G20 Economic Seminar in Nanjing:
China's Role in Reforming the International Monetary System

Carlos Casanova and Laure Pallez reporting from Nanjing

Will this week's G20 monetary seminar in Nanjing constitute a significant milestone on the road of international monetary cooperation? What are China's interests in reforming the International Monetary System? These are all serious issues that require the world's attention and action. The G20 pushes a more active role of China and global Special Drawing Rights (SDRs), an international reserve asset created by the International Monetary Fund (IMF) to serve as an alternative to the US Dollar, the de facto global reserve currency. According to Nanjing University Business School Professor Han Jian, the main reason for countries like China, Russia and India to participate in this type of seminar is chiefly the future of their predominantly dollar-denominated foreign reserves.[1]

What is the G20?

- The G20 is a group of 19 nations plus the European Union representing around 90 per cent of global gross national product, 80 per cent of world trade and two-thirds of the world's population.
- It was originally established in 1999 in response to financial crises in Asia, Argentina, Russia, and other places. The idea was to bring together finance ministers and central bank governors to encourage greater economic coordination.
- With the global recovery under way after 2000, the need for the G-20 was less pressing. Crisis-stricken economies returned to a steep growth path and restructured their economies so as to create a current account surplus and build large foreign currency reserves. During the first decade of this century the G20 made progress on increasing transparency on financial markets and the group fell into disuse.
- It was only in 2008 that the G20 members were called upon to further

2008: Reinvigorated mission

Since the end of 2008, the G20 has met on a regular basis. The city of Nanjing in Jiangsu Province of the People's Republic of China will host a special G20 high-level seminar on the International Monetary System on March 31st. The choice of China as a host country is noteworthy given that the 2011 G20 chair is France. This decision reflects a very significant aspect of the discussions to be held in Nanjing next week: the internationalization of the Chinese renminbi and its integration into the basket of currencies that constitute SDRs. The event is organized by France as Chair of the G20, in close cooperation with the Chinese authorities, and President Sarkozy himself will be present as one of the only heads of state in attendance.

[1] According to estimates from Roubini Global Economics, dollar-denominated reserves account for 65% of China's total reserves while euro-denominated reserves account for 30%

During the 2010 Seoul Summit, the G20 committed to working towards a more stable and resilient International Monetary System (IMS). The G20 planned to take action in reinforcing macroeconomic coordination, reducing the need for reserves accumulation, and in encouraging stable capital flows. The 2011 Nanjing seminar will be a great opportunity for the G20 to ensure an active follow-up on processes already underway and to see that China takes action on issues like accelerated capital flows and macroeconomic imbalances.[2]

China's interests in reforming the IMS

While according to Chinese official sources China's currency exchange rate is not officially on the agenda of the Nanjing seminar, China's position will likely be crucial in resolving issues on the table. In addition, the French presidency will start discussions on the role of Special Drawing Rights (SDRs), with the positions of China and the United States once more likely to be key in determining SDR's future.

According to Nanjing University Business School Professor Han Jian, the Chinese government's main concern is the future of their predominantly dollar-denominated foreign reserves: after the global financial crisis and two rounds of quantitative easing in the United States, China has seen its assets devalue as the dollar depreciates in the global foreign exchange markets.

China's dollar-trap

The problem is thus purely that of a "dollar trap", similar to that experienced by France with the "sterling trap" in the 1920s. To place this in the Chinese context, China has been pursuing a mercantilist strategy heavily based on export-led growth, meaning large trade surpluses and significant inflows of foreign capital. Furthermore, China chose to keep the value of the Chinese yuan fixed in terms of the dollar, thus creating a managed exchange rate. Since the early 2000s, these trade surpluses have continued to grow, as have China's mass of foreign, mainly dollar-denominated reserves. This in turn has helped fund America's substantial trade deficit.

SDRs could provide a viable solution to this trap. They offer the sort of stability experienced under the gold standard with none of the disruptions associated with the extraction of gold. According to Chinese economists like Han Jian, a likely outcome of the dialogue taking place in Nanjing could be the possibility to include the Chinese yuan in the basket of currencies that determine SDRs. In order for this to happen, however, China would need to agree to lift capital restrictions and open its financial system to global competition. This internationalization of the yuan would entail the floating of the domestic currency and would shift China's stance to the untenable situation of having concurrently free capital flows, a sovereign monetary policy, and a fixed exchange rate. Such a change would allow the yuan to be fully convertible. While China is likely to decline such an option initially, plans for reforms carried out over an extended time framework and in a gradual manner have begun to echo strongly in the Middle Kingdom.

[2] According to www.g20-g8.com between 1998 and 2007, total deficits and surpluses of G20 countries rose from $580 billion (2.3% of G20 GDP) to $2.5 trillion (5.6% of G20 GDP)

A coming clash in Nanjing?

The Nanjing meeting is not likely to see any concrete or substantial reforms to the current International Monetary System, primarily due to the conflict of interest between China and other G20 members. Even if the terms of the internationalization of the Chinese yuan are not immediately agreed upon, hosting this G20 seminar reflects China's awareness of the need to reform its economy. It is likely to pursue this matter in a more gradual, natural manner much like it has handled other transitions in the past. Looking back at history, it is clear that China will not bow to international pressures to do this in a time-effective way, but will still require and request the G20 for help and cooperation in dealing with its economic reform.

For its part Europe, led by France as the G20 chair, would like to see a supranational referee that deemphasizes the monetary sovereignty of nations by moving away from national reserves into SDRs, thus leading to greater stability on international capital markets. Some Chinese economists believe that Europe might also have other motivations though, such as seeking a renewed international political position through leading the world in a global financial market reform. In addition, the United States is unlikely to support a shift into SDRs, which could undermine the US dollar's status as the primary reserve currency. Finally, SDRs still constitute a very small portion of total global reserves, which undermines the credibility of such a tool.[3]

On the importance of the G20 monetary seminar in Nanjing, international law specialist and Hopkins-Nanjing Center professor Steven Hill provides his vision on that matter. "The rise of the G-20 as the current forum of choice to address broad-based global financial issues like those to be discussed in Nanjing reflects changing global power dynamics. It shows how international institutions can adapt to these shifting dynamics. Involving China as a responsible stakeholder in these institutions will also help shape China's evolution as a world power. France made the right move in choosing Nanjing for the meeting. There should be more like it."

In the end, even if there is no definitive decision this week in Nanjing, the meeting may mark China's shot across the bow.

Published by the HNC News Community
www.hncnews.org

[3] SDRs represented only 4% of total global reserves as of 2008 year