

Gang, Fan

**Working Paper**

## Currency asymmetry, global imbalance and rethinking again of international currency system

TIGER Working Paper Series, No. 94

**Provided in Cooperation with:**

TIGER - Transformation, Integration and Globalization Economic Research, Warsaw

*Suggested Citation:* Gang, Fan (2006) : Currency asymmetry, global imbalance and rethinking again of international currency system, TIGER Working Paper Series, No. 94, Transformation, Integration and Globalization Economic Research (TIGER), Warsaw

This Version is available at:

<https://hdl.handle.net/10419/140746>

**Standard-Nutzungsbedingungen:**

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

**Terms of use:**

*Documents in EconStor may be saved and copied for your personal and scholarly purposes.*

*You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.*

*If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.*



**T**RANSFORMATION, **i**NTEGRATION and **G**LOBALIZATION **E**CONOMIC **R**ESearch  
CENTRUM BADAWCZE TRANSFORMACJI, INTEGRACJI I GLOBALIZACJI

## **TIGER Working Paper Series**

**No. 94**

### **Currency Asymmetry, Global Imbalance, and Rethinking again of International Currency System**

**Fan Gang**

Warsaw, June 2006

---

**Currency Asymmetry, Global Imbalance, and Rethinking again of  
International Currency System**

**Abstract**

The US dollar has been volatile and falling again and again in recent decades as well as recent years, and for many observers, it is going to be broken sooner or later. The central importance of the dollar is due to the fact that it is not just a currency for the US. Over half of all dollar bills in circulation are held outside of the 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 stabilizes the global currency market. Instead, today it is a major source of instability.

In the back ground, the US fiscal deficits have been running high again under Bush administration, once up to almost 3% of US GDP. And current account deficit is set to about 7% in 2005 and more volatility is widely expected. The situation is very challenging for the central banks of Japan, China, Korea, Taiwan and Singapore which collectively hold about US\$2.8 trillion worth of 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.

And China has been blamed, not only by US congressmen who are understandably not very familiar with either the complicated currency issues or the domestic politics in any other country, but also many economists or business strategists. It was said that it was all because RMB did not revalue, as the source of this “global imbalance” and currency instability.<sup>1</sup>

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

And this seems not really new phenomena at all. It has been all so familiar before and since the “Nixon shock” in early 70s’, and in 80s’ when there was the “Plaza Accord”. The

---

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

convenient targets to blame were the “gold standard”, the Dutch Mark, the Japanese Yen. Now it is turn for Chinese reminbi.

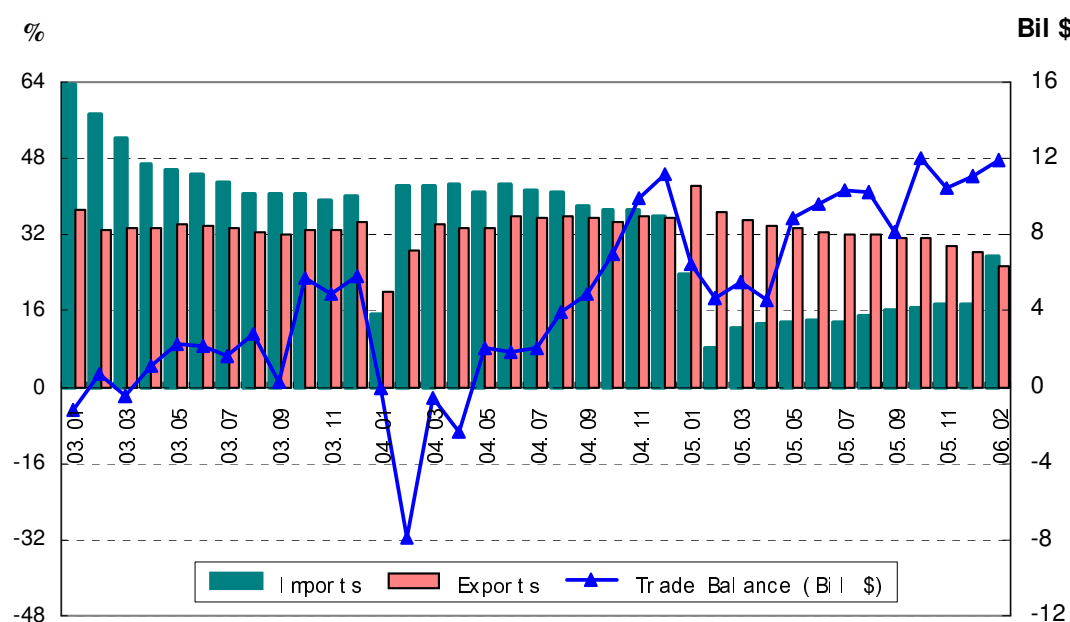
So the question is what are the real causes of the global imbalance and currency instability?

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

## 1. China's trade has been mostly balanced in past 28 years!

China registered record high trade surplus of US\$101 billions and current account surplus of \$146 billion, or about 5% of GDP, in 2005<sup>2</sup>. Although it apparently would put China in a worse position for all the blames, we should look into the situation in more details. For many counts, 2005 for China was a special year facing a slow-down change in aggregate demand after the over-heating in previous 2 years. This can be evident by the fact that the growth rate of imports was 17.4% in 2005, sharply lowered down from previous almost 36% in 2004 and 39% in 2003, while the growth exports also slowed down to 28% from previous years of 35%.

**Fig. 1. China's trade balance**



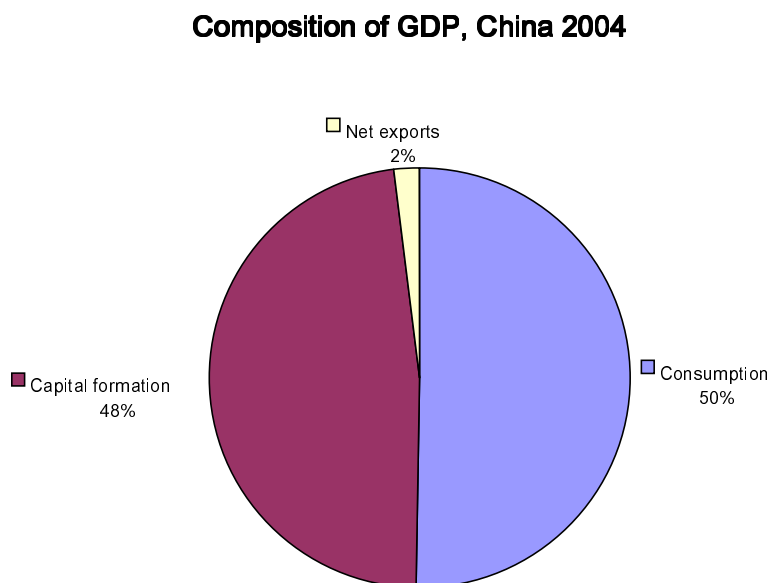
Source: China State Statistical Bureau

Except for 2005 (maybe plus 2006 if we make expectation, because China will be in slow-down phase for a while after the over-heating), in most years in past 27 years, China's trade was more or less balanced, with small surplus in some years and small deficits in others.

<sup>2</sup> It increased by almost 300% in one year compared to previous year's \$30 billion trade surplus. This extraordinary change could also be misleading – it could mean that 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 speculated on the revaluation of RMB. See a recent report in BusinessWeek “China's Trade Surplus May Be an Illusion” by Stephen Green. The article claimed that “Our numbers show that the 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 foreign currency inflows.”

Take 2004 as an example. In this year, as it had been already under fierce pressures for the revaluation, China only registered about US\$30 billion surplus, or about 2% of GDP (see Fig. 2.). The previous record high trade surplus of \$43 billion occurred in 1998 when China was in slow-down/deflation period when everybody in the world was guessing when China would devalue and US government was pressing China for not doing so.

**Fig. 2. China's trade surplus as % GDP, 2004**



## 2. China's trade imbalance with US and the new supply chain in Asia

Why did China get its trade balanced? Of course because China did not only export, but also import, and imported a lot! In most year, China's imports grew by double digits, and during 2003-2004, China's imports grew by almost 40% per year!

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

The following table shows how China run trade deficits with almost all Asian economies except Hong Kong which has been a major trade outlet of the Mainland.

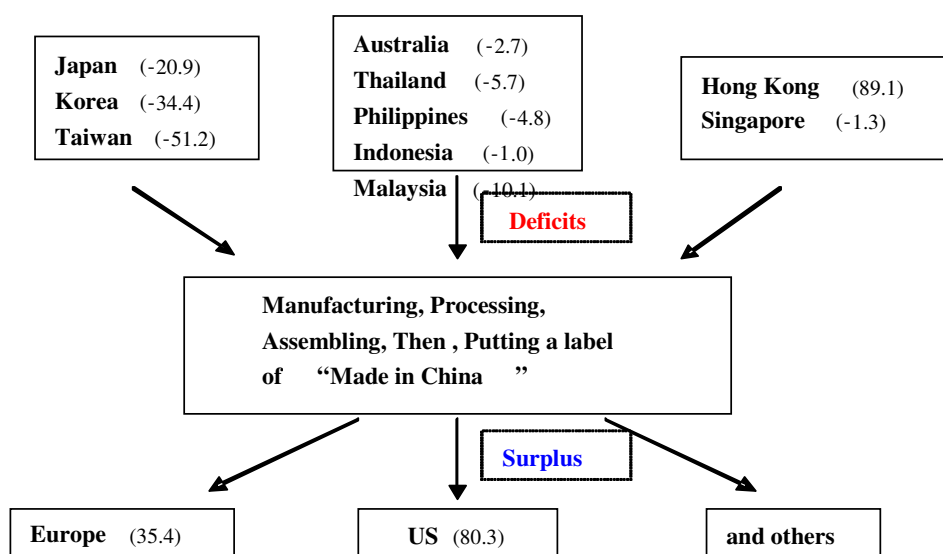
**Table 1 Trade Balance between China and its Neighboring Economies US\$ bil.**

	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: Unite Nation, WTO, PC-TAS; The Ministry of Commerce of PRC.

What has happened in Asia was a newly emerged production/supply chain with China as a center of assembling/manufacturing. The following chart just 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% of China’s exports are from “reprocess manufacture sectors” of which the value-added in China only counts for 10-20% of total prices.

**Fig. 3. Illustrated Triangle Trade Relations – China’s Bilateral Balance in 2004 (\$ Billion)**



What this picture does not show is another relationship - over 50% of China’s exports are produced in China by foreign invested companies, including US companies. This fact is also relevant to the currency issues we are discussing because one of the factors which determine the currency balance is the labor cost which is one of major considerations for foreign investor or outsourcing companies.

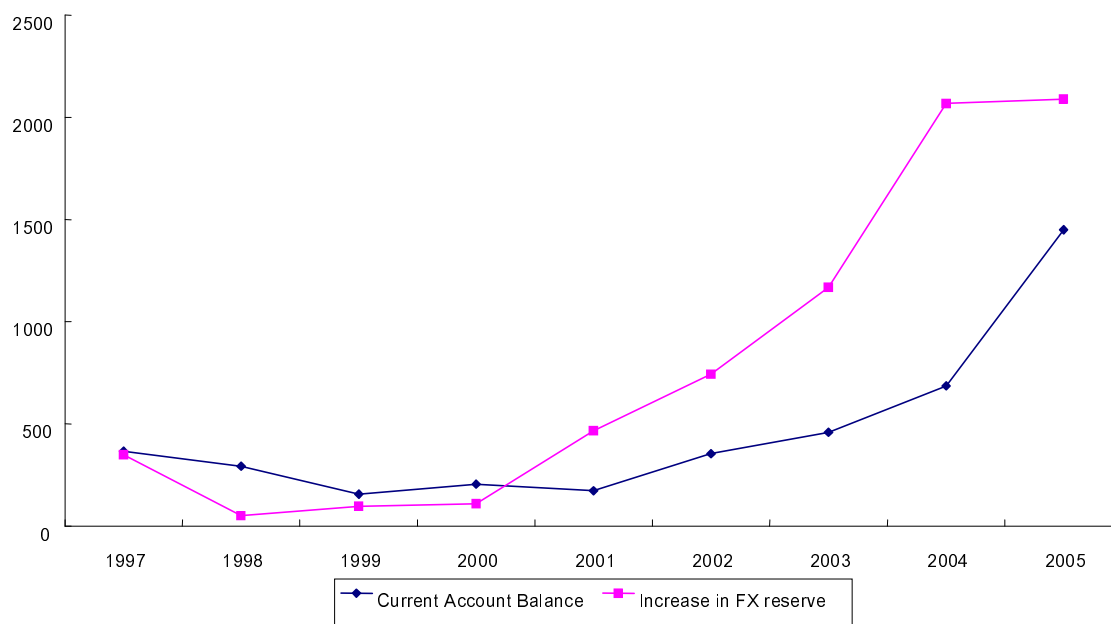
### 3. Where did China’s large foreign exchange reserve come from?

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

Take 2004 as an example. In this year, China’s foreign exchange reserve increased by \$210 billions. This of course included the current account surplus of \$35 billions. But the rest, as much as \$175 billions were from capital inflows! The capital which had been accumulated in other countries, including \$50 billions FDI (suppose it all came in cash and bought goods in Chinese domestic market), and \$20 billions 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.

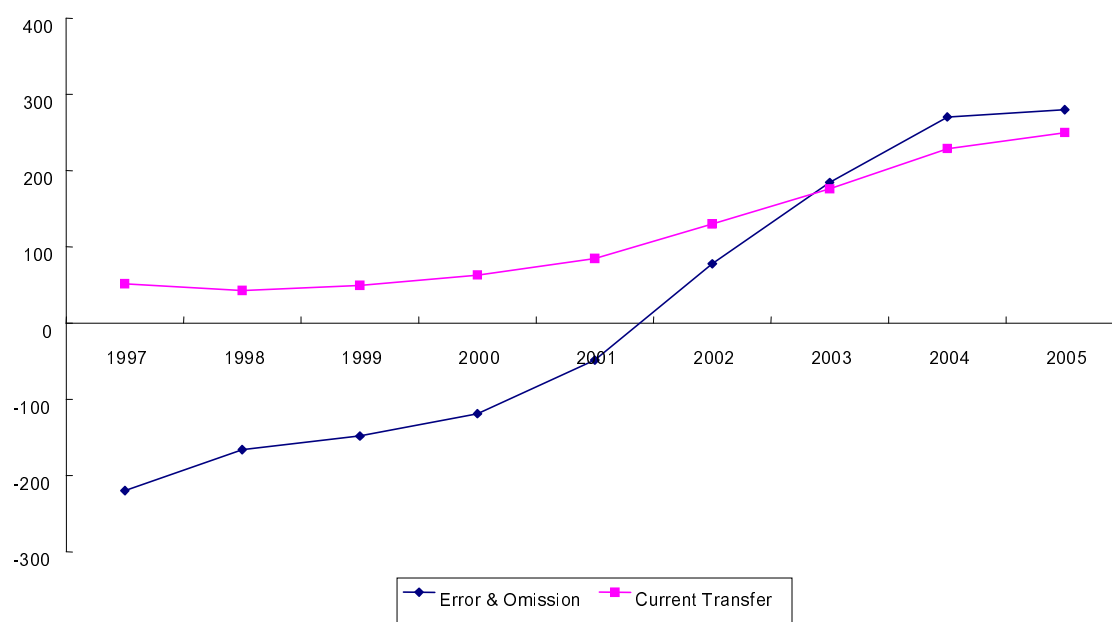


**Fig. 4. China's Current Account Balance and FX Reserve Increase**



For example, the “Error & Omission” item in China’s capital account has been turned from negative (outflow) to positive (inflow) in 2001 as the “market sentiment” turned from RMB devaluation to revaluation, and increase steadily ever since. Also we can see that the item “current transfer” in the current account, which includes the remittance between family members or movements between personal bank accounts, increased more rapidly after 2001.

**Fig. 5. China's Current Account Balance and FX Reserve Increase**



This situation has been changed a bit in 2005 because in this year almost 50% of increase in fx reserve can be explained by current account surplus. Capital inflows reduced to \$100 billions due to the calm-down of the 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 fx 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 the speculation.

#### **4. National savings and global imbalance**

Here comes the issue about savings. The so-called global imbalance is often interpreted as the result of Chinese over-saving and American over-spending. Over-spending maybe, but not necessary there is Chinese over-saving in the sense of international balance of payment.

Chinese does save a lot, often up to 40% of GDP. But as a nation, it spends a lot too - it may not spend much on consumption (only 60% of GDP), but it invests up to 40% (45% in 2004!) of its GDP in industrial capacities, housing, and public infrastructures.

And therefore, China as a nation buy a lot in the international market, of course not much consumer goods, but a lot of investment goods. As the result, China has pushed up resource/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 over spends too - during 2003-2004, it over invested and therefore the economy was over-heated!

What is really relevant to the global imbalances is not the total savings of the nation, but the savings in foreign assets, that is the current account surplus owned by the nationals.

It is important to understand that the net national savings is not equal to the increase of fx reserves - increase in reserves includes the capital inflows which may be the results of foreign savings (or the wealth which was saved before), not the national savings. 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 past years, normally only less than \$30 billions per year. But then, the large scale of global imbalances measured by the US trade deficits up to \$600 billions per year, should be explained by the sum of current account surplus of all economies everywhere, some of them (including almost all economies in Asia) run surplus against China too!

From this perspective, we can see the following:

1. If the US wants to blame someone for its trade deficits, it should blame every one which has some surplus, and therefore "contribute" to the matter directly (as having surplus against US) or indirectly (through countries which has surplus with US).
2. If the US wants someone to revalue its currency in order to help to reduce its deficits, it should ask every one who has surplus.

However, here comes the problem: if you want every one 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 have not revalue, but why the US dollar has always got the tendency of devaluation against everyone else, since 1960's?** First the devaluation against gold standard or against all other currencies in 1970s(the Nixon shock), the devaluation against Dutch Mark and Japanese Yen in 1980s, and, Chinese RMB for now.

## **5. The "Currency asymmetry" and the persistent tendency of US dollar devaluation**

Many have said again and again in past 40 years that under the present "US dollar standard" global currency system, the global financial stability depends on the "good

behavior” of the United States or the good monetary policy of the Fed<sup>3</sup>. But further analyses can show that the fundamental problem is not in the US policies, but in the global currency system itself which may make the US follow a certain behavior pattern. It is a very “old” issue since 1960s, but we may need still pay some attention to it otherwise we may fail to identify the real source of the imbalance.

The break-down of Breton Wood system and de-link of US dollar to 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\$)<sup>4</sup>. From then on, the world had got a major “Asymmetry”, as it was divided all nations into tow categories: the nation which issues its own currency but it serves as international currency (the US), and the nations which only issues their own currency but use USD in international financial market.

On one side, this arrangement of “Currency Asymmetry” has its positive effects. US is the largest and strongest economy with the most efficient financial markets in the world. The world financial system needs some one strong enough to play the role of anchor against the torrents. The 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 certain extent, the seigniorage to US for using US dollar as their security against their own weakness in the economic and financial system, either assets bubbles (Japan), the non-performing loans in the domestic banking sectors (Japan and China), or the massive under-employment of rural labor force in the process of economic transformation (China). And it is convenient to have national currency to serve these purposes since it may be much cheaper than if the international public goods such as international currency would be provided by a expensive international bureaucracy, provided that the US would be a good anchor.

On the other hand, such an currency asymmetry has it 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 of irresponsible

---

<sup>3</sup> 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 behavior.”(Prestowitz, 2005, page169).

<sup>4</sup> 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.

domestic policies leading to high fiscal deficits and current account deficits (or “twin deficits”). However, the country which prints international money may face less penalties – along with the about 50% of total printed papers and 50% of USD denominated financial assets used or hold by all other economies, the financial risks spread over or externalize to other corners of the world. As the result, it seems that no matter how much the US runs on the fiscal deficits, no matter how loose the monetary policies and how much the excessive liquidity provided, it has less likely run into financial crisis like any one else in the world would do. This may delude, if not “corrupted”, people and policy makers in the “anchor country”, as they may not see much “their problems” for running high deficits and printing more money when the bad consequences more become “others’ problem”. Therefore, such a system would naturally result in the persistent fiscal deficits and/or over provision of liquidity as we can see in the US since 1960s. From this perspective, we can recognize the US twin deficits problem is not even a policy issue, it is institutional – not of the US domestic institutions, but of 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, being 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 which are still fragile in domestic system and incapable of handling the risks the liberalized financial market and free capital flows may bring to them. But many countries were seduced to welcome more capital flows because those loans or portfolio investments were so attractive to the capital scarcity 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 get over-heated and have to face the consequences of over capacity of production and over supply 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 dollar as denominating currency, when the dollar devaluates, the 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

loss by devaluation, the US only gains from it! No wonder devaluation for the US is such an attempting thing to do.

**Illustration: Asymmetry in Asset value changes by devaluation**

	US	Any other country
Foreign Assets	Up	Up
Domestic Assets	<b>Unchanged</b>	<b>Down</b>

The problems created by the “US dollar standard” currency system had been debated and discussed repeated by many people for long time. We are repeating it here simply because the history is repeating itself in today’s new circumstance between US and China, similar to what happened in the cases between US and Europe in 1960s and US and Japan in 1970-80s. The repeated similarities in the history just show it is not the problem of policies, but the problem of regularities of institutions!

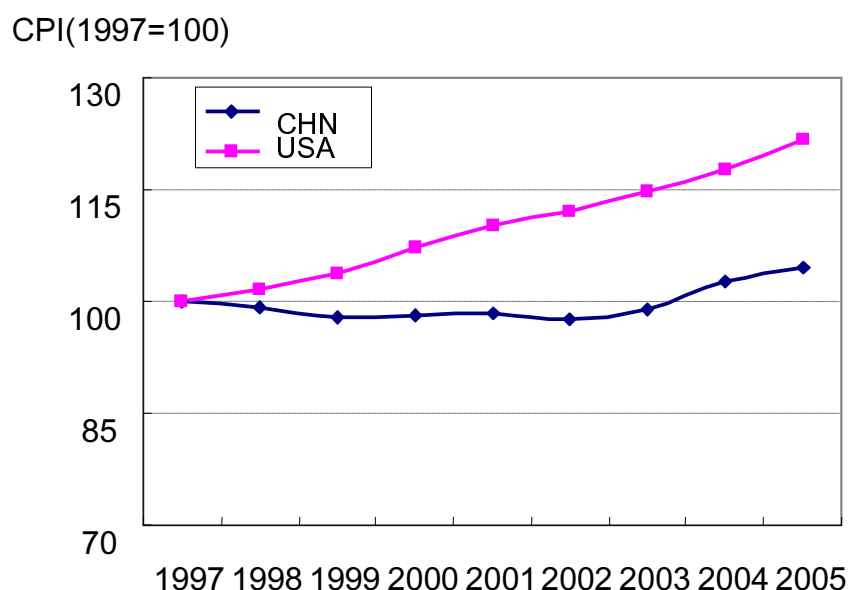
**6. Effective exchange rate and real exchange rate what is developing countries’ possible responsibility for global imbalance?**

As economics can tell, two factors have the roles in determination of changes of real effective exchange rates and therefore the trends of exchange rates:

1. The differences of inflation rates in two countries in concern. If country A’s inflation is higher than B, A’s currency is to depreciate or over-valued otherwise;
2. The differences of wages changes related to the labor productivity changes in the two countries respectively. Productivity changes may vary country to country during different period of time. But as long as their wages can be adjusted fully to the extent the productivity changes, the real exchange rate stay unchanged. Otherwise, the country whose wage increase is less than productivity change should appreciate its currency or its currency is under-valued.

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

**Fig. 6. Inflation: China and US differential**



Source: China Statistic Yearbooks, various years.

The main conclusions we can draw from above arguments is that

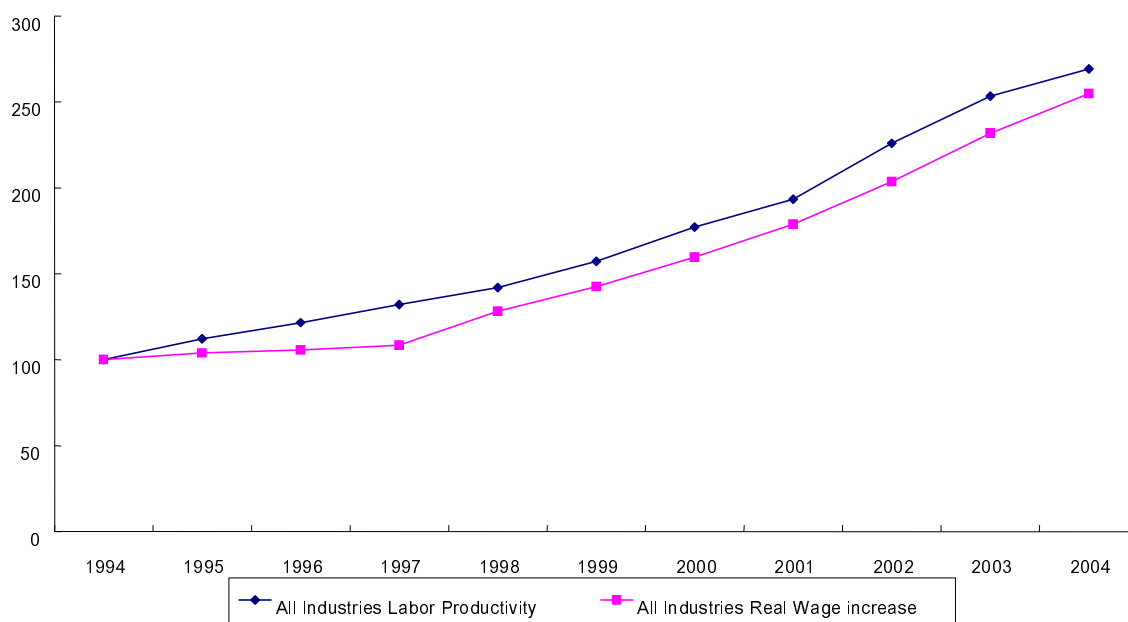
- If we take the financial factors only, the current problem is not RMB revaluation, but the dollar devaluation! And this is the major cause of the current imbalance.
- Or, this means that RMB revaluation will not solve the problem of US deficits not only because China's surplus is not equivalent to US deficits as we discovered in previous sections, but also because the real roots of the problem is not in China if the US inflation would continue due to the loose monetary policies!
- If China can do something in this regard, that would only be to race against the US in creating inflation or printing money. But that are the 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 boundary.

However, if we take productivity/real wage factor into consideration too and think of the real exchange changes, the picture become more complicated and China seems not totally innocent for the current problem. The issue is that, while in the US the wages increases basically up to the level of productivity changes (about 3% per year), China's wages seems more sticky. In recent years since early 90s', China's labor productivity improved at the annual average rate of 10.41%, (see Table, also see McKinnon<sup>5</sup>, 2005) , thanks to the reforms

<sup>5</sup> In this paper, 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 labor productivity: about 9.5 to 12 percent in China<sup>5</sup> versus 2.7 percent in the United States over the decade" (page 7).

and technology progresses. But the wages seems increasing slower than that - it increased at an annual average rate of 9.81% in manufacturing sectors. This is indeed a factor which may cause RMB under-valued, although only by the altitude less that 1 percentage point annually.

**Fig. 7 China's Real Wage and Labour Productivity Changes**



Source: China's Statistic Yearbooks, various years.

But why the wages are so sticky in China than in the US? Is this because Chinese government's control? No, Chinese government seems now days so worry about the slow increase of blue-collar wages as the income disparities widening and social instability threatening. The real reason behind the wage stickiness in China is the market force in the labor market. Although about 200 million rural laborers has been reallocated from the agriculture to industries and service sectors earning about \$1000 per year, there are another 200 millions or more are still in the countryside earning about \$400 per year and eagerly moving out looking for better paid jobs! It is the job competition and the still infinite labor supply which keep the Chinese wages slower changed compared to the labor productivity gains (this also explains higher capital gains for foreign investment and domestic savings, and explains the enlarging income disparities during this stage of industrialization and development, just like most countries experienced in the history).

So what are we doing now at this point? We are blaming Chinese rural poor laborers for the global imbalance!



This sounds ridiculous. But this actually reveals that here comes another global issue, i.e., the poverty reduction and economic development of poor countries! We can see now these issues are related somehow to the currency problem, but they are even more important ones!

Of course this analysis shows that China has some responsibility for the imbalance and calls the revaluation of RMB, but it also shows the reasonable revaluation of RMB should not be more than the differences between the changes in wages to the extent of Chinese productivity increase. In the normal year, it may only count for less than 1%, not big enough to solve the US deficit problem! The main part of the causes of global imbalance is 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"

Within the current global monetary system, characterized by a "currency asymmetry", with the US keeps providing excessive liquidity to the world, such an 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 under-valued at about 1% 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 the 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: time to think again 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, but providing common benefits to all. It should not be a currency of any particular country no matter how strong or dominant it 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 as will. And 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 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<sup>6</sup>. This could be started with using IMF special drawing rights (SDRs) as the reserve currency unit. One of the recent efforts to think about the alternatives is the “World Currency Unit” (WCU) which based on the inflation-adjusted real GDP of major economies (see Lok Sang HO, 2006). It is suggested governments and private firms may issues 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.

---

<sup>6</sup> Actually, M. Keynes was thinking some kind of international currency named “bancor” when he was preparing for the Breton Woods conference in 1944 (see Rothbard, M. 1995).

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 globalizing 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 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 97/98 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’s 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 for if it is an answer to replacing the “currency asymmetry” and thereby reducing the “global imbalance”. An Asia Currency Unit may well reflect the monetary relationships among the Asian economies, but it could lead to a “collective revaluation” against USD under the pressures of market speculations and bear all 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.

## References

- Bergsten, C. Fred et al. *The United States and the World Economy*, Institute for International Economics, Washington DC 2005.
- Bernanke, Ben. The Global Saving Glut and the U.S. Current Account Deficit, At the Sandridge Lecture, Virginia Economics Association, Richmond, 10 March 2005.
- BLANCHARD, OLIVIER J. FRANCESCO GIAVAZZI , and FILIPA SA, *The U.S. Current Account and the Dollar* , MIT Department of Economics Working Paper No. 05-02
- Lindbeck, Assar. *Inflation and Unemployment in Open Economies*, Amsterdam, North Holland, 1979.
- Ho, Lok Sang, 2006, *A Sustainable Currency Regime for East Asia: WCU*”, paper presented at conference on “New Monetary and Exchange-rate arrangement for East Asia”, held at Bellagio, Italy, May 22-27, 2006.
- Obstfeld, Maurice, and K. Rogoff, 2005, “The Unsustainable US Current Account Position Revisited”, forthcoming in Richard Clarida (ed.), *G7 Current Account Imbalances: Sustainability and Adjustment*, (November 2005 version). National Bureau of Economic Research Working Paper 10869, November 2004.
- McKinnon, Ronald. *Exchange Rates under the East Asian Dollar Standard: Living with Conflicted Virtue* MIT Press, 2005. (Chinese translation, 2005; Japanese forthcoming, 2007).
- McKinnon, Ronald, 2006 , ”China’s Exchange Rate Trap: Japan Redux?” conference paper, American Economic Association Meetings, Boston, 7 January 2006.
- Qiao, Hong. “Exchange Rates and Trade Balances under the Dollar Standard”. Stanford University, August 2005.
- Prestowitz, Clyde, 2005, Three Billion New Capitalists: The Great Shift of Wealth and Power to the East, Basic Books, New York.
- Rothbard, M. 1995, Making Economic Sense, Auburn: Ludwig von Mises Institute (page 271 - 273)
- Zhang, Xiaobo, and Kong-Yam Tan, “Blunt to Sharpened Razor: Incremental Reform and Distortions in the Product and Capital Markets in China”, International Food Policy Research Institute, DSGD Discussion Paper #13, August 2004.