

# Third High-Level Conference on Building a New Asia: Towards an Asian Economic Community

Taiyuan, P.R. China, September 15-16, 2005



山西财经大学  
Shanxi University of  
Finance & Economics,  
China

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RIS  
Research and Information System  
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New Delhi, India

Supported by



Sasakawa Peace Foundation, Japan

and

Shanxi Consolidation of  
Social Science, China

Shanxi Foreign Exchange &  
Consulting Center, China

Taiyuan Municipal Government

## Asian Monetary Cooperation:

### Perspective of RMB Asialization

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**Abstract:** RMB will inevitably play an important role in Asian Monetary Cooperation. At present RMB is qualified preliminarily as a regional key currency. In future, China should combine the making of economic policies with the regional monetary cooperation targets to push forward the realization of RMB Asialization by making various efforts. The paper makes some analysis on the necessity, the feasibility and the strategic choice of RMB Asialization.

**KeyWords:** Asian monetary cooperation, RMB Asialization, Regionalization Internationalization

#### 1. Introduction

The Asian financial crises happened in 1997 caused great damages to the overall East Asian region and also made them realize the necessity and the importance of regional economic and monetary cooperation. In recent years there are 3 main strains of thought on East Asia monetary cooperation: single currency monetary union, multi-currency monetary union and key currency regionalization (Zhong Wei, 2001). No matter what thought it is, RMB as a regional key currency will certainly be the most important component of Asian monetary cooperation. Due to the fact that the ties between the economic development of China and the economy of East Asia are increasingly close and the fact that China's position and role in the future East Asian economy is raising, the issue of RMB as an international currency has to be considered and plotted in the overall construction of East Asia monetary system.

The earliest research made on RMB internalization was mainly about how RMB would be a free convertible currency (Zhang Yiwei, 1994). Before 1997, some scholars made deep researches on the necessity, the feasibility, the costs and benefits of RMB internalization and at the same time put forward some suggestions about the development process. (Jiang Boke, 1994; Hu Dinghe, Cheng Haiyong, 1996). After the Asian financial crisis, especially after the occurrence of Euro and the discussion on the dollarization in some Latin American countries, some scholars noticed the importance of RMB regionalization in the RMB internalization process and made some researches on that topic (Pan Liquan, 2002; Li Chong, 2002; Zhong Wei, 2002; Li Xiao et al, 2003). Though some

scholars simply regarded the regional currency as Euro or “Asian dollar” and proposed that RMB should aim at the target of being an international currency (Zhao Haikuan, 2003), most scholars proposed that RMB regionalization should be an inevitable stage or process in RMB internationalization. There are some discrepancies as to the target, the process and the strategies of RMB regionalization. Generally speaking, there are 2 showing characteristics in their research: one is on the target or the benefits, they pay more attention to the seigniorage or the realization of “global multi-polarization” (Wei En, 2002; Tao Shigui, 2002), the other is on the process and path selection, they pay more attention to RMB circulation in the neighboring countries and the spontaneous market process (Li Chong, 2002; Li Jing, 2002).

In all these above-mentioned researches, more attention is paid to the analysis of natural process of RMB regionalization under the market force and no logical system arrangement is found. Based on the researches done by other scholars, the paper makes brief analysis on the necessity and the feasibility of RMB Asialization. The following suggestions on the strategic selection are made: dealing properly with the main currencies in the region; further deepening the economic and financial reform of China and taking gradual coordinating strategies to realize the RMB Asialization target so that a solid foundation will be laid for RMB internationalization in the end.

## **2. Necessity Analysis**

RMB Asialization refers to the process that RMB becomes the key currency within East Asia through its involvement in the systematic cooperation in East Asian monetary and financial fields. It is an inevitable key process in the realization of RMB internalization. And it is determined by the internal and external financial and economic environment China is facing (Li Xiao et al, 2003).

### **2.1. RMB internalization has to depend upon fully “the collective action” of regional monetary cooperation**

The current international monetary system is essentially “a dollar system”. The US dollar serves as the most important international key currency. Mckinnon (2001) pointed out the US has accumulated large current account deficits and formed “the international dollar standard”. According to Mundell, the total amount of US dollar circulated outside the bank is nearly \$400 billion; most of it is existed as an international currency outside the US territory. Only 10-15% US dollar is circulating within the US territory. The United States influences and manipulates the monetary and financial policy of other countries. So the US is the least likely to carry out the reform of the international monetary system (Yu, 2001). This also means that any endeavors challenging the hegemony of US dollar will be opposed and suppressed by the United States.

Any country who tries to realize the monetary internationalization directly without the support of regional financial and monetary cooperation is surely to fail. Two such typical examples are the birth of Euro and the failure of Japanese yen. Hence in the current international monetary system, the regional factor is very important in restricting the selection of a country’s exchange rate system and whether a currency can be a key currency. The stability of nominal anchor in East Asian countries depend upon not only the price stability in the US but also the joint monetary stability in every or major East Asian countries. Due to the very close trade relationship in East Asian countries, whether the currency of any country can successfully be pegged to the US dollar as nominal anchor depends upon to a large extent whether other East Asian partners or counterparts can peg to the US dollar fixedly. Actually East Asian countries practice a system of collective nominal anchor (Zhang Zhichao, 2002). This close ties in money and exchange rate in these countries mean that the currency internalization of any country cannot be realized without the help of currency regionalization.

### **2.2. The inevitable choice of China being involved in the regional monetary cooperation of East Asia**

After East Asian financial crisis, all the countries in the region reached the following consensus: setting up the

related regional macroeconomic index, the monitoring system for the monetary and financial index and the crisis saving mechanism. The setting up of regional monetary system is more important than the help from IMF or other international institutions. So based on these consensuses, the government authorities in East Asian countries start discussing and developing various preliminary regional monetary cooperation.

Ever since “Qiang-mai Initiative” in May 2000, the East Asian regional monetary cooperation has achieved a series of breakthrough mainly in the following: firstly, the major countries in East Asia have signed a series of bilateral or unilateral monetary swaps agreements; secondly, they are studying the possibility of setting up a regional financial supervision system and in November 2001 a research institute was established to provide a dialogue mechanism for the related personals.

In the 1997 financial crisis, the government authority of China promised and guaranteed that RMB would remain stable against the US dollar. Though China withstood the economic assault brought about by the currency depreciation, China played a very important role in stabilizing the East Asia economy. China’s action in the crisis proves that cooperation has larger benefits than “non-cooperation”. Ever since 2001, China has made very rapid currency swaps with other East Asian countries and is becoming a very important force in the financial stability of East Asia.

As a big country in East Asia, China must play an important role in the monetary and financial cooperation of East Asia. Since RMB has not realized the full convertibility under the capital account, direct internationalization for RMB may have great risks to the economy of China. China will have to push forward the Asialization first to achieve the goal of stabilized economic development in East Asia and the sustainable economic development of China. In this way can we lay a solid regional foundation and set a strategic platform for RMB internationalization.

### **3. The feasibility analysis of RMB Asialization**

3.1. We think that five aspects should be considered whether a currency can become a key currency within the region under the background of regional monetary cooperation:

3.1.1. The economic scale, the stability of economic growth and the ability to be the export market for the neighboring countries. The larger the economic scale of a country, the more stable of economic growth. It will be more attractive to the foreign capital and has closer industrial and trade relations with the member countries within the region. So it will have more chances to be the market provider for the region. Thus the demand for such currency is also increased and it will have more opportunities to have monetary cooperation with other economies in the region.

3.1.2. The degree of openness to the outside world. In the situation of financial liberalization and the free flow of capital, a comprehensive index to measure the degree of openness should be adopted. The index should cover the trade openness, investment openness and financial openness (Dai Jinping, Xiong Xingmei, 2001). The higher these three indices, the higher the degree of openness to the outside world will be. It will be more possible to be the key currency in the region.

3.1.3. The degree of acceptance within the region. The degree and scope of a currency used within the region. If a currency is circulated in a larger area, it will have “the network effect” and “the scope effect”. The greater benefits the currency has, the more possible the currency will be regionalized by certain systematic cooperation.

3.1.4. The international public credibility for the monetary and financial policy of a country and the policy

coordinating capability with the member nations within the region. If a country practices higher spillover effect monetary and financial policy to the member nations in the region and its financial policy is more consistent, it will win more public credibility and its coordinating capability to improve the regional monetary and financial cooperation will be strengthened. The position and role of that currency will also be raised.

3.1.5. The internal and external systematic environment for a currency. If a country has more perfect internal system arrangement especially the free convertibility of a currency, more sound market mechanism and more favorable external system environment, its currency will have more chances to be regionalized successfully.

3.2. Above all, RMB is not fully qualified as an international currency, but RMB is partially qualified as such seeing from the present situation in China and East Asian countries.

3.2.1. The economic scale of China is increasing greatly and its position as a market provider for East Asia is strengthened. Firstly, the increased economic growth in China has laid a solid foundation for RMB Asialization. Since 1993, only China remained sustained high economic growth rate in the 10 major East Asian countries. By 2020, GDP per capita for China will be increased from \$1 000 at present to \$3 000. The gross GDP will be reached from \$1 300 billion at present to \$4 000 billion. By that time China will become the third economic power only behind the US and Japan.

Secondly, China played very important stabilization role in East Asian economy. A research done by Mckinnon (2001) showed that in the past 20 years, the economic growth in China was not only the fastest but also more stable than other East Asian economies. It showed that “China played a role of an automatic stabilizer in the increased integration of East Asia.”

Thirdly, the role of China as “a market provider” for East Asia is increasingly prominent. In the past 20 years China has become an important exporter in East Asia. In 2004, 26.4% export and 56.3% import in China went to these economies. The position for Japan, South Korea, Chinese Taiwan and Malaysia in the foreign trade of China is increasing prominently. A typical example is that apart from Hong Kong and Macao, other major neighboring economies all enjoy trade surplus with China. In 2004 Chinese Taiwan had \$51.2 billion trade surplus with mainland China, while Japan, South Korea, ASEAN, Russia, India all had a trade surplus of \$20.9 billion, \$34.4 billion, \$20.1 billion, \$3 billion, and \$1.8 billion respectively<sup>1</sup>.

Roland-Holst (2002) analyzed the effect of economic growth in China on the trade pattern of East Asia by using a dynamic prediction model. The result shows that between 2000 and 2020, China will become the largest trade entity in East Asia. By 2005, China will be the largest importer in East Asia. By 2020, over half of the imports in China will come from the countries in East Asia. Chinese Taiwan and South Korea will be the largest import base for China. So whether the future exchange rate system of East Asia and the monetary cooperation can be successful will largely depend upon the position and the function played by China as “a market provider”.

3.2.2. The degree of openness in China to the outside world is increasing. Compared with the degree of openness in the Euro area and other East Asian nations in 2001, China was approaching or surpassing some countries in the Euro areas, such as Italy and Greece, in foreign trade, foreign finance, foreign investment and the degree of comprehensive openness (Li Xiao et al, 2003). In East Asian region, the degree of comprehensive openness in Japan and China is lower than that in other East Asian member countries. If we take into consideration of their actual and underlying economic scale, the comparison of both is more significant. As the largest creditor nation in

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<sup>1</sup> The Regional Economic Cooperation Policy of China, <http://finance.sina.com.cn>, March 19, 2005

the world, the foreign financial ratio in Japan (40.60%) is higher than China (34.12%). But in the foreign trade ratio and foreign investment ratio and the degree of comprehensive openness, China surpassed Japan. The larger degree of economic openness in China will certainly create necessary condition for RMB Asialization.

3.2.3. With more RMB circulating in the neighboring countries and area, RMB is internationally accepted to a certain extent. After the return of Hong Kong and Macao to the motherland, RMB circulation in Hong Kong and Macao is increasing. At the same time in some neighboring countries that have close trade ties with China, more and more RMB is circulated. In Vietnam, over 90% of border trade is settled by RMB; in Mongolia, the cash circulation of RMB is over 60% of the total amount of cash circulated; in Pakistan, Ishrat Hussain, the governor of Central Bank, expressed that RMB can be used in the export to China. In other neighboring nations, RMB is also used as payment and settlement currency such as in Russia, Burma, Laos, Kazakhstan, Kurdistan, Tajikistan, Afghanistan, India, Nepal, Chinese Taiwan, Thailand, Bangladesh, Malaysia, Indonesia, Philippine, Singapore, Korea and South Korea and etc, altogether 18 countries. Besides, some other countries and regions have RMB as reserves or assets (Xu Hongshui, 2004). According to the calculation result published by the Investigation Statistical Bureau of PBOC, the total amount of RMB circulated in the world is about 20 billion. An officer in ADB figured that it is about 25-30 billion (Zhang Yugui, 2002). The spontaneous circulation of RMB in the neighboring countries and regions has laid a preliminary foundation for RMB to be involved in systematic regional monetary cooperation.

3.2.4. The international public credibility of the monetary authority of China is rising. In Asian financial crisis, the promise made by Chinese government that “RMB will not be depreciated” prevented the competitive currency depreciation in East Asia, kept the confidence of investors, stimulated the international capital to flow back to East Asia, made the economy recover and raised the public creditability of RMB in East Asia. After the crisis, Chinese government took an active supporting attitude and put forward many constructive suggestions about the cooperative frame “ASEAN 10+3”. Especially after the “Qiang-mai Initiative” signed in May 2000, China has signed bilateral monetary swap agreement with Thailand, Japan and South Korea and signed unilateral swap agreement with Malaysia on October 9, 2002. The PBOC is served as the swap bank and is involved in the swap business of US dollar vs. Malaysia ringgit. China set up “Asian Bond Fund” with Japan, South Korea and Thailand in 2003.

3.2.5. The domestic system environment is getting perfect for RMB Asialization. The free convertibility of RMB under the current account has created favorable conditions for RMB to circulate in East Asia. Whether RMB can be fully accepted by East Asia, it has to depend upon the degree of openness for RMB under the capital account. That determined the scale that RMB is used in the transaction by the investors and therefore the confidence for residents and non-residents holding RMB is so determined.

There are still many problems existed in the financial fields of China. Since the road of financial reform is very bumpy and far, the problem and dilemma faced will become the critical factors impeding RMB Asialization. China will have to realize the sound and effective operation of financial system in the gradual opening process. China should set the RMB Asialization as an important force in pushing forward the financial system reform.

#### **4. Policy Suggestions**

To realize the target of RMB Asialization, the following three steps will have to be taken strategically:

4.1. Dealing properly with the major currencies within the region. In recent years, the imports and exports of Japan to China are increasing very rapidly. China has historically surpassed the United States and become the largest

importer of Japan. Hence the friction and coordination in trade and finance between Japan and China will be increased in the next 20 years. The cooperation between RMB and Japanese yen will be the critical point in constructing systematic East Asia monetary system and also the key for RMB to be Asialized. Regarding the relationship with US dollars, in the past 20 years, the export to the US is on the increase. RMB has become the passive currency in foreign reserves and settlement. In the future the benefits for RMB to peg to a basket of currency are more than those of pegging to the US dollar.

4.2. Further deepening the domestic economic and financial system reform. The importance of internal and external economic policy equilibrium being taken into consideration, China's monetary and financial policy should not be directed only to its own nation but should be "a regional policy". This requires us that we should not only seek after the benefits of RMB regionalization but also should take the responsibility and bear the necessary costs. Besides the system reform of bank and treasury bonds and the enlargement of investors holding RMB, RMB should have cooperation with other currencies within the region and we should adjust the exchange rate forming mechanism. The setting up of offshore RMB market is very important.

4.3. Taking gradual coordinating strategy. The economic development in East Asia varies largely. RMB regionalization cannot be realized within a day. We should practice the monetary cooperation in a small scale and then extend it to a larger scale. Now RMB is circulating in Hong Kong and Macao area. In practice, RMB regionalization is the inevitable path for the future economic development and we should realize the target step by step. We should take various measures in the domestic finance and exchange rate system to push forward the process.

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