Closing Panel: "The Way Forward"

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We have had a very rich discussion and I have learned a great deal during the course of our deliberations. But trying to identify "the way forward" for internationalization of the BRICS' currencies and the international monetary system, more generally, is a rather daunting task. So I will focus on a narrow subset of what we have discussed.

I would like to start with the discussion we had about the cost and benefits of internationalization of currencies, especially the RMB. Eric Helleiner laid out these cost/benefits for us, but he didn't come down on one side or the other. In his luncheon remarks, in contrast, Dong He presented his clear perspective of the progress that has been made in internationalizing the RMB, and what he sees as the process that is likely to continue taking China down that path. Let me give you my characterization of what is at play here. I'll focus primarily on the RMB, but will comment on the currencies of the other BRICS as well.

My reading of history is that it was China's accession to the WTO in the late 1990s that lead to China's rapid and impressive integration into the global economy as we know it today. They successfully produced an export-led growth model, involving a managed exchange rate (fixed to the US dollar) and massive accumulation of reserves. And while not the genesis of the global financial crisis, these policy choices — and they were choices China made — accommodated, and in some ways feed, the excessive credit growth that was at the heart of the crisis.

For a number of reasons that we all understand, China must now shift its growth model to one that is more reliant on domestic demand as its engine of growth. To do this successfully will require the development and global integration of China's financial system to support both the necessary rotation of demand from exports to domestic demand and the efficient allocation of domestic savings to meet domestic investment needs. If the first wave of China's successful integration into the global economy was accession to the WTO, the second wave must be its financial integration.

A key question surrounding all of this is: "How one's exchange rate fits in?" In other words, how does a country see its exchange rate regime fitting into its broader policy objectives. Implicit in my remarks above on China — perhaps even explicit — is a view that exchange rate flexibility is what China will need going forward to achieve its economic goals. In our discussions yesterday we observed that the other BRICS counties, other than India, are large commodity producers where a flexible exchange rate has served them well, particularly in responding to swings in their terms of trade. Most forcefully, Johan van den Heever presented us with a good example of how an exchange rate can move in reasonably orderly fashion when there is a well-defined policy framework. His central message was that markets work best when there is clarity of policy objectives and frameworks; it's when markets perceive a policy vacuum that problems arise.

The overriding issue, however, is the importance of economic flexibility in generating sustained growth. Countries need mechanisms — shock absorbers — to help them adjust to changing circumstances. Flexible exchange rates provide one such shock absorber. It is this capacity to adjust that provides lasting economic stability. In other words, stability is a byproduct of the ability of an economy to adjust and adapt to economic and financial disturbances.

Countries, of course, have a choice. At one extreme are monetary unions where monetary policy is set for the collective union; at the other extreme are countries with freely floating exchange rates and an explicit nominal anchor (e.g., an inflation target) with the capacity to conduct domestic monetary policy to address domestic needs.

China has reached a point in its economic development where global financial integration, including exchange rate flexibility and internationalization of the RMB, has become a prerequisite for sustained economic growth and stability.

Yesterday morning Chongyong Rhee asked if we could identify modest reforms, and in so doing achieve what we think we can. There are undoubtedly a number of modest, perhaps better labelled gradual, reforms that can be taken. But unless we have a clear sense of the path forward and how the incremental reforms cumulate, we may end with greater, not less, global economic stability.

To conclude, let me offer two thoughts on the way forward:

- China must stay the course as outlined by Dong He — the progress he described is the right path for China if it is to deliver sustained economic growth and rising standards of living.
- More broadly, development and integration of Asian financial markets, within sound, transparent economic policy frameworks, must be front and centre.