Li Ruogu: The Chinese economy and world economic outlook

Statement by Mr Li Ruogu, Assistant Governor of the People's Bank of China, at the Seventh Meeting of the International Monetary and Financial Committee, Washington, D.C., 12 April 2003.

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I. World economic outlook: vulnerability, risk and policy response

Since our discussion of the world economic outlook last autumn, the global economy has shown some positive signs, but the road to full recovery continues to be bumpy, and, in some areas, vulnerabilities have even increased. In particular, geopolitical instability has aggravated financial market turbulence. The current situation shows that the widespread impact of this instability on the economies of some countries, especially on energy prices and consumer confidence, will certainly not end in the short term. Therefore, I consider a more comprehensive and objective assessment of the negative impact of these factors on the global economy by the IMF staff is justified. In addition, I note the following areas of vulnerability in the world economy.

1. The over-investment that occurred during the time of the U.S. economic boom in the 1990s created a great deal of excess capacity. This problem has not yet been solved effectively. Therefore, a full recovery of the U.S. economy is still going to take some time. At present, the Japanese economy is still lingering on the verge of deflation, and the situation of the major euro area economies remains grim. All these factors are extremely unfavorable for the recovery of the world economy, the growth of which is overly dependent on the United States. I believe that it is necessary to assess fully the enormous risk of the overdependence of the world economy on the U.S. economy at a time when the U.S. economy itself faces great adjustment pressures.
2. The impact of the fall in asset prices in the industrial countries has not yet fully unfolded. While the slide in stock prices in the last two years has been partially made up by a rise in real estate prices, the real estate market cannot remain prosperous forever. Moreover, in a certain sense, the previous longstanding prosperity implies a definite bubble component. The breaking of the real estate price bubble would certainly be no less a blow to investment and consumption than the breaking of a stock market bubble. In addition, owing to the existing problems in the balance sheets of banks and insurance companies in the major industrial countries, considerable stock market uncertainty still exists.
3. Some countries are finding increasingly less room for making macroeconomic policy adjustments. Since 2000, many developed countries have successively lowered their interest rates and increased their fiscal deficits in response to the worsening domestic and foreign economic situation. Since interest rates in some countries have now fallen to the lowest level in decades, there is limited room for further lowering interest rates and increasing deficits. Therefore, while the risk of global economic volatility is rising, the use of policy means to achieve an economic upturn is severely restricted.
4. The volatility of exchange rates among the major currencies will have a differing impact on the economic adjustment of some countries. At present, the depreciation of the dollar has put pressure on the economic recovery of the euro area. If exchange rate volatility and international capital flows were to affect each other, there will be an even greater impact on the emerging market economies whose financial sectors are still not robust.

In consideration of these vulnerabilities, I believe that staff's overall forecast for the world economy and the U.S. economy is too optimistic and that they have underestimated the negative impact of geopolitical instability.

In light of the existing vulnerabilities in the world economy, I believe that all countries should adopt appropriate policy measures to manage and resolve them. In particular, the major developed countries need to assume even more responsibility and pursue supportive macroeconomic policies. The United States should pay more attention to its existing macroeconomic weaknesses and enhance policy coordination with other countries to prevent the negative impact of sharp exchange rate volatility on the vulnerable world economy. The euro area should accelerate structural reform in the labor market area and pursue a looser monetary policy, when necessary. Japan should focus on solving the problem of nonperforming loans and endeavor to carry out financial sector reform to create conditions conducive to economic recovery. To promote economic growth, the developing countries need to further expand domestic demand, improve financing conditions, pursue a robust macroeconomic policy, and speed up structural reform.

II. Crisis prevention: surveillance, standards and codes

In recent years, the IMF has conducted extensive research and made considerable efforts in the area of crisis prevention and resolution. In my opinion, the IMF should now set priorities and focus on those areas that can really enhance the crisis prevention capabilities of member countries.

Enhanced surveillance will be achieved by adjusting its focus. In light of the current situation in which the world economy is more dependent on the economies of the industrial countries, the IMF needs to tighten its surveillance of the macroeconomic and financial policies of the major industrial countries and support developing countries in promoting structural adjustment and preserving their growth momentum to achieve an early and full recovery of the global economy. The industrial countries should enhance policy coordination, actively open up their markets to developing countries, accelerate the transfer of capital and technology to them, and seriously assume responsibility for preserving the sustainable growth of the global economy. To overcome the problem of imbalances caused by globalization and fundamentally improve the global capacity to withstand vulnerability requires the establishment of a new equitable and reasonable international economic and financial order.

In addition, the IMF needs to preserve a balance in overseeing the public and private sectors because in most cases market volatility is the result of the interaction between the two. If only the public sector is to be monitored and is required to increase its transparency, this goes against our original intention of calling for increased transparency. That being said, I believe that much work remains to be done increasing transparency on short-term capital flows. It is hoped that the IMF will pay attention to this important area.

At present, there is still no realistic plan on how to involve the private sector in crisis resolution. In my opinion, the basic principle for private sector participation in crisis resolution is to work out a plan that will be acceptable to both the public and private sectors, and both investors and recipients.

As for standards and codes, I want to emphasize two points. One, the formulation and implementation of all standards and codes is aimed at promoting development and achieving prosperity for all, rather than merely implementing these standards and codes. Therefore, the formulation and implementation of standards and codes must achieve the objective of promoting economic development. To ensure that standards and codes are more objective and fair, the formulation process should have the full participation of the developing countries. In consideration of the differences among countries at different stages of economic and institutional development, we should let all countries voluntarily choose their own implementation timetables based on their respective circumstances. This will be the only way to ensure that the implementation of standards and codes can achieve the aim of promoting development. Two, the facts show that observing the pertinent standards and codes is certainly not enough to effectively prevent the occurrence of crises. Therefore, we should not overemphasize the role of promoting standards and codes in crisis prevention. The implementation of standards should also proceed in an orderly, gradual, and realistic way in accordance with real circumstances. Otherwise, it could divert attention from more important areas.

In my opinion, the most fundamental crisis prevention measure is the promotion of economic growth and social development. The international community should reach a consensus on this and take effective steps to achieve economic growth for the whole world, particularly for the developing countries.

Since the late 1990s, international financial crises have occurred frequently and the crisis countries have found it difficult to access financing on the international financial market, thus posing a threat to global financial stability. The IMF should actively consider using the existing financing facilities for increased support to crisis countries. Meanwhile, it needs to actively promote a quota increase and the general allocation of special drawing rights. In particular, the IMF needs to complete the special one-time allocation of SDRs as soon as possible to strengthen the capacity of member countries to withstand crises.

In addition, the establishment of a new equitable and reasonable international economic and financial order remains one of the basic means of crisis prevention. Therefore, the IMF needs to continue to examine the flaws in the existing international monetary system, reform the irrational international financial architecture, and gradually establish a new international monetary system that genuinely reflects the basic features of economic globalization, fully reflects the interests of the many developing countries, and provides institutional safeguards for the sustainable growth of the global economy. In this process, widespread participation of the developing countries is needed.

III. Crisis management: sovereign debt restructuring

Establishing a fair and reasonable sovereign debt restructuring method is important both for crisis prevention and resolution, and for private sector participation. In the last two years, the IMF has conducted much valuable research on the issue of sovereign debt restructuring. While this work deserves affirmation, the existing options still have certain flaws.

The automatic stay mechanism of the Sovereign Debt Restructuring Mechanism (SDRM) would be favorable to ensuring the smooth conduct of restructuring negotiations. However, since it would widely involve the revision of the laws of all countries and amendment of the IMF Articles of Agreement, I'm afraid that it would hardly be achievable in the short term. It would certainly not be easy to ensure the independence and fairness of the dispute resolution forum, not to mention the many technical problems that still need to be solved.

The Collective Action Clause (CAC) cannot solve the collective action problem for multiple sovereign debts, which is one of the major reasons for the emergence of the statutory approach, i.e., the SDRM. In addition, the CAC impact on the bond issuance cost in emerging market economies is still pending more empirical analysis and study. Its design should contribute to capital inflows for developing countries, and its application should reflect the voluntary principle.

As for the recently proposed code of good practices, there is also a great deal of controversy in this area and its implementation should not be rushed. I particularly want to emphasize that it should not include coercive terms aimed at developing countries.

In short, the establishment of the SDRM still has a long way to go. The SDRM and CAC both have reasonable elements and could supplement each other. We support the continued study and steady improvement of these two approaches, but no rash conclusion should be reached at the current stage.

IV. The problem of the development of the low-income countries: poverty reduction strategy, debt reduction, millennium development goals, and the voice of the developing countries

Owing to the worsening international economic situation in recent years, low-income developing countries vulnerable to external shocks have been faced with even greater difficulties with regard to exports, capital inflows, and poverty reduction. We call on the international community to pay more attention to the development of low-income countries, and we support the IMF in its enhanced cooperation with other international agencies together with intensified assistance and effectiveness. We call on the developed countries to increase their international development assistance to low-income countries, take real actions to implement the Monterrey Consensus, and meet the United Nations' 0.7 percent ODA/GNP target as soon as possible.

We stress that trade is an important means not only of development financing for developing countries, but also of achieving economic and social development and integrating all countries with the world economic system. Therefore, we call on the industrial countries to renounce trade protection and continue to further open up their markets to developing countries to create a favorable international environment. We encourage developing countries to maintain their reform and development momentum. Meanwhile, we urge the IMF to conscientiously oversee the progress of the developed countries in the reduction of trade protection.

As always, the Chinese government supports the Heavily Indebted Poor Countries (HIPC) Initiative. We appreciate all the IMF/World Bank efforts so far. We are pleased that progress has been made in the strategy for economic development and poverty reduction. We hope that the two institutions will streamline their procedures, fully bring into play the autonomy and initiative of the HIPCs in formulating the development strategy, and increase their financial assistance to these countries. While China remains a developing country with quite low per capita income, we stand ready to do everything in our capacity to contribute to the debt reduction of the HIPCs. Not only has the Chinese government made loans and contributed to the IMF's Poverty Reduction and Growth Facility and Enhanced Structural Adjustment Facility, it also has reduced debt for certain heavily indebted poor African countries on a bilateral basis by RMB10 billion. In 2002, China also promised to waive debt for certain of Asia's least developed countries and decided to donate funds to the East African Regional Technical Assistance Center recently established by the IMF.

V. Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT)

The Chinese government is paying close attention to AML-CFT and is actively engaged with the international community in this area. In early 2003, the People's Bank of China announced three new AML regulations. We call on the pertinent AML organizations to create the conditions for the expansion of their representation as soon as possible. In particular, they should include developing country members to enhance the rationality and authority of their proposals. In our opinion, the first priority of AML work should be the financial centers of certain developed countries where money-laundering activities are now relatively rampant and the amounts of money being laundered relatively larger. Since the IMF does not have the required expertise in the AML area, particularly in the law enforcement arena, and since this work is not its core business, the IMF should not overemphasize it. In the course of the pilot program and promotion of proposals, the IMF should always adhere to the principles of voluntary and cooperative participation and respect the sovereignty and national conditions of the governments of all countries.

VI. The Chinese economy

In recent years, while expanding its domestic demand, China has also been steadily opening up to the outside world and participating in global economic cooperation and integration, and preserving its sustained and sound economic growth momentum. The Communist Party of China held its 16th National Congress in October 2002 and achieved a smooth succession to the leadership. The new Chinese government, which took office in March 2003, will continue the policy of stimulating domestic demand through pursuing a proactive fiscal policy and robust monetary policy to promote the sustained, rapid, and sound development of the national economy and overall progress in social causes.

For the first two months of 2003, industrial output grew 17.5 percent, and fixed capital investment grew 32.8 percent, both showing the fastest growth since the same period in 1996. Meanwhile, business efficiency improved sharply, and industrial profits grew 120 percent. Imports and exports maintained their fast growth, being up 44 percent from the same period in 2002. This included export and import growth of 32.8 percent and 57.1 percent, respectively, for a trade deficit of nearly US$600 million and marked the first time that imports have exceeded exports since the Asian financial crisis. The total volume of retail sales grew 9.2 percent, 0.7 percentage points more than in the same period in 2002. Use of foreign capital saw sustained and rapid growth, with the contracted amount being up 59.1 percent (US$14.2 billion) and real use of foreign capital being up 53.6 percent (US$7.54 billion). The consumer price index increased by 0.3 percent. Money supply also increased correspondingly, including broad money, which was up 18 percent from the same period in 2002. We are now paying close attention to the development of the macroeconomic situation. While preventing deflation, we also need to avoid economic overheating.

For 2003, we project that annual economic growth will remain at around 7 percent; the CPI will rise 1 percent; foreign trade will grow 7 percent; and the registered urban unemployment rate will be 4.5 percent.

Due to strong export growth, the economy of the Hong Kong Special Administrative Region (SAR) started to improve in the second half of 2002. While it still faces various, we firmly believe that the Hong Kong SAR economy will definitely weather its difficulties and resume quite strong growth under the leadership of the Hong Kong SAR government. The central government will firmly support all measures taken by the SAR government to restore economic growth.

Since China's resumption of its exercise of sovereignty over Macao, we are pleased to see that its economy has been more prosperous and its society more stable under the leadership of the Macao SAR government. It is expected that Macao SAR will maintain a quite high economic growth rate in 2003.