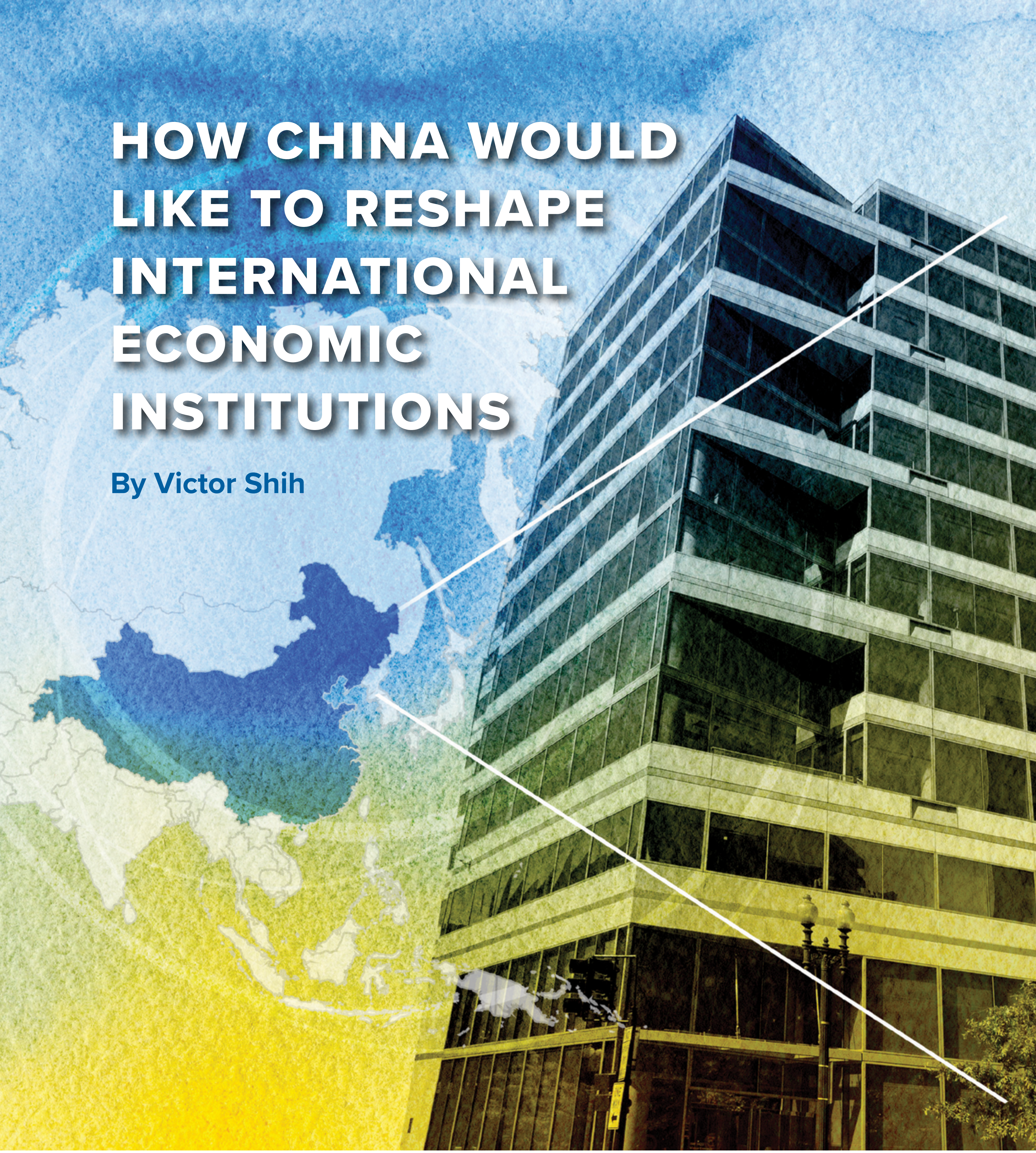
HOW CHINA WOULD LIKE TO RESHAPE INTERNATIONAL ECONOMIC INSTITUTIONS

By Victor Shih



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BRETTON WOODS 2.0

BRETTON WOODS 2.0 PROJECT

This paper is one of four publications launched as part of the Bretton Woods 2.0 Project on October 17, 2022. Launched right after the 2022 IMF-World Bank Annual Meetings, the Bretton Woods 2.0 Project examines the deep challenges facing the Bretton Woods Institutions and leverages interactive data visualizations to reimagine the governance of international finance for the modern global economy. The goal of the Project is to deliver a blueprint for reforms in four key areas: governance and parallel institutions, macro-critical global trends, future of money, and fintech, and non-state and quasi-state actors.

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INTRODUCTION

In the past twenty years, China's share of global gross domestic product (GDP) has more than doubled, from 7.4 percent in 2001 to 19 percent in 2021. China engages in more trade than any other country. Yet, as numerous Chinese officials and scholars have pointed out, China's role in existing international institutions has not reflected the country's growing economic weight, which is second only to that of the United States. The analysis below examines Chinese scholars and officials' dissatisfaction with existing global governance institutions (GGIs), with a special focus on the World Trade Organization (WTO) and the International Monetary Fund (IMF). It also discusses the underlying aspirations that drive proposed changes to various GGIs according to discussions with Chinese experts. In addition to obtaining greater representation and formal power for itself, China is also prepared to navigate a much more fragmented and complex set of GGIs across different regions and issue areas. Organisation for Economic Co-operation and Development (OECD) countries should make existing GGIs more inclusive of all developing countries, including China, and also actively engage with regional governance bodies. Meanwhile, if China is to have global influence in the financial sphere, it needs to carefully navigate toward a clean float and capital-account openness.

CHINA'S ENGAGEMENT WITH THE IMF

First of all, it is important to acknowledge that among the articles cited and sources interviewed for this report, none of them supports a Chinese exit from existing GGIs. In fact, Chinese experts who are involved with existing international institutions remain enthusiastic participants in GGIs, and are very proud of China's growing role in these institutions over time.[1]

Still, Chinese analysts, including economists and those in the security establishment, see GGIs like the IMF as a crystallization of the balance of power in 1945, not today.[2] Chinese experts, officials, and Chinese citizens working in GGIs feel that China's influence and formal power in these institutions do not match its economic-powerhouse status in the world. While China, as the second-largest economy in the world, has

IMF Managing Director Kristalina Georgieva talks to Chinese Premier Li Keqiang before a news conference in Beijing in 2019. REUTERS/Florence Lo.

a vote share of a little more than 6 percent in the IMF, the United Kingdom, which has a GDP that is less than one-fifth of China's, gets a vote share of 4 percent.[3] This representation deficit remains a major source of dissatisfaction among Chinese experts across different disciplines and specializations. The stakes for China are seen as high. According to an expert at the Chinese Academy of Social Sciences, "Since the status of countries in the IMF is directly related to the maintenance and realization of their own interests, the competition of countries to have a greater say (at the IMF) has never stopped."[4]

Chinese experts who work closely with GGIs further note that it has been difficult to place Chinese nationals into senior or even mid-level positions in the World Bank and the IMF.[5] Years of strenuous lobbying by China have led to some notable improvements, such as having a Chinese national as deputy managing director, starting with Zhu Min in 2011. Still, relative to China's role as the second-largest economy and as the largest trading country, its role in the senior management of the IMF and World Bank remains limited relative to smaller economies in Europe. The rising influence of China, however, has led to some notable policy successes, such as the successful lobbying for greater weight for the renminbi in the special drawing right (SDR) basket and revising the discussion on Russia and Ukraine in the spring meeting of the IMF in 2022.[6]

Related, Chinese financial experts also are enthusiastic about increasing the renminbi's role in the SDR basket at the IMF. On the day that the renminbi was first included in the SDR basket in 2015, the People's Bank of China (PBOC) held a special press briefing to discuss the importance of the SDR inclusion. According to Yi Gang, PBOC vice governor and future PBOC governor, the renminbi's inclusion in the SDR basket "is a milestone event. It is of great significance. Its benefits will be felt for a long time to come. It marks the recognition of the international community for China's economic development and the achievements of reform and opening up, especially the recognition of the internationalization of the RMB."[7] Clearly, PBOC technocrats saw inclusion as an important step toward renminbi internationalization because, among other things, it would create an organic demand for renminbi-denominated assets.[8]

In 2022, the renminbi's share of the SDR basket further increased to 12.28 percent from the original 10.92 percent. Both in 2015 and today, the PBOC and Chinese technocrats involved with the IMF remain generally satisfied with the weight of the renminbi in the SDR basket. To be sure, today they would like the renminbi SDR ratio to rise further, commensurate with China's role in global trade, but the far bigger issues remain low Chinese representation in the senior ranks of GGIs and deficits in formal IMF voting power.[9]

Finally, in terms of China's role in the IMF's core mission—debt surveillance and restructuring—China is generally satisfied with its role in the IMF and the World Bank. As a major lender to other developing countries, China increasingly recognizes that sovereign distress needs global cooperation to resolve it, rather than just the isolated efforts of individual countries. At the same time, the Paris Club, dominated by European and North America creditors, has priorities very different from those of Chinese state-owned lenders. Thus, Chinese experts on this issue generally find that the IMF and Group of Twenty (G20) provide much better institutional settings for global cooperation on sovereign-debt restructuring.[10] The recent $1.1-billion packages each for Zambia and Pakistan, and the $2.9-billion package for Sri Lanka, all approved by the IMF, will benefit Chinese financial institutions, which had lent billions to this trio of countries in the past decade.[11] To be sure, not all of the IMF funds will end up in the pockets of Chinese creditors, and creditors in general will likely need to make large concessions in terms of lengthening the maturity of the credit.[12] The Belt and Road Initiative (BRI) clearly shows that external lending is a major foreign policy tool of China, so any global cooperation that limits the financial fallouts of this policy tool is seen as a net positive for China.

CHINA'S FRUSTRATION WITH THE WTO

China has benefited enormously from joining the WTO, and Chinese experts, even Xi Jinping himself, widely acknowledge this.[13] Yet, in contrast to the IMF and World Bank, in which China has had some success in gaining formal representation and agenda-setting power, Chinese trade experts have been frustrated by perceived limitations placed on China's representation in the WTO by the United States. For example, two analysts at the China Institute for International Issues, a think tank affiliated with the Ministry of Foreign Affairs (MFA), outline the multiple channels through which the United States and other OECD countries have blocked Chinese actions in the WTO. First, US or European judges on the Appellate Body delayed resolving cases, sometimes indefinitely, or muddied the water by introducing "irrelevant" issues.[14] Also, because appointing new judges required US approval, US refusal to do so has placed the WTO Appellate Body in stasis with fewer than the minimally required three judges.[15] Today, the Appellate Body has no appointed judges. Even Europe and Canada have found this an undesirable state of affairs.[16]

Chinese analysts also see US maneuvering behind the lack of progress in global trade negotiations. The Doha Round lapsed into inaction because of clashing interests between OECD countries, led by the United States, and developing countries. While advanced countries wanted investment freedom, less protection for services sectors, and more labor rights and environmental reform, developing countries, including China, demanded fewer agricultural subsidies in advanced countries and greater institutional power in the WTO.[17] Zhang Yansheng, a veteran trade economist who has worked for various government think tanks, specifically blames the United States for abandoning the Doha Round in favor of the Trans-Pacific Partnership (TPP) when it ran into resistance to its agenda.[18]

For experts in China, the way forward in the WTO is institutional reform that gives China and other developing countries a greater voice within the institution. As a researcher at a government think tank puts it, “the WTO is a battleground that China does not seek to overturn but to influence and reform gradually so that the global trade order is less influenced by the US and more open.”[19] Unlike the IMF and World Bank, which have weighted voting systems, the WTO requires unanimous consent by members, which means even one member can stop the whole process. This is seen as a major flaw by Chinese experts, the revision of which should be a goal for institutional reform undertaken with the cooperation of European countries, and even Canada.[20] After extensive institutional reform, Chinese experts see the WTO as a promising global body that can eventually extend its regulatory reach to finance, energy, food, the Internet, public health, and even regional security.[21]

In the meantime, rising trade protectionism around the world means that China must find ways around the WTO to facilitate global trade, of which China is still the biggest beneficiary. Trade and geopolitics experts in China agree that regional free-trade blocs are much more nimble than the WTO and do not suffer from the same stasis, which means China should intensify its effort to participate in and build institutions in these regional trading bodies.[22] Chinese analysts, especially the trade economists among them, see regional trading blocs—such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the Regional Comprehensive Economic Partnership (RCEP), the Association of Southeast Asian Nations (ASEAN), and the Shanghai Cooperation Organisation (SCO)—as complementary to China’s dominance in the value chains of many manufactured goods in the Asia-Pacific region.[23] In order to reap the benefits of trading with China, both as buyers and sellers, members of regional trading blocs are more likely to work with China to devise mutually beneficial rules. Some analysts see RCEP as the shining model of regional trading blocs, and one in which China has a role in shaping the organization–

Overall, the Chinese government and Chinese experts are generally satisfied with the underlying institutions and decision-making process in the IMF and the World Bank. Under-representation of Chinese nationals in the senior ranks of these organizations, which also is correlated with China’s low voting share, remains a concern. In the meantime, both the Chinese government and Chinese experts have much more serious issues with the WTO, where the United States is seen as the intransigent defender of an unproductive status quo. China seeks to make incremental changes to the WTO institutions, while building up regional trading blocs in conjunction with regional partners.

LONGER-TERM OBJECTIVES

While scholars and policymakers in China display varying degrees of satisfaction with the current GGIs, what are some of the medium- to long-term Chinese objectives that revisions in GGIs can help realize? Foreign policy experts across different think tanks share a widespread consensus that the United States can no longer exercise hegemonic power in the global order, which opens up space for China to revise the international order in conjunction with other countries.[24] According to one account, the global coordination to rescue the global financial system in 2008–2009 was the last instance in which the United States successfully exerted hegemonic power to compel concerted actions among all major global powers.[25] After that global financial crisis, the United States has lost the ability to compel concerted global action, even in the midst of a true global crisis such as the COVID-19 pandemic. In this new reality, the goal of Chinese diplomatic engagement with the rest of the world would be the revision of global governance institutions

Chinese President Xi Jinping waves as he arrives for a reception at the Great Hall of the People in Beijing. REUTERS/Florence Lo.

from “Western rule” to “global rule,” which involves changing decision-making rules and procedures across all of the major international organizations.[26]

For other scholars, such as Qin Yaqing from the Foreign Affairs College, the end of US hegemony means a global governance system that is “multi-level, multi-issue, and multi-organizational.”[27] In this new reality, China can operate nimbly across regions, issues, and organizations, and can choose allies to achieve various objectives. Ultimately, the fragmentation of global governance institutions would further realize the demise of the previous hegemonic order.[28] In traditional GGIs, such as the UN, G20, Asia-Pacific Economic Cooperation (APEC), and SCO, China can consolidate its influence in them and expand their mandates into new areas of global concerns, such as global public health, Internet standards, and the climate.[29] Meanwhile, financial resources available in China’s own GGIs—including the Asian Infrastructure Investment Bank (AIIB) and New Development Bank (NDB)—can be deployed to address a rising number of issues, in conjunction with regional partners.[30] In a complex global governance system, power and leadership would not necessarily accrue to the traditional core stakeholders, but to “whoever can display sufficient ability to govern and to coordinate.”[31]

Within the financial realm, the internationalization of the renminbi is still seen as a paramount goal that is compatible with a whole range of other objectives. Xia Bin, an influential economist who headed the Institute of Finance in the State Council Development and Research Center, and a former colleague to Vice Premier Liu He, outlined major advantages of the reserve-currency status for the renminbi back in 2011. First, a country with a reserve currency “can invest and buy assets overseas directly with one’s own currency without borrowing another currency,” presumably leaving one less vulnerable to financial sanctions by another country.[32] Second, the monetary policy and financial deepening of reserve-currency countries can affect the distribution of resources around the world. Finally, Xia also notes that wide circulation of the renminbi would produce seigniorage income for China.[33]

More recent analysis by economists close to policymakers suggests that further consolidation of the renminbi as a reserve currency can lead to more than $1 trillion in foreign capital invested in renminbi securities, which would help China's growth.[34] Although these advantages of renminbi internationalization were outlined more than a decade ago, one can only assume that recent sanctions imposed by the United States on Russian financial institutions only intensified China's desire to become independent of the dollar-dominated global financial system. Despite further progress in the SDR basket, foreign holding of Chinese bonds remains modest, at $472 billion in June 2022 after briefly surpassing half a trillion in early 2022.[35] In the medium term, technocrats in China hope that renminbi internationalization will dovetail with currency digitalization, making the renminbi a premier sovereign digital currency in Asia.[36]

DISCUSSION AND OECD RESPONSES

The preceding discussion summarizes the views of Chinese foreign policy experts and practitioners with regard to existing GGIs. A review of recent scholarship by foreign policy and financial experts also reveals two medium-term objectives of Chinese engagement with GGIs. First, Chinese experts see the fragmentation of global financial and trade regimes as an opportunity for China to play a greater role in shaping agendas across key issue areas.

The IMF provides a model for how existing GGIs can be governed more inclusively. The IMF has had a transparent voting system, which is determined by relative GDP and countries' past and current contributions to the organization. As the GDP share of developing countries or regions rises, their influence in the IMF has grown. For some regions, such as Africa and South America, the GDP weight of individual countries remains limited in most cases, but their weight as a region has risen, which can be reflected in their representation in GGI management and, in the future, in GGI voting power. Meanwhile, South Asia's GDP weight has also become significant (independent of China), and should be reflected in GGIs' governance. This more inclusive governance also would address China's concern about the US- or Western-centric nature of traditional GGIs.

Core members of the traditional GGIs—such as the United States, the United Kingdom, Japan, and the European Union—would do well to recognize institutional fragmentation as facts on the ground, which are basically unstoppable at this point. If OECD countries would like substantial roles in emerging GGIs like CPTPP and RCEP, as well as a consolidation of the traditional GGIs, they, like China, must "display sufficient ability to govern and to coordinate."[37] OECD countries, either together or on their own, should come up with coherent strategies to advance some of their core concerns, including intellectual-property rights, environmental protection, and labor rights, in these various regional governance bodies. The key to navigating the new complexity is to be prepared to form issue-based alliances with China or other countries in order to advance a set of core agendas.

In terms of China's quest to internationalize the renminbi, the Chinese government should recognize that capital-account closeness will continue to be a major barrier to this objective. The IMF should continue to advise China on how to gradually move toward a "clean float" of its currency and open its capital account without triggering a crisis. Ultimately, however, this will be a difficult process that requires a great deal of political will within the Chinese government.

Victor Shih is the Ho Miu Lam Chair in China and Pacific Relations and associate professor of political science at the University of California, San Diego School of Global Policy and Strategy. He is the author of *Factions and Finance in China: Elite Conflict and Inflation* (Cambridge University Press, 2008). It is the first book to explore the linkages between elite politics and banking policies in China. His second book, Economic Shocks and Authoritarian Stability, will be published by the University of Michigan Press. He is the author of numerous articles appearing in academic and business journals, including the *American Political Science Review, China Quarterly, Comparative Political Studies, Journal of Politics, Wall Street Journal,* and *China Business Review*, and he is a frequent adviser to the financial community. Dr. Shih holds a B.A. from the George Washington University and a doctorate in government from Harvard University. He also was a former principal at the Carlyle Group in the global market group. His current research concerns coalition composition under Mao Zedong and Deng Xiaoping. Specifically, the research inquires whether Mao and Deng strategically promoted certain types of officials into senior positions in the military and in the party in order to safeguard their power. Dr. Shih also has ongoing research projects on quantitative measurements of factions and the impact of factions on elite promotions, rent-seeking activities, and the growth of the private sector. He is also researching the footprints of Chinese defense firms around the world.

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ENDNOTES

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