Comments on Professor Yu’s Paper
The Global Financial Crisis
and China’s Policy Responses

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Global imbalance and the RMB issue

How to reduce the current account surplus
- Current account as the gap between savings and investment
- Raising consumption as the key to reduce current account surplus

China’s transition to a floating rate regime
- The need to restore autonomy in monetary policy
- Similarity between China now and Japan in the early 1970s
Changes in current account balances in China and the United States reflecting the savings-investment balance

(Ratio to GDP, %)

Note: Current account balance \( \equiv \) savings – investment
Source: China’s statistics based on China Statistics Summary 2009; Statistics for the U.S. and Japan based on the International Monetary Fund's World Economic Outlook Database, April 2009
International comparison of private consumption in relation to GDP (2007 figures)

Dwindling private consumption amid widening income disparities

* Per capita disposable income and per capita net income are used to measure urban and rural income, respectively.
Source: *China Statistical Abstract* 2009
Redressing China’s regional disparities

- **Domestic FTA**
  - Dismantling barriers impeding the mobility of labor (e.g., household registration system), goods, and capital to form a unified domestic market

- **Domestic Flying Geese**
  - Investment flow from high-income to low-income regions

- **Domestic ODA**
  - Japan’s local allocation tax as a model
Higher growth rates in Western China (first half of 2009)

China's rising “twin surpluses” and foreign exchange reserves

Note: Increase in foreign exchange reserves = current account balance + capital account balance + errors and omissions.

Source: State Administration of Foreign Exchange http://www.safe.gov.cn/
Need to move to a more flexible exchange rate system

- Twin surpluses as the direct result of the government’s efforts to maintain an undervalued RMB
- China moved to a managed floating system in July 2005, but has returned to the dollar peg system as an emergency measure
- Moving to a floating rate system needed to restore monetary independence (given rising capital mobility)
- Keeping exchange rate fixed to the dollar will give rise to asset bubble and inflation
The “impossible trinity" in international finance

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<th>Free Capital Mobility</th>
<th>Independent Monetary Policy</th>
<th>Fixed Exchange Rate</th>
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<td>Capital Controls</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>China (before July 2005)</td>
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<td>Monetary Union</td>
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<td>Hong Kong, EU</td>
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<td>Free Floating</td>
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<td>Japan, Australia</td>
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Source: Created by author