).

Table 2 Asymmetry in Asset Value Changes by Devaluation

	US	Any other country
Foreign Assets	Up	Up
Domestic Assets	Unchanged	Down

free capital flows may bring them. But many countries were seduced into welcoming more capital flows because those loans or portfolio investments were so attractive to the capital scarce economies and they simply looked so cheap! When the trade deficits were financed by the provision of more cheap dollars (the present magnitude of capital flows is related to the previous money printing), the other economies may become overheated and have to face the consequences of overcapacity of production and oversupply sooner or later. The so-called global imbalance today seems much more dangerous for other countries rather than the US.

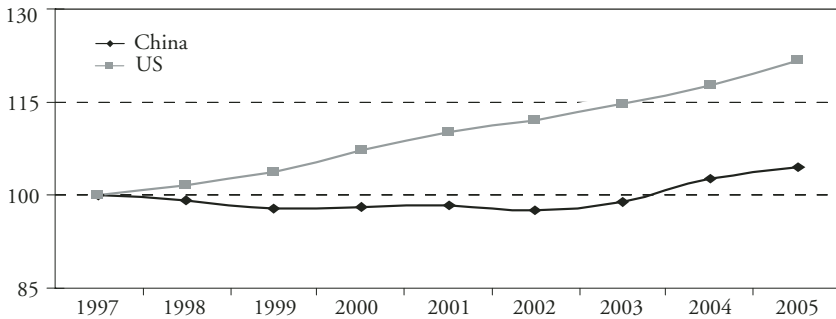
The “currency asymmetry” is reflected most clearly in the following fact: In the world of everybody else using the dollar as denominating currency, when the dollar devalues, US foreign assets appreciate, but US domestic assets do not depreciate, while for everyone else, if you devalue your currency, your own assets all depreciate! That is, while everyone else may lose by devaluation, the US only gains from it! No wonder devaluation for the US is such an attempting thing to do.

The problems created by the “US dollar standard” currency system had been debated and discussed repeatedly by many people for a long time. We are repeating it here simply because history is repeating itself in today’s new circumstance between the US and China, similar to what happened between the US and Europe in the 1960s and the US and Japan in the 1970s and 1980s. The repeated similarities in the history just show it is not the problem of policies, but the problem of institutional arrangements!

6 Effective and Real Exchange Rates: What Is Developing Countries’ Responsibility for Global Imbalance?

As economists can tell, two factors play a role in determining changes of real effective exchange rates and therefore the trends of exchange rates:

Figure 6 Inflation: China and US Differential
(CPI, 1997=100)



Source: China Statistic Yearbooks, various years.

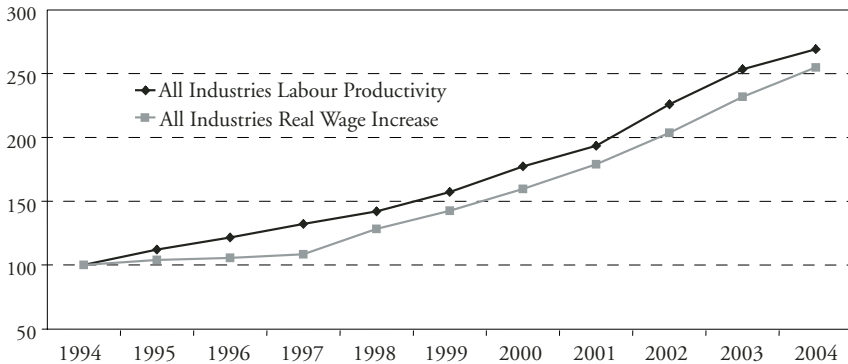
1. The differences of inflation rates between two countries. If country A's inflation is higher than B's, A's currency has to depreciate or be overvalued otherwise;
2. The differences of wage changes related to the labour productivity changes in the two countries respectively. Productivity changes may vary country to country during different periods of time, but as long as their wages can be adjusted fully to the extent the productivity changes, the real exchange rate will remain unchanged. Otherwise, the country whose wage increase is less than productivity change should appreciate its currency; if not, its currency is undervalued.

In the previous section, we were actually dealing with the factor that may cause the changes of effective exchange rates, i.e. the factor of inflation. The current currency arrangement, which makes the US run high fiscal deficits and provides excessive liquidity to the world, results in higher inflation rates in the US than in some other countries such as China in past years. As a result, the US dollar tends to devalue against the RMB.

The main conclusions we can draw from the above arguments are that:

- If we only look at the financial factors, the current problem is not RMB revaluation, but dollar devaluation! This is the major cause of the current imbalance.
- This means that RMB revaluation will not solve the problem of US deficits, not only because China's surplus is not equivalent to the US deficit – as we have seen in previous sections – but also because the real root of the problem does not lie in China. US inflation continues due to the loose monetary policies of the US!

Figure 7 China's Real Wage and Labour Productivity Changes
(1994 = 100)



Source: China's Statistic Yearbooks, various years.

- The only thing China could do in this regard would be to race against the US in creating inflation or printing money. But those are things China may not want to do because China does not print international money so it has to bear all the negative consequences of inflation within its own boundaries.

However, if we also take the productivity/real wage factor into consideration and think of the real exchange changes, the picture becomes more complicated and China seems less innocent with regard to the current problem. The issue is that, while in the US the wages increase basically up to the level of productivity changes (about 3 percent per year), China's wages seem to be more sticky. In recent years since the early 90s, China's labour productivity improved at an annual average rate of 10.41 percent (see Figure 7; also see McKinnon, 2005⁶) thanks to the reforms and technology progresses. But the wages increased slower than that – they increased at an annual average rate of 9.81 percent in the manufacturing sectors. This is indeed a factor that may make the RMB undervalued, although only by less than 1 percentage point annually.

⁶ In this paper, the author writes: "China's money wages had to grow in line with its rapid productivity growth. From 1994 through 2004, money wages in manufacturing increased 11.7 percent in China per year and by just 3.0 percent in the United States – see Figure 5. This wage growth differential approximately reflected the differential growth of labour productivity: about 9.5 to 12 percent in China versus 2.7 percent in the United States over the decade." (p. 7).

But why are the wages in China more sticky than in the US? Is this because of Chinese government's control? No, the Chinese government seems concerned about the slow increase of blue-collar wages as the income disparities widen and social stability is threatened. The real reason behind the wage stickiness in China is the market force in the labour market. Although about 200 million rural labourers have been reallocated from the agriculture to the industry and service sectors earning about \$1000 per year, there are another 200 million or more still in the countryside earning about \$400 per year and eager to move out looking for better paid jobs! It is the job competition and the still infinite labour supply that keep the Chinese wages changing more slowly compared to the labour productivity gains (this also explains the higher capital gains for foreign investment and domestic savings, and explains the enlarging income disparities during this stage of industrialisation and development, just like most countries experienced in history).

So now we are blaming rural poor Chinese labourers for the global imbalance!

This sounds ridiculous, but this actually reveals that there is another global issue, i.e. the need for poverty reduction and economic development in poor countries. We know that these issues are somehow related to the currency problem, but in fact, they are even more important.

Of course, the analysis in this chapter shows that China has some responsibility for the imbalance and it calls for a revaluation of the RMB. But it also shows that a reasonable revaluation of the RMB should not be more than the difference between the changes in wages and the increase of Chinese productivity. In a normal year, it may be less than 1 percent – not big enough to solve the US deficit problem! The main part of the cause of global imbalance lies still in the currency asymmetry, which is out of China's control.

7 Concluding Remarks

A number of conclusions can be drawn from the discussions above:

Conclusion 1: China's role in the "global imbalance" is limited

Within the current global monetary system, characterised by a "currency asymmetry" that keeps the US providing excessive liquidity to the world, the global imbalance will persist and the global market will continue to

face high volatility. China cannot be said to be the cause of this “global imbalance.”

China may well have contributed to the “global imbalance” through its slower rising wages compared with productivity growth, via the real effective exchange rate mechanism. The renminbi, in this context, could be undervalued at about 1 percent per year. China has certainly to face up to its responsibility to addressing the “global imbalance”, but it must do so with due consideration to the task of poverty reduction and raising the living standards of its rural poor.

From this point of view, the “managed floating” is a right exchange rate regime for a country like China. In today’s global monetary system of “currency asymmetry”, a fully floating exchange regime for many developing countries means that they would bear the major consequences of the liquidity glut created in the US, or “unilaterally” bear the burden of adjustment for reducing the global imbalance if the US refuses to do anything. Not exactly a sound recipe for global stability, and not fair.

Conclusion 2: It is time to think again about alternatives to the “currency asymmetry”

From a policy point of view, the policy implication of the “currency asymmetry” is simple: if this asymmetry is not removed, the situation could continue to worsen. The US dollar is no longer a stable anchor in the global financial system, nor is it likely to become one: thus, it is time to look for alternatives.

Ideally, there should be an international currency standard which is truly independent of self-interests of participating countries, and provides common benefits to all. It should not be a currency of any particular country no matter how strong or dominant that country is in the world market.

Here the “gold standard” readily comes back to mind again. Gold, a gift of Mother Nature, is not something that a government can print at will. A gold standard is totally impartial as well as unsparing when it comes to punishing those who are fiscally irresponsible and the profligate. And at least, with a gold standard, the global imbalance caused mainly by US dollar’s tendency to depreciate would not be interpreted or misunderstood as another currency’s failure to appreciate. But the critics of the gold standard have repeatedly pointed out, and correctly, that it is a rigid system, which leaves no room for any policy

action, however prudent and sensible it may be.

A second alternative that has often been suggested is some form of “international currency”, governed by a truly disinterested internal body tasked with the job of maintaining global financial stability.⁷ This could be started with using IMF special drawing rights (SDRs) as the reserve currency unit. One of the recent efforts to think about alternatives is the “World Currency Unit” (WCU), which would be based on the inflation-adjusted real GDP of major economies (see Lok Sang HO, 2006). It is suggested that governments and private firms may issue bonds denominated with this WCU against the market risks and hold these bonds as part of their reserve assets, as the first step towards a true global currency.

The gold standard and an international currency represent two ends of the spectrum. Both ends are extreme: the gold standard is extremely rigid, whereas a genuine international currency may prove to be unrealistically utopian. A practical answer may lie somewhere in between. That is precisely the challenge – the devil is in the details.

This highlights the core problem of our age: the utter lack of accountable global governance and the sufficient provision of global public goods in a rapidly globalising world.

As stop gap measures, there are some regional efforts in order to deal with the problem.

For example, partially encouraged by the success of euro, Asians are trying to take some collective actions. In early May 2006, the Asian Development Bank held its annual general meeting in the Indian city of Hyderabad. At the meeting, the finance ministers of China, Japan, and South Korea met with their counterparts from ASEAN and announced that they would sponsor a research project entitled “Towards greater financial stability in the Asian region: Exploring steps to create regional monetary units”. This is no ivory tower academic exercise. Both China and Japan are very serious about it.

An Asian currency unit (ACU) would be an index that seeks to capture the value of a hypothetical Asian currency by taking a weighted average of several of the key regional currencies. The weight for a particular currency in the index could be determined by the size of the economy and the volume of its total trade. The reason why progress is

⁷ Actually, M. Keynes was thinking some kind of international currency named “bancor” when he was preparing for the Bretton Woods conference in 1944 (see M. Rothbard, 1995, pp. 271-73).

likely to be quite fast in this development is an unusual consensus between China and Japan. While Japan has championed this idea ever since the 1997-98 crisis, China had been reluctant to be involved in a scheme that could potentially be dominated by the Japanese yen. In the more recent past, the weight of China's GDP and total trade volume has made itself felt. And there is now no fear of potential dominance by the Japanese yen. While the research will be done in Japan, the final determination of the composition of the ACU will be led by ASEAN, which has come increasingly under China's influence in recent years.

What is intriguing is that the ACU is not meant to be a real currency to replace the regional currencies, as is the case of the euro. It is meant to be a guide for the Asian countries to coordinate and manage their exchange rates. In other words, the ACU could become a new benchmark independent of the US dollar. Thus, the potential is for the ACU to become a viable "currency" for Asian countries to denominate their export prices, cross-border loans, and cross-border bond issuance; thus weaning themselves away from their current total reliance on the US dollar.

The question remains if it is an answer to replacing the "currency asymmetry" and thereby reducing the "global imbalance". An Asian currency unit may well reflect the monetary relationships among the Asian economies, but it could lead to a "collective revaluation" against the US dollar under the pressures of market speculations and bear all of the burdens of "currency asymmetry" by themselves collectively and unilaterally, leaving the US doing nothing. Remember here, without the US doing something against its own short-term interests in the present global monetary system, nothing else can really solve our problem of global imbalance for the long run. The real solution must be global and multilateral, not regional and unilateral.

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