Internationalization of yuan

GLOBAL ECONOMY

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While the controversy about the dollar-yuan exchange rate and its impact on China's export competitiveness and the U.S. trade deficit continues to be relevant, the international status of the Chinese currency will surely attract greater attention and debate in years to come.

Before one thinks about the use of the yuan in international transactions and as a reserve currency, one must first analyze the prospects of its convertibility.

The Chinese economy is the world's second largest, and will soon become the largest. It is already the world's leading export power, and one of the most heavily involved in foreign direct and portfolio investment.

Another factor in the equation has to do with the size of China's foreign exchange reserves, now topping 3.2 trillion dollars.

A number of countries maintain liquid assets in yuan, and China has concluded currency swap arrangements with South Korea, Hong Kong, Malaysia, Belarus, Indonesia, Argentina, Iceland, Singapore and other countries.

China can play a constructive role at the G20 and in the creation of a firewall to prevent the eurozone crisis from spiraling out of control.

In other parts of the world, especially Africa and Latin America, China has become a major trading partner and investor. Its footprint is now evident around the world.

Steps taken to bring the yuan into play as a convertible currency are not be understood as the beginning of the end of the U.S. dollar as the world's reserve currency.

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The volume of trade and financial transactions accounted for by the dollar is just overwhelmingly important and will continue to be so for the next decades.

Most Chinese trade, in fact, is denominated and settled in dollars. Chinese financial markets, especially bond markets, are still underdeveloped.

One of the most vexing problems surrounding the yuan has to do with the capital controls that China has in place. Before such controls are removed, China needs to strengthen the institutional structure of its financial system.

An important aspect of this will be giving financial intermediaries and banks more leeway when it comes to making decisions about credit.

China must develop a regulatory and supervisory structure that is not intended to serve as a protectionist mechanism.

China will be able to project its voice and influence in international organizations to the extent that it reforms its financial system.

The reform measures adopted as part of the 12th five-year plan are very important in this respect. If successful, they will promote a second transition in the Chinese economy, from export-oriented manufacturing to the service sector.

Financial system reform is certainly part of this shift, and it will enable China to play a more prominent role in global financial affairs.

Eurozone crisis: solvency or liquidity?

GLOBAL ECONOMY

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The eurozone countries facing problems with their public finances, including Spain, Italy, Portugal and Greece — the case of Ireland is different since the Irish crisis is a banking crisis and not a fundamental economic crisis — can be divided into two groups.

Portugal and Greece are funded by direct loans from the European Union and the International Monetary Fund; Spain and Italy are funded in the financial markets, but with a major contribution from government bond purchases by the banks in each of these countries, which have access to funding, such as three-year repos at an interest rate of 1 percent, from the European Central Bank (ECB).

So the consensus is that the crisis can be ended by lending more to these countries, in the form of loans to these countries' Treasuries.

For some countries, including Portugal and Greece, this would be done via public financing; for others such as Spain and Italy, by monetizing their government debts indirectly, since the ECB does not buy government bonds directly, or only small amounts, but provides financing to the banks that buy these government bonds with funding obtained from long-term repos.

This organization enables the eurozone to gradually pull out of the liquidity crisis that many countries have encountered:

Greece and Portugal are financed by the European Union and the IMF until the end of 2013; the banks purchases since the end of 2011 have helped lower the interest rates on Italian and Spanish bonds.

We can therefore definitely say that the pro-activity of the European institutions, the European Commission, the heads of state and the ECB has prevented a major liquidity crisis in certain eurozone government bonds and perhaps a break-up of the euro.

But even so, is the eurozone crisis over? The key question is whether we are dealing with a liquidity crisis or a solvency crisis. If a country is faced with a liquidity crisis, emergency financing must be organized like the IMF does and in the way it is being done now in the eurozone, until the country once again has access to the financial markets at normal conditions.

But if a country is insolvent, there is no point in lending any more to this country. The solvency problem for eurozone countries may be twofold: external solvency — the ability to repay the external debt and fiscal solvency — the ability to repay the public debt. These two different types of solvency are not necessarily linked: Ireland, for example, has eliminated its external deficit, but still has a huge fiscal deficit; the eurozone as a whole does not have any external deficit but had a fiscal deficit in excess of 4 percent of gross domestic product in 2011.

When we look at the public finance and current-account balance situations of the four troubled eurozone countries, we can first see that Italy's solvency situation is not worrying; the fiscal deficit is rapidly shrinking and will be lower than 3 percent of GDP in 2012.

The external deficit was roughly 2 percent of GDP at the end of 2011 and linked to the fiscal deficit: Italian industry is dynamic and generates a surplus in the industrial trade balance.

Spain and Portugal are rapidly reducing their external deficits, not only thanks to the fall in domestic demand, which is far more encouraging, but also thanks to rapid export growth linked to companies' improvement in competitiveness and efficiency.

However, Spain and Portugal still have substantial fiscal deficits, and Spain's deficit is shrinking only very slowly: it was still 8.5 percent of GDP in 2011 due to the weakness of the economy. But if these two countries are able to restore their external solvency by wiping out their external deficit, it will become far easier to finance their fiscal deficits since they can be financed by using the countries' domestic savings, instead of savings borrowed from other countries.

This leaves us with the very difficult case of Greece. The country's production capacity has collapsed: output is declining, investment is plummeting and labor productivity is falling, which shows the degree of disruption to the economy; exports have dropped by 30 percent since 2008, and industry now accounts for only 7 percent of the economy. In this situation, Greece cannot possibly reduce its fiscal deficit, which was worse in 2011 than in 2010, or eliminate its external deficit.

The Greek situation therefore raises a daunting issue for the European Union: how to deal with the case of a country that is insolvent in external as well as in fiscal terms.

Lending more to Greece, even by reducing part of its public — and accordingly external — debt, is by no means enough to restore the country's solvency.

It would require solidarity between the other European countries and Greece to help the country create new jobs and rebuild an export-oriented industry, and this solidarity in terms of financing and transfer of activities is not present today.

Issue Focus

Can Europe be saved?

By Alfred Gusenbauer

In 2011, Europe's financial and banking crisis escalated into a sovereign debt crisis. A problem that began in Greece ended up raising doubts about the very viability of the euro and even of the European Union itself. A year later, those fundamental doubts remain undiminished.

But, if one compares the EU with the United States or Japan where public debt equals 200 percent of GDP, the Union's current poor image is unjustified. Indeed, employment in the EU as a whole remains high, as do private savings rates. Moreover, the Union's trade is in balance with the rest of the world.

One reason for doubt about the euro and the EU is that, since the spring of 2010, Europe's leaders have rushed from one crisis summit to the next, each time devising supposed solutions that provided too little and arrived too late. Europe's leaders have never fully deployed their economic and political firepower. On the contrary, rather than taming the financial markets, as they once intended, Europe's leaders continue to be besieged by them.

It should come as no surprise that, with national governments' parochialism impeding joint EU action, financial markets are using what the communists used to call "salami tactics" to slice away at the Union by attacking its member countries one by one. Indeed, the European Parliament and the European Commission have been sidelined, while a new management model for Europe has emerged: Germany makes the decisions, France gives the press conferences, and the rest nod in agreement except the British, who have chosen isolationism once again.

This management structure is neither democratically legitimate nor justified by its performance, which appears to consist of mere reactions to pressure from financial markets. Indeed, some estimate that, by 2050, Europe will produce only 10 percent of the world's GDP, and will comprise just 7 percent of its population. By then, not even Germany's economy will be significant in global terms, to say nothing of the other European economies.

As early as 2012, when the world economy is expected to grow by only 2.5 percent, the battle for shares of the global pie will become fiercer. Europe is fighting for its economic survival, but it does not seem to know it.

So, do we Europeans intend to remain relevant in the 21st century, which means strengthening our position? Or are we prepared to undergo a painful decline brought on by nationalist infighting and complacency?

I advocate a strong Europe that embraces the challenges of a relentlessly changing world. We need a new contract among European nations, generations, and social classes, which implies difficult choices. We must bid farewell to national egoisms, vested interests, dirty tricks, and assumed certainties. If Europe wants things to remain as they are, things will have to change dramatically.

First, the EU must become a true democracy — with a directly elected president and a stronger parliament — if pan-European decisions are going to have full legitimacy. The fiscal pact to which EU members except the United Kingdom and the Czech Republic agreed in December 2011 cannot be left to bureaucrats and courts alone. The European people, the true sovereigns, must ultimately gain the right to make Europe's policy choices via elections.

Second, we must close the income gap. The growing divide between rich and poor, stagnating real wages, and deep regional disparities in unemployment are both morally unacceptable and economically counterproductive. The EU's increasing income inequality misallocates the purchasing power that its economy desperately needs for growth and employment.

Finally, the welfare state needs a serious overhaul. Today, the EU allocates a large part of its public spending to pensions and health care for the elderly, while education suffers from underfunding. A welfare state that focuses mainly on the elderly, and does not provide sufficient opportunities for younger generations, is not sustainable. Moreover, the inequities created by privilege, such as public-sector pension schemes and discretionary advantages for vested-interest groups, must be addressed.

In order to make these changes, higher taxation of wealth and capital income is inevitable. But, while these additional tax revenues would improve Europe's public finances, they would not obviate the need to reform the welfare state. Indeed, at best, they could facilitate a socially responsible transition to more efficient forms of social protection. It is also a mistake to believe that austerity measures — the prime focus of Europe's leaders up to now — will consolidate public finances. Europe is on the brink of recession. Governments should therefore restrict spending cuts to those that will not cause the economy to contract. Likewise, they should increase only those taxes that, when raised, do not reduce consumption, investment, or job creation.

In addition, a "European Marshall Plan" that provides investment in infrastructure, renewable energy, and energy efficiency is needed. Such an initiative would not only foster growth, but would also lower current-account deficits, because expensive fossil-energy imports could be reduced. Public finances would be consolidated only by growth, not by austerity. The European Central Bank must adapt to the fiscal pact's new rules. National governments' vulnerability to the financial markets and their exaggerated interest rates must be reduced. Only the ECB, by taking on the role of lender of last resort, can stop the eurozone's capital outflow and restore confidence in Europe's capacity to solve its own problems.

Alfred Gusenbauer was Federal Chancellor of Austria in 2007-2008. For more stories, visit Project Syndicate (www.project-syndicate.org).

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비결이 뭐죠?
스스로 마당발이라고 자랑하는 김사장.
비결을 묻는 사람들에게 그는 어깨를 으쓱대며
핸드폰을 꺼내든다.

2
"여기에 들어있는 사람들만도 수 천명이야.
그게 다 이 모임 저 모임 할 것 없이
열심히 얼굴을 비춘 덕이지."

3
이런 그가 신상품 설명회를 주최하며
사람들을 초대했다.
최소 수 백명은 올 거라고 예상한 그는
큰 호텔에서 가장 넓은 장소를 빌렸다.

4
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