Remarks on Regaining Control at Bretton Woods

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Good afternoon Ladies and Gentlemen,
It gives me great pleasure to attend today's conference and exchange views with you on the past, present and future of the international monetary system. I will address the following four issues:

First, a Review of the Bretton Woods System

As an old Chinese saying goes, "to grasp the trend of future development, one must first of all learn from history". Before we discuss ways to improve and develop the international monetary system, we need to take a hard look at the problems in the old system and draw lessons from them. A review of history shows that the Bretton Woods system, established in 1944 with the United States in the driver's seat, played a key role in the evolution of the international monetary system over the past century and more. This system gave a strong boost to post-war economic recovery. Although it is no longer in operation, its experience and lessons have given us much food for thought.

First of all, the collapse of the Bretton Woods system shows that there are inherent flaws in the international monetary system that depends on a single currency. An international monetary system dominated by a single currency is bound to face the "Triffin Dilemma" and can hardly remain stable. Second, it is impossible to avoid moral risk arising from attempts made by the core country to take advantage of its special position as having the global currency to manipulate international finance. Moreover, the collapse of the Bretton Woods system also demonstrates the importance of making institutional arrangements for making dynamic adjustments in response to the changing global economy. The stability of the international monetary system that centers only on a single currency depends heavily on the economic strength of the issuing country of the currency. The decline of the economic power of the issuing country will inevitably lead to instability in this system. It is therefore highly necessary to develop an international monetary system that consists of multiple currencies and has reasonable flexibility.

Second, an Assessment of the Current International Monetary System

In the 1970s, the Unites States, without prior consultation with the international community and the consent of the IMF, unilaterally announced the suspension of the convertibility of the US dollar into gold, thus abandoning its solemn commitment to the world of making the US dollar an international currency. The reason behind such an irresponsible act is that the dollar is the currency of the United States rather than the currency of the international community.

The international monetary system then entered the era of the "floating exchange rates". But because of the inertia in the world economic system and the special position of the United States in the global economy, the US dollar has remained the major currency of international reserves, credit, pricing and settlement. In fact, it has continued to serve as the dominant international currency. The current international monetary system is unable to address the flaws of the old Bretton Woods system; what is more, it has created new problems, as shown in the following two aspects:

First, actions taken by the issuers of major reserve currencies are not bound by law, and there is a disconnection between the benefits gained by the relevant countries and their obligations. The United States enjoys huge economic benefits brought about by the US dollar's status as the world's de facto dominant currency, but undertakes no corresponding responsibilities and obligations to maintain the stability of the US dollar. When the Fed makes monetary policy, it takes into consideration only the needs of the United States but not the macroeconomic policy needs of other countries. In other words, there is a mismatch between the demands of other countries for the US dollar and the decision of the United States to increase or decrease the US dollar supply. This mismatch has been one of the major triggers of international economic crises. Since the outbreak of the current economic crisis, the United States, Europe and Japan have injected massive liquidity into the market by adopting quantitative easing policies. This is quite similar to what the Fed did in the 1960s. What these countries have done has made it impossible for developing countries to guard against exchange rate fluctuations and negative impacts on the world economy caused by unilateral policies pursued by the issuers of major reserve currencies. The developing countries have been forced to share the costs and risks caused by economic restructuring of major currency issuing countries. Their unilateral monetary policies have also greatly undermined the growth and stability of the global economy.

Second, there is a lack of benchmark for floating exchange rates. The floating rate system is used in quite a few countries, but the absence of a reference for "floating" makes the so-called "floating exchange rate regime" a self-deceiving one. Because under such a system, only the US dollar can float freely, while other currencies can only respond passively. This arrangement has become a major factor causing numerous economic and financial crises of varying degrees.

As for some of the arguments raised about Bretton Woods II, I don't think the root cause of the so-called imbalance is the exchange rate of the yuan renminbi; rather, it is the inequitable US dollar-based international monetary system. Only by reforming this inequitable system can the so-called imbalance be addressed. This is a view that I have expressed on many occasions. In today's world where countries are highly interdependent economically, it is impossible for developed economies like the United States, the EU and Japan to turn for the better without economic growth and import expansion of China and other emerging market economies. Since the exchange rate reform was introduced in China in 2005, the yuan renminbi has appreciated by over 35%, and China's current account surplus to GDP ratio has dropped from over 10% in 2007 to 2% at present. However, US trade deficit with China continues to rise. This fully shows that the current account deficit of the United States has little to do with the exchange rate of the yuan renminbi. Many countries, including developed ones, have seen their export to China grow substantially, giving a strong boost to international trade growth. Still, some countries, in disregard of the fact that China is world's second largest importer, refuse to recognize China's market economy status. They keep using discriminatory trade regulations and investment policies against China. The reality, however, is that it is the quantitative easing policy pursued by major Western countries that has exerted substantive impact on the international foreign exchange market. Don't you think this is exchange rate manipulation? The repeated signals sent by Fed recently to taper its quantitative easing policy has led to a big drop in the exchange rates of the currencies of many developing countries and a sudden slowdown in their economic growth, with only the yuan renminbi remaining stable. Therefore, neither the reform of the international monetary system nor re-balancing of the world economy should target the exchange rate of the yuan renminbi. What the major reserve currency issuing countries need to do now is to conduct domestic structural reform to regain economic competiveness by cutting welfare benefits and income, reducing fiscal deficit and changing policies that hinder trade and investment liberalization.

Third, on the Reform of the International Monetary System

History shows that all the changes in the evolution of the international monetary system, from the gold standard to the Bretton Woods system and then to the current floating-rate system, reflect profound changes in the global economy. The world economy has now entered a new era of multi-polarity, and there is an urgent need to build a new international economic order. In keeping with economic polarity, the focus of the endeavor to reform the international monetary system is to make it a diversified one that is internally well regulated and externally coordinated. The ultimate goal is to form a unified international monetary system based not on a single currency, but on a stable and sustainable currency arrangement.

In the mid-term, the international community should seriously consider creating a diversified monetary system consisting of major currencies, including the US dollar, euro and the yuan renminbi and based on coordinated exchange rates. Since an exchange rate stabilization mechanism is central to the international currency order, to form a diversified international monetary system, it is important to strengthen policy coordination among major currency issuing countries to ensure stability of exchange rates among major currencies. It is therefore necessary to impose greater legal restraints on and conduct tighter supervision over the domestic macroeconomic and monetary policies of major currency issuing countries so as to prevent them from pursuing expansionary monetary policies to solve their domestic structural problems.

The reform of the international coordination mechanism and financial institutions is essential for reforming the international monetary system, and the focus of such reform should be to ensure that the governance structure of the international financial institutions truly reflect changes in world economic structure and the interests of emerging and developing economies. However, the IMF and other international financial institutions do not have any mechanisms in their governance structure to regulate monetary policy-making in major currency issuing countries. Despite the remarkable growth of their overall strength in the world economic system, emerging economies still have much less influence in the international economy and financial system than developed economies and cannot influence policy-making of developed economies. It is thus hard for emerging economies to promote and uphold their development interests.

To advance the reform of the international financial institutions and the supervision and coordination mechanisms, three steps are called for:

First, increase the say, voting rights, and management power of emerging economies and developing countries so as to address power imbalance between developed and developing countries through replenishing resources in the World Bank and the IMF and other international financial institutions. During this process, it is particularly important that developed countries should be open and not hostile in their position.

Second, promote regional cooperation and policy coordination in finance and currency among emerging economies and developing countries so that they will become important participants in the international economic and financial order.

Third, strengthen functions of the IMF and other international financial institutions to ensure that they are capable of coordinating policy-making of developed countries and that the macropolicies of developed and developing countries are more compatible with each other.

Fourth, on the Internationalization of the Yuan Renminbi

Lastly, I would like to address the internationalization of the yuan renminbi. According to a report released by the Bank for International Settlements, the yuan renminbi has become one of the top 10 global trade currencies. In recent years, it has become an increasingly active player in the international market and is well on its way to becoming a major international currency. The internationalization of the yuan renminbi will not only facilitate trade and investment between China and other countries, but also promote both regional and global financial market stability. It may also provide support for a more diversified future international monetary system. Obviously, this meets the common interests of both China and other countries.

The internationalization of the yuan renminbi is the result of the growth of China's economy and its financial market. At the end of the day, it is the market that will decide whether the yuan renminbi will be internationalized. This process cannot be accelerated if conditions are not ripe; but neither can it be stopped when conditions are in place. China will, in light of changing domestic and overseas conditions, create an enabling environment for using the yuan renminbi in cross-border trade and investment transactions. One step we can take is to further adjust policies on cross-border use of the yuan renminbi and liberalize relevant regulations. Another step is to further improve China's financial market by deepening its reform and opening-up. By taking these steps, we can create more favorable market conditions for the internationalization of the yuan renminbi. This is also a priority target for financial reform set at the Third Plenum of the 18th Central Committee of the Communist Party of China in November 2013. Capital account convertibility is a long-term goal pursued by China. Our next step is to further open the capital account provided that risks are under control. Here, I would like to point out that a certain degree of capital account regulation will not hinder the internationalization of the yuan renminbi. International currencies such as the US dollar, Japanese yen and Deutsche mark were all internationalized when their capital accounts were not yet fully convertible.

Ladies and Gentlemen,

It is always necessary for us to view things from a long-term perspective. This is what all of our countries should do in our efforts to reform the international monetary system and reshape the international financial system. Let us bear in mind our common interests, build consensus, strengthen policy coordination and work together towards our shared goal.

Thank you!