# International Monetary and Financial Committee

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Statement by ZHOU Xiaochuan, Governor, People's Bank of China, China

On behalf of China

**Statement by the Honorable Zhou Xiaochuan**
**Governor of the People's Bank of China**
**and Governor of the IMF for China**
**at the Twenty-Second Meeting of the**
**International and Monetary Financial Committee**
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## I. THE GLOBAL ECONOMY AND FINANCIAL MARKETS—PROSPECTS AND POLICY CHALLENGES

Despite the large-scale intervention by many countries, the global recovery remains weak and highly uneven and financial markets highly turbulent. Uncertainties have increased.

The most fundamental problems at present are the slow progress of developed countries in repairing and reforming their financial systems, and the continued reliance on government stimulus packages for financing. This not only increases fiscal burdens but, more importantly, it reduces the effectiveness of supportive monetary policy. The countries concerned need to accelerate their disposition of toxic assets, restructure problem institutions, supplement bank capital, strengthen financial regulation, and rebuild sound financial systems.

We must continue to pay close attention and respond appropriately to sovereign debt risks. Considering the enormous amounts of maturing debts and fiscal deficits in developed countries in the current and the coming year, sovereign risks could deteriorate again at any time, producing systemic effects on the global financial stability. The countries concerned should formulate and implement credible fiscal consolidation plans, and prevent sovereign risks from damaging financial stability.

At present, recovery in developed countries continues to rely heavily on unconventional stimulus policies, and private consumption and investment continue to be inhibited by high unemployment and insufficient credit. Whether to continue or withdraw from stimulus measures is a dilemma for macroeconomic policy formulation at present. To respond to these challenges, in addition to accelerating financial restructuring and reform in order to restore the supply of credit, developed countries must also intensify the reform of the labor market and goods and services markets to create jobs and raise potential growth rates.

The strong recovery in emerging markets has primarily benefited from bold reforms adopted before and during the crisis to establish sound macroeconomic policy frameworks. However, facing the global financial crisis, emerging markets also face many problems, including rising prices and asset values, external demand uncertainties, and volatile capital flows. In particular, the continuation of extremely low interest rates and unconventional monetary policies by major reserve currency issuers have created stark challenges for emerging market countries in the conduct of monetary policy. In addition to continuing to press ahead with their own structural reforms, emerging markets also depend on global institutions to strengthen their surveillance and coordination of the macroeconomic policies of the major reserve currency issuers.

The task of low-income countries to further develop their economies has become more urgent and arduous during the current crisis. The international community, and particularly the developed countries, should continue to expand support and assistance to low-income countries and fulfill their aid commitments. Measures like opening of markets, technology transfers, and increased investment can help raise the autonomous development capabilities of low-income countries, reduce the harm caused by the financial crisis, and assist them to maintain financial stability and economic growth.

Strong, balanced, and sustainable growth is our common objective. In view of the deepening trading economic and financial ties, the international community should guard against the risk of trade and financial protectionism, continue to strengthen global cooperation, and enhance policy coordination and cooperation.

## II. Chinese Economy and Policies

In 2010, China has continued to implement the package of policy measures in response to the global financial crisis, strengthened macroeconomic management, and accelerated the transformation of the economic development model. The growth has been strong, and prices are essentially stable. In the first half of 2010, GDP growth was 11.1 percent, which was 3.7 percentage points faster than the same period last year. From January through August, value added by industrial enterprises of a certain scale experienced growth of 16.6 percent, 8.5 percentage points higher than the same period last year; urban fixed asset investment grew 24.8 percent; total retail sales of consumer goods grew 18.2 percent; consumer prices rose 2.8 percent; and producer prices rose 5.6 percent. At the same time, the early effects of structural adjustment began to appear, with a reduced surplus of current account in relation to GDP. From January through August 2010, the trade surplus is down 14.7 percent from the same period last year; reserve growth slowed down; and the financial system remained stable. On June 19 of this year, China further advanced the reform of the Renminbi exchange rate mechanism to allow greater flexibility.

Although the overall trend in economic development looks good, China remains a developing country. China's gross domestic product per capita is only US$3,743, ranking it below the world's top 100; gaps between the urban and rural areas and between regions in China continue to expand; with a labor force of nearly 800 million, China is faced with enormous employment pressure; China's resources per capita are low, and arable land and fresh water per capita are only approximately 40 percent and one third of world average levels, respectively, constraining further development. It is also confronted with many uncertainties in the external environment. Viewed from the perspective of the internal environment, we continue to face new contradictions and problems in the operations of the domestic economy, including uncertainties in the achievement of stable and higher agricultural yields, formidable energy conservation and emissions reduction tasks, substantial pressure to manage inflationary expectations, a tightening enterprise operating environment, and high housing prices in some large and medium-sized cities.

In order to maintain steady growth in China's economy, we will continue to implement aggressive fiscal policies and appropriately accommodative monetary policy, maintain the continuity of macroeconomic policies, enhance the targeted nature and flexibility of macroeconomic controls, and strive to promote stable and relatively rapid economic development. We are confident that the series of measures adopted by the Chinese government, namely, encourage independent innovation, energy conservation, and emissions reduction, protect and improve the standard of living, and advance the progress of urbanization, will further stimulate domestic demand in China, providing enduring and powerful impetus to the Chinese and global economy. China will exert great efforts to transform the economic development model, adjust the economic structure, and sustain strong and balanced growth.

**Economy of Hong Kong SAR.** The Hong Kong SAR economy continued to show a broadly-based recovery since the second quarter of 2009. For the first half of 2010, the economy expanded by 7.2 percent. The domestic sector stayed resilient while merchandise trade remained vibrant, propelled by the strong growth in many Asian economies and the recovery in import demand in the U.S. The unemployment rate rose marginally to 4.6 percent in the second quarter of 2010, after successive declines since mid-2009. The underlying consumer price inflation was 1.5 percent in the second quarter. Looking forward, Hong Kong SAR is forecasted to grow by 5–6 percent, with underlying CPI at 1.5 percent.

**Economy of Macao SAR.** Benefiting from the good performance of the travel service industry, growth in the first half of 2010 reached 40.2 percent. The decline in goods exports and investment narrowed, growth in private consumption and services exports expanded, the strong growth in the economy as a whole propelled continued improvements in the employment situation, and the inflation rate returned to a relatively high level. Because the base number for the same period last year was relatively large, economic growth in the second half of 2010 is expected to slow down slightly.

## III. FUND REFORMS

At present, the international community is attaching great importance to the Fund's own reform progress. Governance reform aiming at enhancing the Fund's legitimacy and effectiveness is the starting point and precondition for all other Fund reforms. Quota realignment is the core and foundation of the Fund's governance reform, and its fundamental objective is to increase the voice and representation of emerging market and developing countries, so that quota shares of member countries are in line with their relative weights in the world economy. We urge all parties, in the spirit of cooperation and compromise, to complete the fourteenth general review of quotas by the agreed deadline in accordance with guidance by the G20 Pittsburgh Summit and the IMFC Communiqué of last October, to achieve a shift in quota shares to dynamic emerging market and developing countries of at least 5 percent. We are also committed to protecting the quota share of the poorest members.

Such quota realignment may lay the foundation for broader governance reform and should leave no country severely underrepresented. Given the significant flaws, the current quota formula should be reviewed within two years after completion of the fourteenth review. A 100 percent quota increase is needed to keep the Fund a quota-based institution.

As the Fund's governance structure is based on the quota structure, the objectives and ultimate outcome of governance reform should be consistent with that of quota reform, to raise the voice and representation of emerging markets and developing countries in the decision-making, management, and operational work of the Fund. Governance structural reform consists of a broad range of topics and should be advanced in steps. Those that have obtained consensus and do not depend on the quota reform outcome should be completed immediately. We believe the effectiveness of the IMFC first and foremost depends on its representation rather than the level of participation and decision-making power. The Fund management should be selected through an open, transparent, and merit-based process.

Since the developed countries have adopted floating exchange rate regimes, the Fund's current surveillance framework, which focuses on exchange rate policies, effectively leaves developed countries outside the Fund's oversight. The impact of the current financial crisis illustrates that inappropriate fiscal, monetary, and financial sector policies of the developed countries, particularly those of reserve currency issuers, are more damaging to global economic growth, employment, trade, and the international monetary system, and the remedies for such failures are more difficult. Therefore, the following three objectives must be achieved in the reform of Fund surveillance. First, there must be a conscientious strengthening of the surveillance of fiscal, monetary, financial, and structural policy, and the focus must no longer be on exchange rate policy alone. Second, surveillance must be fair and evenhanded. The recent European sovereign debt crisis demonstrated that countries can trigger systemic risks, regardless of their size. Therefore, bilateral surveillance must be the foundation and core, and importance must be attached to analysis and surveillance of the spillover effects of the policies of each member country. Third, the surveillance burden must be reasonable, with ample consideration of the burdens to and capacities of member countries and Fund staff. In order to achieve these three objectives, surveillance decisions and rules must be rewritten.

Sixty-six years ago, the founders of the Fund summarized and absorbed the lessons of the experience of turbulence in the international monetary system, and granted the Fund the duty to "oversee the international monetary system in order to ensure its effective operation." Forty-one years ago, in response to a serious U.S. dollar crisis, the Fund established the Special Drawing Right (SDR) to help maintain international monetary stability. However, as developed countries successively moved toward floating exchange rate regimes, the role of the SDR has been overlooked. The current global financial crisis and economic recession, the most severe since the Second World War, has alerted us to the necessity to accelerate the reform of the international monetary system. Conditions should be created to strengthen the role of the SDR. The Fund is about to conduct its review of the SDR. We hope that positive progress will be achieved in a broad range of fields, including improvements in the basket of currencies and strengthening of the SDR's role.

We welcome the lending toolkit reform the Fund has recently introduced. The Fund should fully develop its crisis relief role as the lender of last resort, continue to improve crisis relief functions, and press ahead with the reform of lending tools geared toward low-income countries, in order to fulfill its duty to maintain global economic and financial stability. However, the Fund should pay attention to the safety of its own resources, conduct regular reviews, evaluate the effects of reforms and potential risks, and adjust the relevant toolkits. Once reformed lending tools attract more countries to apply to the Fund for precautionary uses, the Fund's resources will face a massive demand, and it will be necessary to complete the quota reform as quickly as possible to replenish its resources. The Fund's primary missions in crisis prevention are to strengthen evenhanded macroeconomic surveillance and to prevent the accumulation of systemic risks; surveillance must not be weakened as the result of lending reform.