CHINA and the G20

The Interplay Between an Emerging Power and an Emerging Institution

SIIS | FRIEDRICH EBERT STIFTUNG

Edited by

Catrina Schläger
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Foreword

Friedrich-Ebert-Stiftung (FES) and Shanghai Institutes for International Studies (SIIS) are long-term productive partners. For more than thirty years now the two institutions have combined their respective resources and capacities in a range of international academic activities and brain-storming seminars, which have produced wisdom and policy suggestions and have promoted healthy debates in the mass media. In addition, foreign and Chinese academics and decision-makers have strengthened their understanding and exchanges. Since the great financial crisis of 2008-2009, the role of the G20, as an updated global macroeconomic coordination mechanism, has been substantially boosted in global economic governance. FES and SIIS have held several international seminars on this issue, inviting experts from the main member countries of the G20 to debate various important issues facing the G20 and global economic governance, such as the G20's role in strengthening and promoting global macroeconomic coordination, reform of the international financial system, the stability and effectiveness of the international monetary system, the integration of international trade and investment regimes, the new agenda of international development and the complex relations among the major powers. This book reflects these experts' observations on the development of the G20 and its influence on global economic governance.

China is the largest developing country, the biggest emerging power and also the second largest economy in the world. This political status and economic scale have made China one of the most important actors in the G20, with a special role. On one hand, as the largest developing country and emerging power, China has the responsibility to pursue and safeguard the general interests of developing countries; in the other hand, as the second largest economy in the world, China also has the responsibility to cooperate with the developed countries, to construct and maintain a more open and equal global economic governance environment. Besides, China is the important middle link of the global product chain and global value chain and has a crucial role in connecting developing economies and developed economies. Therefore, the sustainability of China's economic development and its foreign economic relations are key to the prosperity and stability of the global economy. The first part of this book mainly discusses policy issues such as finance, trade and development; in the second part, the focus turns to China's relationship with the United States, the EU and the other BRICS countries and their implications for the G20's development.

China is actively bidding for the right to host the 2016 G20 Summit. We hope that this collection of papers, pooling wisdom from different countries, as a contribution to the various academic and policy debates before the Summit, can help to stimulate and invite further insightful and foresighted views. We also hope that this book can make some contribution, however small, to enable China to smoothly host the Summit and to make the G20 a better global economic governance mechanism. We thank all the scholars and officials who managed to participate in our seminars, despite their very busy schedules, as well as the organizers. Without their support, our two institutions' continuous and productive international academic cooperation would be impossible.

Chen Dongxiao, The President of Shanghai Institutes
for International Studies (SIIS)
Catrina Schläger, Resident Director Friedrich-
Ebert-Stiftung (FES), Shanghai Office

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Barry Carin

1. Introduction

The prospects for the continued rise of China and the effectiveness of the G20 are closely intertwined. There have been two significant trends in the world economy in the last five years. First is the consistent economic and financial growth of China. Second is the growing concern about the ineffectiveness of the G20 as the premier forum for international economic cooperation. The 2009 London and Pittsburgh G20 Summits are generally recognized as successes. The decisions were widely applauded. However, since 2010, the G20's performance has been well below expectations, especially in terms of implementation of its earlier decisions.

This chapter makes two arguments. First, sustained economic growth in China depends in significant part on an effective G20, and second, that the future relevance and effectiveness of the G20 will be primarily determined by Chinese leadership. It reviews the prospects for Chinese leadership in the G20 in light of the legacy of Deng Xiaoping's "quiet" foreign policy approach—*Taoguang yanghui*. Then it concludes with specific procedural and substantive suggestions for leadership in the G20 that China may find appropriate.

2. China's Economic Prospects

China is recognized as a major global economic and trade power. It is currently the world's second-largest economy, largest merchandise exporter, second-largest merchandise importer, second-largest destination of foreign direct investment (FDI), largest manufacturer, and largest holder of foreign exchange reserves [...]. Many economic analysts predict that on a PPP basis China will soon overtake the United States as the world's largest economy [...]. This will occur by 2017 and that by 2030, China's economy could be 18.6% larger than that of the United States'(Morrison 2013). In its 2013 Global Manufacturing Competitiveness Index, Deloitte (an international consulting firm) ranked China first in manufacturing in 2013 and projected it would remain so in five years (the United States ranked third in 2013 and was projected to rank fifth in 2018).[1]

Continued Chinese growth at rates close to the last thirty years is essential to deal with China's domestic challenges. High growth rates will be dependent on a stable and prospering global economy. China was affected significantly by the 2008 global economic crisis. As international trade plunged, China's exports, imports, and FDI inflows declined, GDP growth slowed. The need for customers for China's exports translates into a need for sustainable balanced growth in the rest of the world. China needs to avoid a world of international financial instability and competitive exchange rate devaluations. China needs G20 trading partners to maintain the standstill on protectionist measures. For Chinese growth to continue, the G20 must be successful in its mission as the "premier forum for international economic cooperation". United Nations' organs—ECOSOC or UNCTAD—are not up to the job of coordinating national macro-economic policies or maintaining an open trading system.

China is projected to become the largest net oil importer by 2020 (due in part to projected increases in U.S. domestic oil production). By 2035, China's net oil imports are projected to exceed 13 million barrels per day. The U.S. Energy Information Administration (EIA) projects that by 2035, China's carbon dioxide emissions (CO_2) could be nearly double its current levels. The emergence of China as the world's largest emitter of greenhouse gasses is a future challenge in the making. A study by ExxonMobil projects that, by 2030, China's CO_2 emissions could equal the level in the United States and EU combined.

A stable rules-based global market will be required to satisfy China's growing demand for energy and raw materials, and avoid conflict concerning its emissions. The world will attempt to come to grips with imminent unacceptable consequences of climate change by exploring measures to reverse the growth of emissions. If China is not active in organizing a multilateral response, desperation may lead to unconventional trade restrictions that limit China's exports. Ideas such as making border tax adjustments consistent with World Trade Organization rules may be proposed to discipline high emitters. China will be better served by being one of the rule makers rather than a rule taker.

There are several global issues whose positive resolution would support China's growth. China has specific interests that must be defended in the areas of an international reserve currency, better regulation of financial derivatives, reform of international financial institutions and on developed country agricultural subsidies. The legacy of the United Nations Convention on the Law of the Sea, which came into effect in the 1990s, has triggered a large number of international disputes regarding the exploitation of undersea resources. It is in China's interest to establish a system to amicably resolve the numerous disputes affecting China's interests. Peaceful resolution will remove uncertainty and stimulate investment.

An effective G20 is important for Chinese continued growth. There is no more promising venue than the G20 to break the deadlocks or make progress in all these global issue areas. In fact, there is no alternative venue on the horizon.

3. The Future Effectiveness of the G20 Depends on Chinese Leadership

In 2008, the G20 supplanted the G7 as the core group of countries that devise the rules for the global economy. Initially the G20 was praised for its crisis management and macroeconomic policy coordination. The record of the last four years is discouraging. Currently, there is a well-founded concern about the effectiveness of the G20. The G20 is at risk of evolving into irrelevance, with no clear alternative for an effective global crisis management committee, let alone a global economic steering committee. In fact, given the hopeless stalemate in the American government and Europe's parochial inwardness due to the never ending Euro crisis, the future relevance of the G20 will be primarily determined by Chinese leadership.

3.1 Substance

In terms of substance, the G20's main success is the 2009 coordinated economic stimulus package, which prevented a looming global depression. There is nearly universal agreement that the G20 action was critical and the counterfactual would have been a disastrous world-wide depression. The establishment of the Financial Stability Board is counted as a success by most observers, but the G20 is still criticized for the very leisurely timetable for action on shadow banking, over the counter derivatives and on systemically important financial institutions (too big to fail). The G20 has been criticized for non-delivery of several of its commitments—notably IMF quota reform and inefficient fossil fuel subsidies. The apparent diagnosis is that the G20 has no leadership. The United States is paralyzed by gridlock, which is unlikely in the near future. Middle power countries like Korea, Mexico, Australia and Turkey do not have the weight. Russia was an enigma in 2013.

Recent failures include vacuous Communique language on critical international economic issues like the Doha round, and on the United Nations negotiating process on climate change. Progress is poor, some argue regressive, on coordinated macro-economic actions (New Rules for Global Finance 2013). In the development field, there are few concrete examples of significant concrete commitments, just a lot of empty talk on food security, financial inclusion, and infrastructure. There are many other global governance gaps that will not fill themselves. From think tanks to the *Financial Times* to the World Economic Forum, observers have noted the G20's declining credibility (Thirlwell 2012).

3.2 Process

In terms of process there have been several unfortunate decisions that compromise the G20's effectiveness and reputation. First was the ill-advised surrender to the demands of the non-G20 countries to be at the G20 table. Twenty at the table already tests the limits for the size of an effective decision making committee. The first G20 presidencies surrendered and reacted to Spain's whining by inviting it as a permanent guest—despite the gross overrepresentation, by any measure, of Europe in the original G20. The 2010 hosts, Canada and South Korea also invited the chair of NEPAD, the chair of the African Union, and the chair of ASEAN. Singapore has been invited as chair of Global Governance Group (3G), an informal grouping of 28 non-G20 countries. Recent hosts have taken the liberty to invite a local neighbor. Australia is inviting New Zealand to the 2014 Brisbane Summit. Thus, 20 became 25 (or 26 since the European Union gets two seats). Despite these attempts to improve legitimacy, the pressure is unremitting from those still excluded from the table. Norway's foreign minister has described "the group of the 20 most important industrialized and developing nations .... as the 'greatest setback' for the international community since World War II" (Store 2010). But, the bigger and the more representative the group, the less effective it will be.

The second regrettable process decision was the Canadian and South Korean G20 presidency invitations to international organizations to join the summit. The United Nations, the International Labour Organization, the World Bank, the International Monetary Fund, the Organization for Economic Co-operation and Development, the World Trade Organization, and the Financial Stability Board all now expect an invitation.

The third unhappy decision has been that G20 presidencies have in effect trashed the Troika concept in practice. The idea is to include the previous and future presidency in a Troika with the annual rotation of hosts. The Troika was to provide for the institutional memory and continuity required in an informal organization that does not have any form of a permanent Secretariat.

4. Prospects for Chinese Leadership in the G20

4.1 "Never seek leadership"

It is not in China's interest for a "G Zero" with an "empty driver's seat" (Bremmer and Roubini 2011). China's growing economic power has made it a critical and influential player on the global stage on a number of issues, such as global economic cooperation, climate change, nuclear proliferation. But China has been perceived as consciously pursuing a "quiet" foreign policy, avoiding international leadership, while concentrating on domestic challenges.

In the early 1990s, Deng Xiaoping is widely credited with setting out the approach for China's quiet foreign policy approach—*Taoguang yanghui*.

His aphorism of twenty four Chinese characters has various translations but is usually expressed in English as:

> Observe calmly, secure our position, cope with affairs calmly, hide our

> capacities and bide our time, be good at maintaining a low profile. Never claim leadership.[2]

This common English translation is pointed to as the explanation of China's low profile, and diffidence in discussions of global governance.

One explanation of Deng's advice is that the emphasis on the low profile in international affairs "was to avoid flashy politics and grandiose demonstrations of leadership, escape carrying the socialist or developing countries flag [...]". Confusion stems from a lack of conceptual clarity about its content resulting from its translation. Some translations have included "hide brightness, nourish (or cherish) obscurity", suggesting duplicity. Zhang Qingmin disagrees, arguing that adoption of a low profile and self-effacing demeanour in foreign policy dealings is a "style" rather than a strategy (Bluen 2011).[3]

Wu Jianmin (2012) also describes the customary interpretation of Deng's advice as the result of a poor translation. The guideline should be translated as "keep a low profile and bide our time, while also getting something accomplished". He explains that:

> Keeping a low profile means being modest and prudent, rather than arrogant and complacent. Like a person, a state should also be practical, realistic, modest and prudent, rather than domineering and making enemies everywhere.
>
> Keeping a low profile does not mean doing nothing. Solving the domestic affairs of China well is beneficial to both Chinese people and the world.
>
> Keeping a low profile and being modest and prudent also mean abandoning the attitudes and actions of a major power and treating all countries equally, which is a trump card in Chinese diplomacy.

"Those in favour of abandonment of *taoguang yanghui* argue that with China's increasing power and economic muscle in the international system, it should adopt a more responsible and outspoken foreign policy" (Tyler 2013). Bremmer put it well: "Outsiders, particularly Americans, have called on China to become a 'responsible stakeholder' in the international system and have wished aloud that as its economy depends more heavily on investment in countries and companies in every region of the world, it would begin to behave as a global partner, one that privileges peace and predictability above all else" (Bremmer 2013).

4.2 Graduating from Deng's Maxim

China is a different country than it was in the early 1990s. "China has increased its GDP tenfold since reform and opening up and has averaged 8% annual GDP growth, even through a series of global economic downturns. China has recently overtaken Germany as the world's largest exporter and Japan as the world's second largest economy. China today is not only the world's second biggest economy but is also home to the second-largest number of billionaires" (Factor 2010).

Jonathan Pearlman wrote that 2009 "will be remembered, say analysts, as the year China abandoned its diplomatic quietism and Beijing displayed a clout on the international stage to match its global economic weight." Pearlman was writing about the climate change conference at Copenhagen, where China was a key player. He noted comments that China's willingness to exercise global leadership during the financial crisis was largely welcomed and encouraged by the West.

Wang Yizhou recently wrote that "China's new leaders somehow possess a different global consciousness than their predecessors—more confident, ambitious and enterprising" (Wang 2013). He quoted Xi Jinping: "Leaders in this term of office are shouldering the great mission to realize the dream of Chinese national revival." Wang noted that besides economic growth and increased national security the third goal of the Chinese dream is "to act as a newly emerging great power and contribute to peace and prosperity in East Asia, as well as global development [...] emphasizing China's role as a responsible great power [...] dedicated to the cause of helping to create a more reasonable and just world order, thus gaining more respect from the world".

Wang's prescription was to "build a smart balance of contention and co-operation", as in traditional Chinese strategic thought, "to resist but not fight, to co-operate but not assimilate." He recommended attempting to "keep the balance between solving problems on the basis of international common practice and providing public goods with Chinese characteristics".

There is a mutual self-interest and investment that all G20 members have in the global economy. Reporting on a September 2013 conference in Shanghai, Melissa Conley Tyler noted that the "Chinese representatives used reassuring language: 'do away with zero sum thinking', 'do away with Cold War mentality' and 'build a progressively cooperative mentality' for a 'harmonious and prosperous world'" (Tyler 2013).

An authoritative version of Chinese thinking was provided by State Councilor Yang Jiechi, in September 2013.[4] A close reading reveals several encouraging dimensions.

- The Party Central Committee [...] has promoted innovations in diplomatic theory and practice [...], and taken a number of major diplomatic initiatives which [...] enriched and developed the system of diplomatic theory with Chinese characteristics.
- China's new collective central leadership is committed to reform and opening-up, the path of peaceful development and the strategy of win-win cooperation.
- *Deeply engaging in and shaping processes of multilateral diplomacy.* China's commitment to the advocacy and practice of multilateralism and the great value it places on the important role of the United Nations and other international organizations.
- BRICS provides a strong impetus to the establishment of a new international political and economic order that is fairer and more equitable.
- China's diplomacy displays such features as rich ideas, clear priorities, firm positions, flexible approaches and distinctive styles.
- Win-win cooperation, abandoning a zero-sum mentality, accommodate the other's interests while seeking one's own, promote common development while developing oneself, and continue to deepen the pattern of shared interests.
- Strong synergy between the domestic and external agenda.

Perhaps the most encouraging sentence in Yang Jiechi's speech was:

> While continuing to improve on strategic planning, *we should give greater play to the leading role of leadership diplomacy*, vigorously grow relations with other major countries, step up friendship and win-win cooperation with our neighboring countries and other developing countries

and move the international order in a more just and equitable direction (Yang 2013).

5. Chinese Leadership: G20 Initiatives

China's unquestioned first priorities should be to maintain stability at home and protect its development. These priorities are in fact no different than those of the other G20 countries. Leadership in the G20 can support these priorities. China has been described as seeking "change through accommodation, negotiation and consensus-building over a long time span. G20 is the perfect forum for the relationship-building required. [...] China has everything to gain from embedding its relationships with other major players in a congenial multilateral forum like the G20, which represents developed and developing nations equally [...] a forum to build relationships and pursue its interests as common interests for incremental and long-term reform of the international economic system" (Tyler 2013).

China will hopefully be the G20 president in 2016, following Australia in 2014 and Turkey in 2015. At the time of writing, the choice is between China and Japan.[5] A Chinese G20 presidency can rescue the G20 from irrelevance and promote several win-win substantive initiatives. But first, the G20 work methods must change to enable effective results.

5.1 Process Innovations

The process is suffering from several dimensions, including the sidelining of the Troika, excessive involvement of international organizations, the lack of a secretariat, and the excessive tilt appeasing demands for outreach, transparency and accountability.

In its presidency, China should exploit the prerogative of the chair and redesign the G20's informal institutional framework and functions, rather than passively accepting those already existing. The first reform should be to transform the Troika into a "bureau" or executive committee by adding the US and one other major country, the core group that will crunch the issues and do the work. Moises Naim advises "forget about trying to get the planet's nearly 200 countries to agree. We need to abandon that fool's errand in favor of a new idea:

minilateralism" (Naim 2009). With a five country inner body, work can actually get done. There were more than 100 people in the room at the December 2012 Sherpa meeting in Moscow—a guarantee of paralysis. The bureau's meeting would be open to the other G20 Sherpas, but the work would be expected to be done by the five formal members.

A second reform should remove international organizations from the G20 Sherpa process—one option is to invite them to send in their ideas before meetings. Another option is to create an IO20, analogous to the B20, for international organizations to meet together and submit their consensus ideas to the Sherpa process.

A third reform would be to cease the practice of inviting Spain and other guests. More than fifty people have been seated at recent G20 summit tables—depreciating the word "summit". The meetings of leaders have degenerated from intimate conversations at the initial G7 meetings into a circus where bilateral meetings on the margin have become more important than leaders meetings where no one pays attention.

Outreach exercises and the time and resources they demand have grown to outlandish proportions, both to solicit ideas and to report results. This has been a grievous mistake. Expectations have been raised that cannot be fulfilled. As the cliché goes "If everything is a priority, than nothing is a priority". A fourth reform would cut back outreach dramatically. One option would be to limit outreach to one enormous "Davos" type conference early in the presidency.

The G20 has suffered from agenda creep despite each summit host's announcement to go back to basics and focus the agenda on its core priorities: global economic growth, financial stability, and international financial institution governance reform. In 2010 for example, the South Koreans added Development to the agenda despite Il Sakong's warning "don't dilute the agenda by adding heavyweight issues like climate change". As a fifth reform, the Chinese presidency could implement the recommendation that any country proposing a new topic must explain in writing an explanation of a critical gap for which the G20 can usefully provide political guidance, how the G20 can advance the issue and the "sunset provision" for G20 involvement (US-China Study Group on G20 Reform, 2012).

The lack of a permanent secretariat to provide for institutional memory and continuity is a clear deficiency of the G20's preparatory and follow-up process. Proposals to set up a formal secretariat have been opposed by most members who insist that the G20 remain an informal group controlled by leaders. In 2010, just before France's presidency of the G20, French President Nicolas Sarkozy proposed the formation of a G20 secretariat to oversee the implementation of its decisions.[6] The call for a secretariat has been persistent—a recent example is the call by the China Center for International Economic Exchanges to address the weakness in the forum by the "establishment of a permanent secretariat for the Group of Twenty in order to implement proposals agreed upon at summits and give emerging countries a greater voice".[7]

A "non-secretariat" is a promising option to provide continuity. In diplomatic tradition, a "non-paper" is an informally provided discussion document, without an identified source, title, or attribution. It does not commit anybody to anything; rather it is provided as an aid to facilitate negotiations. As a sixth reform, China could establish a G20 "non-secretariat", to carry out preparations for summits should become the norm. It would be resident in the G20 host country, rotating with the presidency. To ensure control is retained by leaders, it would be staffed by officials from the troika governments who would remain on their own governments' payrolls. Other governments could second staff on the same basis. The Secretariat could be managed by the troika countries sherpas. In September, 2013, the BRICS group (Brazil, China, India, Russia and South Africa) announced it will "inaugurate a virtual secretariat for better coordination in global affairs among the member countries within months" (Bricspost 2013).

5.2 Ideas on Substantive Issues

As an active G20 president China can proactively shape global rules as well as increase the effectiveness of the G20. It can begin in 2015 as a member of the Troika, with Turkey and Australia the 2014 presidency. China can prepare the ground by initiating work to inform G20 decisions in 2016. For example, China could decide to bolster the international financial system, including by revisiting the recommendations to go slow on making the Financial Stability Board (FSB) a treaty-based legal personality and financial autonomy.[8] A second idea would be to try to reinforce the international economic system where it is weakest. In 2015, it may become apparent that the United Nations needs help for both climate change and post 2015 development agenda processes—both may breakdown in disagreement. Or China may decide to focus on some other gap in global governance, perhaps in the trade system or in internet governance, for example.

The G20 has yet to act to mitigate the potential systemic risks associated with shadow banking. These include spillover effects with the regular banking system, risks of "runs" on money market funds, perverse incentives associated with securitization, among others. There is still much work to be done on the regulation of over the counter derivatives. China's signature initiative could be envisioning the ideal powers, resources and governance structure of the FSB of 2020, and drawing the G20 roadmap to make it happen.

The United Nations Framework Convention on Climate Change is an impending train wreck. Each year the negotiators paper over their differences, claim success and agree to meet again. David Victor has argued that progress can only arrive "via fragmented and multispeed efforts" in a decentralized system "akin to the messy federalism that James Madison embraced in the U. S. Constitution", a global federalism of climate policy emerging through innovation within nations, regions, and individual firms (Victor, House and Joy, 2005). It will become apparent in early 2015 that yet another deadline has been missed and that there is no prospect for agreement on binding emission targets and financial transfers. Then Chinese leadership will be sorely needed.

China could champion some bottom-up initiatives that will be constructive parts of any climate solution. One example is a global Research and Development consortium to produce open source, license-free, patent-free results. The organization could be modeled on the International Space Station, or the Large Hadron Collider; alternatively, expenditures could be focused primarily in a network of cooperating institutes located in countries that provide the financial support.[9] Another example would be to focus the ongoing work on standards on heavy emitting production processes.

A consensus is unlikely to emerge from the intergovernmental process to succeed the Millennium Development Goals. The sheer number of candidates for

Post 2015 Development Goals will make an agreement elusive. Special interests will promote their own priority: poverty eradication; jobs; food security; water; health; education; sustainability; connectivity to power, transport, financial and communication infrastructure; resilience; peace and security, democratic governance, rule of law, gender equality and human rights. China could craft a narrative that recognises the intrinsic inter-linkage among goals, and which integrates the three dimensions of sustainable development. China could propose a single framework and a set of universal Goals, applicable to all countries, while taking account of differing national circumstances and respecting national policies and priorities. Fashioning a judicious win-win approach to unlock the coming stalemate, impossible in the UN context, endorsed by the G20 will be very welcome.

Conclusion

China's peaceful rise and continued economic growth require global stability and rule of law. The economic landscape is constantly changing. Technological innovations lead to spillovers and cross border effects. Regulation is no longer effective if it stops at the national border. The rules of the game need constant updating. The G20 has been designated as the forum for international economic cooperation. The G20 has been drifting, partly because the United States is no longer providing leadership to the multilateral system.

China can re-energize the G20 process by building on the Troika to establish an effective executive committee, rationalizing the involvement of international organizations, non G20 attendance, and outreach, tight agenda management, and establishing a "non-secretariat". China can build momentum to fill key global governance gaps or unlock deadlocked multilateral processes. The crisis in financial industries' regulation, the need for action in climate change negotiations, and the search for a post-2015 paradigm to succeed the Millennium Development Goals are all great opportunities.

It is time for the G20 to do more and avoid empty talk. While remaining modest and prudent, China can lead the G20 by exercising the recognized prerogatives of the G20 presidency, pursuing innovative solutions and devising win-win results to the benefit of all countries.

Notes

[1] The index was based on a survey of 550 chief executive officers and senior leaders in manufacturing companies around the world.

[2] E.g., http://www.nydailynews.com/opinion/deng-xiaoping-architect-china-rise-defined-decade-article-1.475194#ixzz2nZR4ldP6.

[3] Reporting on address of Peking University Professor Zhang Qingmin to the Thinkin China community on the history and debates around the continued applicability of China's Foreign policy approach of *taoguang yanghui*.

[4] Yang Jiechi is State Councilor and Director of the Office of the foreign affairs Leading Group of the CPC Central Committee, People's Republic of China.

[5] Carin (2010) for the "bucket system" of rotation of the G20 presidency.

[6] http://en.trend.az/regions/world/europe/1740884.html.

[7] Found at http://www.chinadaily.com.cn/china/2013xivisitcenterasia/2013-09/07/content_16950939.htm.

[8] Currently the legal identity of the FSB is as an association under Swiss Law. http://www.financialstabilityboard.org/publications/r_120619c.pdf.

[9] E.g. the Consultative Group on International Agricultural Research, whose objectives including reducing rural poverty, and increasing food security, consists of 15 Research Centers across the globe that generate and disseminate knowledge, technologies, and policies for agricultural development.

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The G20 at Six and China's Role

Ye Yu

The G20 was upgraded to a summit-level institution in November 2008. In the six years since then, the group has held nine summits. Though still at an early stage, some trends in its evolution are worth analysing. Former British Prime Minister Gordon Brown said of the G20 that it was "creating a new world order", while former Brazilian President Lula declared that it was "marking the change of global politics". But before long, pessimistic views came forward characterizing the group as a mere talking shop. In February 2014, G20 finance ministers articulated the goal of lifting the collective GDP growth by 2 per cent above the currently projected trajectory in the future five years. Their ambition was to boost morale, but it was not enough to dissipate public suspicion. China, as the economy experiencing the greatest growth dynamics and perhaps the principal global economic variable, attracts worldwide attention for every step it takes. Starting with the suspicion of and distance it kept from G7 or G8 summit meetings up to the end of the twentieth century, to being an invited guest at the G8 summits from 2003 to 2008 and a full member at the end of 2008 and now to the chance to stage the 2016 summit, China has completed its transformation from guest to host in global economic governance. However, its actions, role and influence still arouse suspicion. In this chapter we attempt to assess the G20's performance in the six years since 2008 and its interaction with China.

1. Assessment of G20 Performance in the Past Six Years

1.1 Institutional Innovations

Both the G20 finance ministers' meetings, first held in 1999, and the G20 summits, first held in 2008, originated within the G7/G8, an institution that has developed its own mechanisms for proceedings, as well as for internal and external communication. The framework of the G20 was established and developed after nine summit meetings in six years. While inheriting the basic structure from the G7/G8, the G20 has made innovations so as to adapt to the new situation.

First, the G20 has strengthened the mechanisms for global economic governance to enable better adjustment to the world's changing economic landscape. The Pittsburgh Summit established that the G20 summit would be held annually as the premier forum for coordinating international economic cooperation. It established the G20's role as the hub for global economic governance and represented a milestone in the transition of the international system, representing qualitative, not just quantitative change. The G20 has helped the emerging economies, such as China, to enhance their discourse power. It has also provided a fairer process for further reform of the international system. It belongs to the "primary rule" change and has systematic importance. As the former Director-General of the World Trade Organization, Pascal Lamy (2009) has pointed out, a global governance triangle is taking shape with the G20 providing economic leadership.

Secondly, there have been innovations in internal and external communication and operations. The G20 inherited the G7/G8's idea of soft mechanisms and its operational model based on a trans-governmental network. Although it has not established a Secretariat, as some have requested, the Cannes Summit laid down that three successive hosts take responsibility for the G20's internal and external communications, like an informal Secretariat. Compared with the G7/G8, the G20 allows greater representation. But this greater representativeness has been criticized because it is based on GDP[1] rather than population or region. The Seoul Summit met the requests of Singapore, Switzerland, Chile and other small states to establish a "Global Governance Group" (3G), promising that the G20 would conduct external consultations in a more institutionalized manner, build constructive partnerships with diverse organizations, such as the United Nations, regional blocs, civil society, trade unions and academia, and invite no more than five non-members to attend G20 meetings (but at least two from

Africa).

Thirdly, it has established a member-driven multilateral review process. The G20 is more innovative than the G7/G8 because it has initiated a peer-review mechanism modelled on the OECD, namely the Mutual Assessment Process (MAP) on macroeconomic policy, with a view to promoting policy review and coordination among major countries, especially reserve currency issuers and countries with large trade surpluses, addressing the underlying problems concerning economic imbalances and the international monetary system. This is laying a solid foundation for transforming the G20's function from delivering short-term relief for crises to providing long-term economic governance. It is also part of the framework for "strong, sustainable, and balanced growth" (SSBG) set up at the Pittsburgh Summit. In 2006 the IMF launched a multilateral consultation process involving the United States, the Euro Erea, Japan, China and Saudi Arabia, aimed at reducing global economic imbalances, but it has achieved little to date. What made the MAP outstanding was the fact that it was driven by G20 members with technical assistance from the IMF. This mechanism was not legally binding, however, and not without operational problems. Although it was questionable whether it could incorporate the economic policies of major countries into a multilateral framework, it was still called a "potentially historic exercise" by the seasoned G20 expert Mike Callaghan (2013). It demonstrated G20 members' willingness to cooperate and their efforts to explore a brand-new form of coordination, signifying that this was the beginning of a collaboration between developed and emerging countries.

1.2 Agenda Outcomes

1.2.1 Responding to Short-term Crises

G20 responses to crises can be divided into three periods. The first was from 2008 to 2010, when the sub-prime mortgage crisis hit America hard and triggered the global financial crisis; the second was the response to the European debt crisis commencing in 2010; and the third was the response to economic turbulence in the emerging economies since 2013. The main actions taken by the G20 were mobilizing worldwide resources and enhancing the executive capabilities of the relevant international organizations. G20 members set out the largest and best coordinated plan for global economic recovery since the inception of the G20 summits, including relaxing fiscal and monetary policies in member countries and injecting USD 1.1 trillion into international financial institutions, which stopped the spread of the financial crisis and was widely acclaimed for its effective implementation. Although a substantial portion of the 1.1 trillion package had already been mobilized before the G20 summit was introduced, the summit at least strengthened the coherence and effectiveness of collective action. Comparatively, the G20 has performed not so timely in response to the European debt crisis. It was only in the first half of 2012-two years into the debt crisis—that the G20 finally pushed its Members to pledge additional funding of USD 450 billion for IMF. This was because, at first glance, the debt crisis looked like a governance problem within the European Union rather than a global one and it was assumed that the Euro Area and EU countries should be accountable. However, the crisis was protracted due to the diplomatic stalemate between France and Germany. Notwithstanding their delayed involvement, the G20 and the IMF have contributed to easing the crisis. Their involvement has provided greater legitimacy and executive capabilities, enabling EU core members to demand contractionary fiscal policies on the part of debtors (Pisani-Ferry 2013). The recent economic turbulence in the emerging countries, although not reaching crisis level, prompted the G20 to build up a global financial safety network to forestall a potential crisis.

1.2.2 Advancing Long-term Global Economic Governance

The G20 has achieved a lot in this regard. First, it has set up a framework for the sustained governance of the world economy, namely, the SSBG established as an aim at the 2009 Pittsburgh Summit. According to IMF(2011), "strong" means "above potential", "sustainable" means "broad-based across G20 members" and balance means "e.g. increasingly led by the private sector". Since 2008, the world economy and correspondingly the G20 governance has experienced a "W" shape, and therefore it is until recently that the growth became the top priority of the G20 in Russia and Australia. The 2% GDP growth speed-up goal for the next five years is an unprecedented achievement. Increasing infrastructure investment through the public-private partnership(PPP) is a focus point. The Brisbane Summit concluded in Nov.2014 announced the establishment of the Global Infrastructure Hub in Sydney so as to facilitate the implementation of the infrastructure strategy. Secondly, it has strengthened financial supervision and other structural reforms so as to prevent future crises. The nine G20 summits have invariably regarded enhancing financial supervision as part of the core agenda, including raising the capital requirements for financial institutions, revising payment rules and standards, strengthening supervision of systematically important financial institutions, cracking down on tax havens, and reorganizing the Financial Stability Forum into the Financial Stability Board, which later acquired legal status. However, the implementation of the new rules at national level is discounted and it is problematic whether the financial crisis will repeat in the future. But significant progress has been made on dealing with the "Base Erosion and Profit Shifting" (BEPS). G20 Finance Ministers approved the Common Reporting Standard for automatic exchange of tax information in Sept. 2014. Reducing sovereign debt is another key reform agenda of the G20, though the goal of halving the fiscal deficits of advanced economies by 2013 set at the Toronto G20 Summit in 2010 was not achieved. Thirdly, it has promoted reform of international financial institutions (for instance, the 2010 reform package pushed by the World Bank and the IMF). The capital increase and voice reform in the World Bank have been put into practice, but the reform of quotas in the IMF has met resistance in the US Congress. The Ukraine crisis was not able to break the stalemate, but a turning point might be closing as the G20 is seeking alternative options and new initiatives like BRICS Contigent Reserve Arrangement emerge. The G20 has also pursued an agenda on trade, energy and climate change, and suitable development, but has been less influential in these areas.

1.3 Inherent Limitations

There are still disagreements over the G20's role and value. Criticisms are rising in recent years. Peel (2009) argues the shock caused by the financial crisis on the global economy and the balance of power was paltry compared with the impact of the fall of the Berlin Wall. Song (2013) argued that, except for a few publications issued after a number of G20 meetings calling on developed economies to well communicate their monetary policies, the G20 has not put forward any detailed suggestions, let alone implemented practical measures. The most extreme view regards the G20 as "a mission impossible". Less radical views hold that the group says a lot but does little. There are positive opinions as well. The G20 Information Centre jointly created by Canada and Russia tracks G20 leaders' compliance with their commitments. Using a quantifiable method to assess the G8's performance, the Centre marked countries' accomplishments in a range (−1∼+1) according to compliance with commitments within one year of G8 summits and then conducted comparative studies. The first five compliance assessment reports show that the Washington Summit got the highest mark, 0.67. Performance after the London Summit dipped to 0.23, followed by 0.24, 0.28, and 0. 50 for the next three summits. Converting the marks into percentages, the compliance rates of the five summits are, respectively, 84 per cent, 62 per cent, 62 per cent, 64 per cent and 75 per cent. Given the fact that the G20 is only a soft mechanism, member states have performed fairly well.

No doubt the methodology of the quantative assessment needs further improvement. But critique of the G20 implies impractical expectations. Global governance always plays a minor rather than a dominant or leading role. Its value lies in constraining and containing spillover arising from poor domestic governance (Thakur 2010). Above all, the purpose of the G20 is to address the worldwide consequences of US mismanagement of the sub-prime mortgage crisis. In an increasingly globalized world, with growing plural interest groups and NGOs, governments are facing greater constraints and national and global governance have become more and more challenging. Thus the G20's limited capacity is understandable. As an informal and soft institution and a platform for collective leadership, the G20 cannot dispel the underlying problems arising from divergence of interests among major countries, but it can facilitate information sharing, seek common ground and ease international conflicts. If the global economic governance system can be compared as a pyramid, the G20 is at the top, but those most important are the major regional and national structures that lay real foundations.

Therefore, the G20 is in some ways no more than a larger negotiating table. It may diagnose symptoms but cannot cure the disease. What concerns the emerging economies, China included, are persistent and structural problems that are still being met more by words than by deeds. The discussion about the

United States tapering of its quantitative easing policy was limited to its spillover effects but not its negative impact, because the root cause was the structure of the international monetary system. Secondly, the G20 can ease but not overcome crises. Strengthening financial supervision is a game between governments and markets and it is still questionable to what extent financial supervision can prevent future crises. The growing quantity and scale of global flows of capital has made crises far more unpredictable and unforeseeable (*force majeure* or "acts of God"). What the G20 can do is promote the enhancement of global firewalls and safeguard mechanisms against potential crises. Thirdly, the G20 serves as the highest, if not necessarily the most important platform for international cooperation. Comparatively, bilateral and regional coordination between China, the United States and the European Union could play a more fundamental role.

However, the G20 still has unique value, which includes top leadership, dialogue on the most pressing and complicated economic issues, increasing mutual trust and information sharing. For the flawed international economic system, it will be a second best option for countries in the international community to sit down together and discuss possible approaches to repair the world economy. Compared with a hegemonic pattern, the governance of a multipolar world is much more difficult and complicated. It is only natural that the G20 falls short of the international community's increasing demands. At the same time, the improvement of the G20 as an institution is a long-term process and therefore assessment of its performance should also take a long view. Morris Goldstein of the Peterson Institute for International Economics has graded the G20 summit "a solid B", saying it is "good but not great" (Giles 2009). Drezner (2012) also provides a more objective assessment of the G20's performance.

2. G20-China Interactions

2.1 The G20 as a New Platform for China's Multilateral Economic Diplomacy

China's involvement in the G8 framework dates back to 2003 when it participated in the "G8+5" dialogue mechanism. However, at that time China was only a guest attending breakfast or luncheon meetings on the sidelines of the G8 summit; the agenda was dominated by the G8 and activities were managed by the OECD. By comparison, the G20 offers a new platform for China to engage in dialogue with other major economies on an equal footing; greater scope for China to assert its interests and join in global governance; and a better opportunity for it to proactively integrate into the international economic system and take more international responsibility. China cannot afford to overlook the G20's role and importance as a new platform for dialogue, because it reminds us that China's resumption as a member state in the United Nations likewise provided an opportunity for China's voice to be heard in a global forum (Wu 2006). As stated in the Eighteenth Party Congress report, the G20 is one of the major platforms for multilateral diplomacy.

The G20 to be sure has formal and symbolic meaning for China. But form creates content to some extent. For instance, the upgrading of the G20 has led to the expansion of memberships of a number of international financial institutions, such as China's accession to the Financial Stability Board, the Basel Committee on Banking Supervision and the Global Forum on Taxation, the three major international financial standard-making institutions, and to the Technical Committee, one of the core institutions under the International Organization of Securities Commissions (Jin 2014). The G20's joint efforts in accelerating the reforms of the IMF and the World Bank have also helped China to increase its voice in the international arena.

2.2 China's Greater International Responsibilities

Since the inception of the G20, China's financial contributions to international economic organizations have increased substantially. In 2009, then US Secretary of the Treasury Timothy Geithner helped strike a package deal of IMF reforms that would raise its quota to USD 750 billion. The deal met resistance from the US Congress, however, and has not materialized so far. As a transition measure, IMF borrowed USD 430 billion from its members so as to respond to the European debt crisis, in which China subscribed USD 43 billion roughly one tenth of the total. At the end of 2013, the 17th IDA Replenishment process concluded with China pledging to grant USD 300 million for 2014-2016-in contrast to the West's declining donations in foreign aid—the largest ever donation by China to an international organization.

At the same time, China has engaged more constructively in the international monetary and financial systems. During 2006-2008, the US Administration brought the RMB exchange rate issue to IMF, which led to a pause of China's interactions with IMF. The stalemate was broken when the G20 was upgraded in 2008. China adopted an active posture to promote reform of the international monetary system and to call on international organizations to strengthen supervision of the policies of reserve currency issuers. China is to host the G20 summit in 2016, which will provide China a perfect opportunity to show its international responsibility. However, given its inherent deficiencies, the G20 itself cannot address the underlying structural dilemma facing China's economic diplomacy, nor can it replace major-power economic diplomacy. Instead, the G20 platform serves as a complement to China's bilateral and regional economic diplomacy with the United States, the European Union and neighbouring countries in the overall framework of China's economic diplomacy.

2.3 The G20's Agenda and China

If the G20 is a platform for dialogue between developed and emerging countries, then China—the biggest variable in the international system and the most important of the emerging economies, with systemic importance in the international monetary and financial systems, trade and investment, and development—attracts most attention for every step it takes and for the impact of its actions. However, still located at the lower end of the global industrial chain and the weaker position of the international economic system, with inadequate experience in global economic governance and a lesser role in multilateral institutions such as the WTO than developing countries such as India and Brazil, China's influence in the G20 is still limited. *The Economist* (2009) thinks that "the shortcomings of China's political culture limit its ability to make a full contribution to global debate". On 2 November 2013, at a meeting with members of the 21st Century Council, an American think tank, Chinese State Councillor Yang Jiechi pointed out that "China is an active participant, supporter and contributor in the G20". His characterization of China's role and engagement in the G20 was objective. But China's constructive role has not been fully recognized by the international community.

2.3.1 Helping to Design the Overall Framework

Speeches by China's leaders during G20 summits on the development of the international economic system represent an attempt to play an active part in shaping the world order. China's impact on the institution is manifest in the G20's basic framework and core agenda. As Wright (2009) had pointed out, effective multilateralism requires effective cooperation among key members. Coordination among key G20 members—China and the United States are the two most important—remains a major force propelling the institution. It was during the 2009 G20 Summit in London that President Hu Jintao and President Obama agreed at their bilateral meeting to initiate the Strategic and Economic Dialogue between their two countries. Six months later, at the Pittsburgh Summit, the G20 established the SSBG framework, which later became the core mission of the G20. At the press conference following the 2009 Pittsburgh Summit, Timothy Geithner, US Secretary of the Treasury, revealed that the framework for strong, sustainable and balanced growth derived from the outcomes of the Chinese-US Strategic and Economic Dialogue held two months before. As to the "balance" agenda, China and Germany, economies with a trade surplus, have been facing great pressure. During 2010-2011, when G20 finance ministers were negotiating the Indicative Guidelines on persistent and large-scale imbalances, China opposed the proposal to limit the ratio of the current account balance to GDP to below 4 per cent as an indicator. But this issue is much less relevant when China's current account surplus vis-a-vis its GDP declined to less than 3%.

2.3.2 Exerting Influence on International Monetary System Reforms

The 2008 financial crisis came at a time when China had only a limited degree of financial market liberalization and a strictly regulated capital account; China's financial sector was largely sheltered from the crisis. Therefore, China expressed little concern when Western countries discussed issues relating to financial regulations and moved faster than the West in terms of implementing banking supervision. China supports the tax cooperation efforts of the G20 as an external driver for its anti-corruption action. China was one of the main promoters of governance reforms proposed for the international monetary system and international financial institutions. As one Chinese government official involved in the relevant agendas put it, "China's involvement in promoting the governance reform of international financial institutions has strengthened the representation and voice for developing countries and is a good case in which China steers the debate on relevant international issues" (Jin 2014). On the eve of the 2009 London Summit, in a signed article, Zhou Xiaochuan, governor of China's Central Bank, called for reform of the dollar-dominated international monetary system and for an enhanced role for the Special Drawing Right. Deputy Premier Wang Qishan also wrote to articulate China's stance. Paul Krugman, the Nobel prizewinning economist, commented that by doing so, China was rather sending the international community an SOS signal than challenging the dollar's preeminent role (BBC 2009).

2.3.3 China's Influence on Trade and Development Issues

China is one of the members within the G20 framework firmly opposing to trade protectionism. On the eve of the Brisbane Summit in 2014, China and US reached agreement on updating the Information Technology Agreement (ITA), which could help boot global trade system. At the Los Cabos G20 Summit, China, together with Indonesia and India, promoted greater infrastructure investment by the G20 in developing countries to create new growth for worldwide economic recovery. But China's initiatives on trade and development issues have been largely proposed on regional platforms, especially through integration on its periphery. China has taken its advantage of hosting the 2014 APEC Summit in November and is actively promoting interaction between the trade and infrastructure agendas under the G20 and APEC. One is to try to draw a roadmap for the vision of establishing a Free Trade Area for the Asia-Pacific regions (FTAAP) proposed by Canada ten years ago and promoting the integration of TPP and RCEP. Secondly, China strongly supports the implementation of the infrastructure agenda emphasized by last year's APEC host Indonesia. More broadly, this is part of China's grand strategy of "One Belt One Road". The framework agreement on establishing the Asian Infrastructure Investment Bank(AIIB) was successfully signed at the end of October so as to advance infrastructure connectivity and economic integration in the Asia-Pacific region. For the same purpose, China has unilaterally established the Silk Road Fund worth of USD 40 billion. The basic idea behind the Chinese new strategy is to enhance more comprehensive capacity building for neighbouring countries, expand common interests and more trade connections. In addition, the bilateral agreement between China and US on climate change newly reached in 2014 is a big plus for global climate negotiation.

2.3.4 Promoting BRICS Participation in G20 Agenda Coordination

The G20 has hastened the emergence of flexible sub-coordination mechanisms, among which BRICS is the most noticeable, representing a new momentum for South-South cooperation led by emerging countries. BRICS was first initiated by Russia in 2006 and was later upgraded from a ministerial-level mechanism to a summit-level one, expanding from a political agenda to an economic one. China has been an active promoter in this process. Some American scholars were concerned that the grouping might instigate poisonous bloc politics that could handicap America's diplomatic manoeuvring within the G20 framework (Jones and Gowan, 2011). But an open world requires open global governance. If the BRICS New Development Bank (NDB) and Contingent Reserve Arrangement (CRA) can help foster new world growth and make emerging economies safer, that will be a significant contribution to the G20 and the world.

However, indeed, there are still obvious limitations for the role of China in the G20 and global economic governance. Fundamentally, the complicated position of China in the world, i.e., big in aggregate but weak in structure, defines its influence in the G20. The position is characteristic of coexistence of both ambition and ambiguity, both strength and weakness. The implications are that the more pragmatic approach for China to participate in global economic governance is to start from regions or cross-regions to drive global reforms rather than directly lead the global agenda. The Doha Round cannot be a China Round as expected. Global climate negotiation cannot be led by China, either. Certainly, any new initiatives at regional or cross-regional levels China supports should really take care of interests of all stakeholders and promote mutual benefits so as to bridge gaps in the supply of international public goods; otherwise, they could risk only increasing the fragmentation of global governance without benefiting people. Last but not the least, taking good care of itself will be the most important contribution that China can make to the world. In 2014, China committed 134 measures for the G20's Growth strategy, which are expected to contribute most to the 2% growth target by 2018.

Notes

[1] If EU members and other European economies like Switzerland and Norway can be considered as one unit, G20 members are roughly the 20 largest economies in the world. This was the case 15 years ago when the Ministerial G20 came into being, and also true when it was upgraded to the summit level except that Argentina was surpassed by Venezuela. See World Bank, Total GDP 1999, Gross Domestic Product 2010.

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Part I

Policy Areas

Chapter 1
Macroeconomic Policy Coordination in the G20: Tremendous Success or Disappointing Failure?

Heribert Dieter

1. Introduction

The Group of Twenty (G20), which existed as a meeting of finance ministers from 1999, was elevated to leaders' level in 2008 after financial turmoil erupted in the United States. To its credit, what was henceforth known as the G20 provided successful *crisis management* and a coordinated response to the subprime mortgage crisis. A protectionist reaction to the crisis was avoided, and monetary and fiscal policy was harmonised. However, it has still not managed to establish itself as an agent of *crisis prevention*: in both trade and finance, the G20 has not been able to provide tangible results.

In finance, the G20 started with great ambitions, aiming at the comprehensive re-regulation of the financial sector. During the first summits, the impression was created that the G20 countries intended to establish common rules and regulations. Rules were to be negotiated at the supranational level and implemented by the member countries at the national level. However, this has not happened. An increasing number of countries, foremost the United States, have been departing from the goal of global rules in finance. Washington is, for example, no longer willing to accept the principle of "home country regulation" and requires foreign banks to establish full-scale US subsidiaries that need to be equipped with sufficient capital. The United States has thus embraced the principle of "host country regulation", which is not necessarily a bad thing, but is resulting in a balkanisation of financial regulation.

In contrast to the majority of analysts that lament the inability of the G20 to come up with global rules for global finance, I advance the heretical suggestion that this regulatory development represents an opportunity rather than a problem. Diversity in financial regulation and what the Warwick Commission (2009) identified as the benefits of an "unlevel playing field" would enhance, rather than weaken, the longer term stability of the international financial system. Financial regulation should and will remain principally the preserve of sovereign states.[1]

By contrast, the lack of further development of the multilateral trade regime is a major failure of international cooperation. The global regulation of trade is an area in which global rules can continue to provide significant welfare gains for hundreds of millions of people. In trade, the trend is for preferential trade agreements, which are second-best solutions. In short, the G20 should advance global rules for trade and complete the Doha Round, and at the same time, it should accept national rules for finance.

Rhetorical commitments to the completion of the Doha Round notwithstanding, all major players in the WTO have sidelined the conclusion of the Doha Round in favour of pursuing preferential trade agreements. The agreement in Bali in December 2013 has not changed the picture. In Bali, all critical issues were avoided, and the agreement reached essentially addresses what has been labelled "low-hanging fruit". Bali, in the words of the *Financial Times*, may have been a tropical fling rather than a renewal of the multilateral regime.

In the financial domain, however, state policymakers and regulators have all too often permitted the sector to dominate the debate and pursue its own agenda. The high level of influence of the financial sector has contributed to weakened support not just for market economies, but also for the very concept of democracy. Societies have experienced that under-regulated financial sectors can impose enormous costs on taxpayers. Iceland, Switzerland, the United Kingdom and the United States are examples of the high costs incurred by societies that permit the unfettered growth of their financial industries. In order to both reduce the risk of global financial crises and to re-embed responsibility for regulation in the national political sphere, the search for global regulation of finance should be replaced by national or regional approaches.

This paper is organised as follows. Section 2 presents a brief analysis of the development of past crises. One reason for the growing frequency and depth of crises is the comprehensive dismantling of restrictions on capital flows and the globalization of finance. Section 3 addresses what might be called the "structural limits" to economic regulation of finance.

2. Financial Crises and the Collateral Damage Caused by Globalized Finance

2.1 Building Regulation on False Assumptions

With hindsight, the development of global standards in finance has not resulted in a more stable international financial system. For example, the main standard, Basel II, has not prevented the two most recent crises: the sub-prime crisis and the crisis in Europe. Rather, both crises were fuelled by ill-designed rules. For instance, whilst Basel II required banks to set aside capital according to pre-defined risk criteria, it failed to consider the potential need to have liquidity available in the event of panic. Thus, since the Lehman shock in September 2008, solvent banks have found themselves in an illiquid position due to their inability to sell assets in collapsing markets (Levinson 2010:81).

In addition, Basel II was fairly lenient towards mortgage lending. Before 2007, lending to homeowners had been a low-risk business. Regulators around the world assumed that lending to medium-sized and large corporations was riskier. Basel II and III specifically tried to develop a rulebook that ensures a global level playing-field. But the drawback has been that all players followed the same, or at least similar, strategies. Andrew Haldane from the Bank of England suggests that this identical approach amplified the crisis:

> The level playing field resulted in everyone playing the same game at the same time, often with the same ball. Through these channels, financial sector balance sheets became homogenised. Finance became a monoculture. In consequence, the financial system became, like plants, animals and oceans before it, less disease-resistant (Haldane 2009:18).

While the failures of regulation prior to the US crisis are now largely acknowledged, there appears to be too little reflection on the appropriate path of future regulation. Time and again, in the aftermath of financial crises policymakers vow to get it right this time. This is a well-known pattern. The idea that the next crisis will be avoided by "better" regulation is as inevitable as financial crises themselves. As Carmen Reinhart and Kenneth Rogoff (2009) observed in their seminal book *This Time Is Different* there is a reoccurring pattern of hubris in financial markets. But that sense of overconfidence is not limited to market participants; it affects regulators as well. New regulation is put in place in the hope that this time will be different and, after a certain fermentation period, the financial sector repeatedly has successfully found new ways to circumvent regulation. The G20's efforts to introduce new regulation are also following this course.

Two main factors account for these repeated failures. First, financial regulation by definition is based on past experience. Reform is an exercise in shutting the stable door after the horse has bolted. New regulation invariably fails to envisage, or is pre-empted by, new developments in finance. While the actual benefits of so-called "innovation" in finance is often far from obvious, new instruments certainly create new challenges to supervisors, who regularly fail to step up.

Second, global rules can be, indeed frequently are, traduced by financial sector lobbying. Bankers have time after time succeeded in pressuring policymakers to accede to what Gordon Brown famously called "light touch regulation". The financial sector's lobbying efforts have often been effective and have resulted in a race-to-the-bottom by policymakers. The concern to miss out and lose business to the financial sectors in other countries has often (mis-) guided policies. The most commonly used tactic is the appeal to the so-called "level-playing field". The argument is that unless the rest of the world, or at least the rest of the G20, also implements certain rules, any tightening of regulation at the national level will result in a deterioration of the competitive position of that country's financial sector.

Of course, this rhetoric has been exploited not just by the financial sector, but also by policymakers themselves, who too often have given the interests of banks preference over the interests of society. In short, Wall Street has dominated and Main Street has had to suffer the consequences. Policymakers have been "cognitively captured" and have adopted the reasoning offered to them by those benefiting from unrestricted finance.

Globalization—narrowly defined as the increase of economic transactions between nations due to the lowering of hurdles for trade and finance—has been said to reduce the policy space of individual societies. The force of ever-increasing interdependence, it has been argued, compels policymakers to deregulate economies and to reduce the level of regulatory restrictions. For instance, the liberalization of capital flows has been labelled inevitable and an absolute must. It was argued that there is, to paraphrase Margaret Thatcher, no alternative to dismantling restrictions on cross-border capital flows. Since the end of Bretton Woods in the 1970s more and more OECD countries have scrapped restrictions on capital flows and have thus embraced neo-classical doctrines. In most cases, this decision to liberalize capital flows has not been discussed in the political arena, let alone subjected to a wider democratic debate.

In the European Union, supporters of unrestricted capital flows were not confronted with any opposition. European integration enjoyed widespread political support, and there was no differentiation between the integration of markets for goods or labour or capital markets. Economies such as Spain and Ireland joined the economic and monetary union but at the same time were unable to protect themselves against unwanted capital inflows. In the event, both economies experienced a real estate boom and the national authorities had few instruments to cope with the consequent overheating.

Consider the situation in Spain, for example. Roughly a decade after Spain emerged from years of authoritarian rule, the country joined the European Union. Until it joined the Eurozone in 1999, the authorities were able to manage developments in the financial sector pretty well. The combination of membership of the euro zone (which resulted in a dramatic reduction in both nominal and real interest rates) and unrestricted capital flows resulted in an unsustainable real estate boom. Capital flows into Spain reached unprecedented levels. Between 2006 and 2008, Spain's current account deficits—reflecting capital inflows of the same magnitude—were between 9 and 10 per cent of GDP (OECD 2011). Evidently, capital inflows of that magnitude pose a risk to an economy and, being locked inside the euro zone and neo-classical bias, Spanish policymakers were forced to observe the unfolding drama without being able to do anything about it. Of course, a hubristic atmosphere also characterized policymaking in Spain in the years of the boom.

The drawbacks of multilateral rules have become evident in the European crisis since 2009. The euro zone left participating economies with too few instruments to fight a credit boom. In Ireland and Spain in particular, authorities were unable to fight the obvious real estate bubbles. They had no tools at their disposal: interest rates were set at a uniform level by the ECB in Frankfurt, and other robust restrictions were not permitted due to European rules. Both countries had nothing available to them to slow the inflow of foreign capital, which fuelled the booms. Neither taxes on inflows nor other restrictions were permitted, thus exposing these two economies to market failure of enormous dimensions. Even the attempts of the Spanish authorities to tighten supervision of local banks could not be very strict: bypassing these national rules by borrowing elsewhere in the euro zone was relatively straightforward and did not even entail currency risk.

2.2 The Consequences of Scrapping Capital Controls

However, this alleged need for unrestricted capital flows essentially reflected the interests only of the few. In particular, internationally operating financial firms have been keen on lowering restrictions on capital flows. As Jagdish Bhagwati observed back in 1998:

> Wall Street's financial firms have obvious self-interest in a world of free capital mobility since it only enlarges the arena in which to make money (Bhagwati 1998:11).

For most members of society, the issue of restrictions on capital flows is marginal. Apart from holidays and the occasional transfer for a nephew's birthday, cross-border capital flows do not affect the wider society. Stable or volatile exchange rates are much more important. Volatility of exchange rates affects all sectors of the economy that are either exporting or competing with imports. In fact, with reference to Robert Mundell's observation in 1963 that an impossible trinity exists in monetary policy, I suggest that policies in recent years have reflected the growing political influence of those parts of societies that benefit from unrestricted capital flows at the expense of those who would benefit from stable exchange rates.

Essentially, Mundell suggested that of the three goals that monetary policy aims to achieve (stable exchange rates, unrestricted capital flows, independence of domestic monetary policy) only two are achievable at the same time (see Mundell 1963; for a discussion of the exchange rate policy trinity see Obstfeld et al. 2005). In democratic societies, the independence of domestic monetary policy—that is, the ability of a central bank to raise or lower interest rates according to domestic economic developments—is indispensable.[2] Thus, there is a simple political choice: either unrestricted capital flows or stable exchange rates. In the Bretton Woods era, capital flows were restricted, which reflected the weak position of the financial sector and the relative importance of manufacturing industry. The turn to unrestricted flows clearly demonstrated that the financial sector had regained the strong position it had before the Great Depression and was again able to strong-arm domestic policymakers.

A key issue here is the utility of capital inflows for an economy. In the 1970s, when restrictions on capital flows were still widely applied, liberal economists suggested that unrestricted flows would benefit the poor. Capital, it was argued, would flow from capital-rich economies to countries were capital is scarce, primarily developing economies.[3] Why would that happen? The underlying theory is the so-called "efficient-market hypothesis", which argues essentially that financial markets process all available information efficiently. Thus, markets will realize that the more efficient use of capital will be in developing economies, rather than in established, developed markets. Of course, some capital has flown to developing countries, but in the first decade of the twenty-first century, capital has rather been flowing upstream, from poorer economies to the United States. Empirical research has confirmed the strongly diverging utility of different types of capital inflows. Aizenman, Jinjarak and Park have analysed capital flows to about 100 countries in two time periods, 2000-2005 and 2006-2010. While they confirm the positive contribution that foreign direct investment can make to economic development, they have not found evidence of portfolio investment combined with short-term debt. The latter can even have negative effects on growth, particularly in phases of financial turmoil (Aizenman et al. 2011:18).

Today, it is obvious that the unwillingness to restrict capital flows resulted in a severe penalty for the countries failed to consider the negative effects of capital flows. This of course is a failure of politics, not economics. Policymakers have to consider and defend the interests of society at large, not just those of the financial sector.

2.3 Crises Revisited: What Can Be Learned?

Occasionally, one gets the impression that societies get used to financial crises as inevitable events. Hyman Minsky suggested in 1977—when such crises were occurring, but at a much lower frequency and intensity than today—that financial crises are systemic, rather than accidental events (Minsky 1977: 10). His core argument is that economic booms change the behaviour and expectations of market participants. When a boom develops, standards change and risks are ignored:

> The tendency to transform doing well into a speculative boom is the basic instability in a capitalist economy (Ibid:13).

Minsky developed a minority position that was of course disregarded by the neoclassical mainstream, who continued to believe in the superior rationality of financial markets and their ability to process information efficiently. By contrast, Minsky suggested that financial stability cannot be achieved:

> There is, in the financial instability hypothesis, a theory of how a capitalist economy endogenously generates a financial structure which is susceptible to financial crises, and how the normal functioning of financial markets in the resulting boom economy will trigger a financial crisis (Ibid:15).

Developments since the 1970s have confirmed Minsky's financial instability hypothesis. His plea sounds very contemporary. He advocated a "*good financial society*", in which the tendency of business and bankers to engage in speculative activity is constrained (Ibid:16). However, he did not provide a strategy for how this goal could be achieved.

3. Consequences for Financial Regulation

3.1 The Limits of Global Regulation

For more than two decades, the dominant view in the debate on financial regulation has suggested that global rules—and only those—can make the financial system safer and more stable. My contrasting view gives preference to tailor-made national and/or regional level solutions. A regulatory patchwork would be the result. While such an approach would not automatically prevent financial crises, the effects of turmoil would be mitigated because, as we know from biology, diversity stabilises complex systems, whereas monocultures transmit and even exacerbate shocks.

Of course, if the record of both regulators and academic observers in identifying future risks were better than it has been then the case for diversity would be weaker. However, as numerous financial crises have demonstrated, the widespread assumption that authorities are able to learn from past mistakes has repeatedly led to hubris and turbulence. Global rules may eventually result in global crises. There is no evidence that the ability to predict future risk is so well developed that the implementation of more global standards in finance will contain it.

Andrew Haldane, Executive Director for Financial Stability at the Bank of England, has interpreted the financial system as a "complex adaptive system" (Haldane 2009:3). He suggests that four mechanisms influence the stability of the network: *connectivity*, *feedback*, *uncertainty and innovation* (Ibid: 8). All four have the potential to turn a hitherto stable system into an unstable one. Let us look at them in turn.

The connectivity of participants in financial markets—facilitated by cross-border capital flows—can serve as a shock absorber, but only within a certain range. Past a certain "hard-to-predict" point connectivity turns into contagion:

> But beyond a certain range, the system can flip the wrong side of the knife-edge. Interconnections serve as shock-amplifiers, not dampeners, as losses cascade. The system acts not as a mutual insurance device but as a mutual incendiary device. [...] Even a modest piece of news might be sufficient to take the system beyond its tipping point (Ibid:9).

We have seen numerous examples of the Janus-faced side of connectivity. At first benign and not problematic, cross-border financial flows suddenly turn from sources of relatively cheap finance into unmanageable liabilities. For instance, for many years the financial flows into Asian economies prior to the 1997 crisis appeared to be a blessing, only to become a liability when the tide turned.

For the definition of feedback, Haldane refers to epidemiology. The speed with which crises, or diseases, spread, very much depends on the perception of market participants. Their views "construct" the crisis. The reaction of market participants to crises thus determines the rate of transmission (Ibid: 12).

Uncertainty is the third factor in Haldane's analysis. Networks generate chains of claims, and while in boom times the question of counterparty exposure is often ignored, in the event uncertainty creeps in. Is there a Bernie Madoff or a Warren Buffet at the end of the chain? (Ibid: 14).

Modern finance has of course done its utmost to conceal counterparty exposure and thus has increased uncertainty. The widespread use of over-the-counter derivatives—in essence private contracts between two parties without authorities or other market participants knowing about them—has been a key factor. Consider, for example, the surprise that hit many, including the US government, when the full exposure of AIG, the world's largest insurer, to credit default swaps became clear the day after Lehman Brothers collapsed. Haldane suggests that "*counterparty risk is not just unknown, it is almost unknowable*" (Ibid: 14).

Finally, "innovation" contributes to the instability or fragility of financial systems. In fact, innovation in finance has to be sharply separated from the real economy. In finance, innovation is associated with increased complexity and less transparency. Indeed, any utility of innovation in finance remains to be demonstrated. Take, for example, some of the "innovations" that contributed to the 2007/2008 crisis in the United States. One particularly opaque and dangerous instrument was the "squared collateralized debt obligation" or CDO^2. An investor in a CDO^2 would have had to read in excess of one billion(!) pages to understand the product (Ibid: 16).

Against this background, I suggest taking an agnostic view of banking regulation. One will never be able to know what the risks of future developments will be, and even if tough rules were implemented, it is safe to assume that the financial sector will find innovative ways around them.

3.2 Policy Recommendations

My proposal to reverse the current emphasis in global economic governance needs to be specified and put into context. Three key messages emerge from the financial crises of recent decades. First, financial innovation in most cases is modern alchemy, pretending to being able to create gold from base metal using financial engineering. It sometimes can, but only for a short time and, more importantly, only for a very limited group of people. Financial innovation has not contributed meaningfully to improving conditions for investment and thus has not contributed higher welfare. Moreover, as in particular the subprime mortgage crisis demonstrated clearly, the gains of some people in the financial sector accrued prior to the crisis subsequently had to be covered by taxpayers.

Second, the increase of cross-border capital flows since the late 1990s has not contributed to a more sustainable financial system, but has instead opened new avenues for the transmission of financial shocks from one country to another.

Third, attempts to regulate more prudently will always be exposed to powerful campaigns by the financial sector, often supported by academic economists who all too often benefit personally from the policy recommendations they give. Time and again, there will be crusades against proposals for tight regulation of the financial sector, and past experience suggests that today's world is no different.

What are the benefits of the greater segmentation of financial markets that we are suggesting? For instance, financial innovation that would have to be explained to a domestic audience would most probably receive less support. I am suggesting that the regulation of finance ought to be put back into the national polity. Because societies have to bear the consequences of failed regulation of the financial sector, they should be provided with direct ownership of the regulatory process.

In addition, the segmentation of markets from one another would help to contain national financial crises from having contagion effects. A crisis in one country would not have devastating effects on other economies, apart of course from slowing demand from the affected economy. Crisis would still occur, but more in isolation.

In essence, I emphasize the recommendations of the 2009 Warwick Commission. Their proposal to switch from home country regulation to host country regulation has been endorsed by some commentators (for example, Levinson 2010: 87). As long as business cycles structurally diverge between economies, national approaches to regulation would provide more stability than uniform, global approaches.

My recommendation to improve diversity of regulation has two dimensions. First, in line with the recommendations of the 2009 Warwick Commission on International Financial Reform, I suggest a departure from the principle of home country regulation and the introduction of host country regulation. In essence, this would enable regulators to require both national and international banks to provide local minimum capital requirements for local risks (Warwick Commission 2009: 8). This shift to national regulation would make the activities of big international financial firms more difficult and would favour the development of national financial systems. In this regard, I share John Maynard Keynes' observation that "above all, let finance be primarily national" (Keynes 1933: 758). Of course, the application of this approach would also have consequences for the European Union. At a minimum, it would put member countries of the EU in a position to apply diverging rules in banking regulation.

4. Conclusions

The proposal to abandon attempts to make finance safer by developing more global rules could be interpreted as a recipe for reversing globalisation—it is not. Rather, I suggest that in light of my discussion above, there are sufficient reasons for drawing a sharp distinction between global rules in trade and those in finance. I am a staunch advocate of further liberalisation of trade. As Jagdish Bhagwati suggested in 1998, after the Asian crisis, trade in widgets and trade in dollars differ from one another (Bhagwati 1998).

In contrast to the so far unproven positive economic effects of unrestricted capital flows, trade economists have shown time and again the benefits of fewer restrictions in trade. While trade may have negative effects for some parts of a country's population, the overall benefits far outweigh the negative dimensions. At the risk of generalisation, it is fair to say that the worst cases of poverty occur in countries that continue to try to protect their citizens from a more liberal approach to trade. Moreover, the advanced industrialised societies benefit as well. Consumers would not enjoy the same range of goods and services if there were significantly less trade. All these are tangible benefits of relatively free trade.

Global rules on trade continue to be the first-best solution, as all acknowledge. The liberal trade regime is not faultless, but on balance, it has helped hundreds of millions of people to leave absolute poverty behind them. The rise of China and other emerging economies would not have been possible so rapidly without a relatively open trade regime. Moreover, the G20 should acknowledge these facts and should no longer permit a few countries—less than five out of a WTO membership of 159—to obstruct the conclusion of Doha.

The G20 has played an important role in managing the latest financial crisis. It has been a success as a crisis manager. The global economy did not slide into depression, protectionism and political tensions. These are indeed important achievements. Nevertheless, the G20 should do more.

In particular, the G20 should end the destruction of the global trade regime. All big players, including China, have an obligation to keep the WTO at the centre of global trade regulation. Emerging markets, again including China, have been constructive members of the WTO. Of course, there have been and will be disputes, but these can be settled within the WTO. All major players should use the upcoming G20 Summit in St. Petersburg to develop an agenda for the renaissance of the WTO. Of course, I am aware that a lot of political capital has already been invested in prestigious new projects such as the Transatlantic and the Transpacific Preferential Trade Agreements (TTIP and TPP). However, failure to put the WTO back on the agenda will result in the emergence of competing structures, and this would not be a positive development. Countries that have developed within the governance structures that the United States and, to a degree, European countries shaped after the Second World War will seek alternatives. The world may indeed slide back into the situation that characterised the 1930s: preferences, the exclusion of rivals and international relations that cease to be characterised by cooperation.

China is of course an important player in this development, but for the time being has not yet made significant proposals for the advancement of global economic governance. In both trade and finance, China has been defensive rather than creating its own agenda. China is operating within the economic order created by the United States and its allies and has not shown a keen interest in establishing new, competing regimes. In trade, China continues to support the multilateral order and, in contrast to the EU and the United States, is not negotiating a mega-regional trade agreement with another large economy. In finance, many Chinese observers criticize the dominance of the dollar, but Beijing has not attempted to establish a competitor to the US currency, at least not yet.

Nevertheless, given the current state of affairs in global economic governance, being a silent observer may not be sufficient. Of course, the ability of China to set the agenda is negatively influenced by some policy choices made in the past. Specifically, the unwillingness of the Chinese government to support a multilateral agreement on the prevention of further climate change was probably one of many factors that prevented success in the 2009 Copenhagen Summit on Climate Change. For many leaders and observers, including German Chancellor Angela Merkel, Beijing's reluctance to at least permit an agreement among OECD countries raised questions about China's position in the global governance architecture of the twenty-first century. Today, China is probably exposed to a sentiment in international relations that the Chinese leadership helped to create in the late 2000s. Today, some observers consider China to be pursuing narrowly defined political goals in international relations. Of course, many countries, including the United States, are demonstrating a similar approach, but China prior to 2009 appeared to be a more benign player. After Copenhagen, the previously positive evaluation of Chinese foreign policy has at least suffered a blow to some extent.

However, even if it wanted, China would not be able to weaken the current headwinds that global governance is facing. The approach of the G20, however, could and should be reversed. In contrast to the current approach of the G20, I advocate global rules in trade, but national or regional rules in finance. To achieve this goal, the taxation of capital flows could be an instrument to provide polities with the necessary "policy space" in which they can develop tailor-made solutions. The financial sector, supported by academic economists often hand in glove with Wall Street, will argue that taxing cross-border flows is anathema.

This is no surprise: Bhagwati noted long before the subprime crisis and the various crises in Europe:

> And despite the evidence of the inherent risks of free capital flows, the Wall Street-Treasury complex is currently proceeding on the self-serving assumption that the ideal world is indeed one of free capital flows [...] It is time to shift the burden of proof from those who oppose to those who favour liberated capital (Bhagwati 1998:12).

At the very least, global rules should not discourage the introduction of additional regulatory measures at the national level. Of course, this proposal has severe drawbacks. One should not be under any illusion about the limitations of this approach. Tougher regulation at the national or regional level will also be exposed to intensive lobbying. Players will relocate to less restricted market places. It was ever thus. However, the benefits of a soundly regulated national financial sector outstrip the costs.

Notes

[1] In 2009, the University of Warwick (United Kingdom) established a Commission to analyse the options for international financial reform. The Commission's report was published in the same year (Warwick Commission 2009).

[2] Under the gold standard, the political climate was of course different. Trade unions were non-existent or much weaker, and policymakers had more freedom to set interest rates according to external economic conditions. Barry Eichengreen, economic historian at the University of California (Berkeley), argues that the rising power of trade unions explains the collapse of the gold standard much better than the decline of British hegemony after the First World War (Eichengreen 2008).

[3] For a discussion of the effects of liberalization see Eatwell (1997).

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Chapter 2
The Role of the G20 in Resolving Deep-rooted Problems in the World Economy

Liu Zongyi

1. Introduction

The outbreak of the financial crisis in 2008 laid bare some deep-rooted problems in the world economy. Essentially, it is characterised by two contradictions. The first is the mismatch between the changing world economic map and the current global economic governance structure. The second is the bottlenecks encountered by all economies or economic zones due to their old development models. In the context of economic globalization, resolving the current world economic contradictions and difficulties calls for concerted efforts by all economies. The G20 is the best platform for international cooperation and coordination. This chapter analyses the reasons for the world economy's current conflicts and suggests more extensive cooperation on the G20 platform as a solution.

2. The Changing World Economic Map and the Failure of Global Economic Governance

The world economic map has undergone significant changes in the past two decades. At the end of the twentieth century, Japanese scholar Kenichi Ohmae suggested that the world was made up of three economic "plates". One was centred on the United States, including Canada and Central and South America.

One was centred on the European Union, including the EU countries, Commonwealth of Independent States and Africa. The other was centred on Japan, including, China, South Korea, Southeast Asia, West Asia, Australia, and New Zealand (Ohmae 1985). However, especially since the global financial crisis in 2008, the global economic map has changed drastically, forming three new plates: developed countries, Asian countries (representing a pan-Asian plate) and energy countries. These plates have already shattered the traditional geographical concept completely with their consistent economic cycles and stronger connection with the global economy (Zhu 2012).

The most obvious change in the world economic map is the rise of the pan-Asian economic plate. The economic development of China and India has already transformed Japan's superiority in Asia economy. Although China's and India's economic growth has slowed down in the past two years, change is already under way. Now the Asian economic plate, with its vertical supply chains, has broken the original pattern divided by traditional geographical locations. Besides the countries geographically in Asia, some Latin American and African countries, such as Brazil, Chile, Tanzania and Gabon, also belong to this economic circle. The supply chain of the pan-Asian economic plate, which continues to expand, will attract more countries and create more opportunities for economic development. Owing to the rise of pan-Asian economic plate, the GDP of developing countries has risen to account for about 50 per cent of the world's total, which will have an enormous impact on the global economy by changing the global demand structure. The emergence of the BRICS countries has clearly indicated the change in the global economic order. Among the BRICS, there are highly productive countries such as China and India, but also countries with abundant natural resources, such as Russia, Brazil and South Africa. Highly economically complementary, they can harvest the benefits if they can further strengthen their cooperation. It is expected that in 2015 the economic aggregate of BRIC (not including South Africa) will surpass that of the United States, and their GDP increment is likely to account for one-third of total global GDP (Lin and Zhou 2011:63).

Meanwhile, the great powers that emerged after the Second World War still play an important role in the global economy. In 2013, the European Union was still the largest economic zone, accounting for 23 per cent of global GDP, almost twice the size of the Chinese economy. In the same year, US GDP (16.24 trillion dollars) was almost double that of China (9 trillion dollars), thus remaining the largest economic entity in the world. A recent World Bank report announced that measured in terms of PPP China's total GDP will outweigh that of the United States in the course of 2014, which has received wide criticism from the American scholars: calculated according to the real exchange rate, there is a vast difference between China and the United States. The G7, including Japan and excluding China, made up 46 per cent of global GDP. According to the IMF evaluation, even in 2016 China will account for 15 per cent of the global economy, but the EU and the G7 will still account for 20 per cent and 43 per cent, respectively.[1] Obviously, it is premature to deny the continuing importance of the members of the G7 and the EU, as well as Japan as world economic powers.

However, since 2001, the so-called "war on terror" and the financial crisis have proved the limitations of the United States and Europe in financial and military terms. The United States and European countries have lost their power to dictate to other countries with regard to global governance, which now requires active support from emerging economies, led by the BRICS (especially China and India). Currently, the global economic map is in a period of transformation. The balance of power between developed countries and the BRICS is changing. However, this process will take a long time because the global economic order is still dominated by the developed countries and they wish to retain their advantage in making global rules. As the aftermath of the international financial crisis shows, the United States and the EU want to use the sizable foreign exchange reserves of the emerging economies to contain the crisis, utilize their power to strengthen global governance and make them shoulder international responsibility without letting them share the same rights. These emerging economies also hope that the world will emerge from the crisis as soon as possible and thus have been trying to help Europe and America to stabilise international debt by retaining a considerable amount of developed-country debt. But they do not want to suffer debt losses for no reason, although that is inevitable. They therefore hope the developed countries will treat them equitably and have made long-term plans to stabilize the debt situation, hoping that they will obtain compensation for future losses. They need gradually to change their passive position in global governance, to reform the international finance system, including the international monetary system, and to have a greater voice in the global economic governance institutions, such as the World Bank and the IMF. However, Europe and America are reluctant to give up their position. In March 2013 and March 2014, the United States Congress rejected the IMF reform programme, thus obstructing an increase in the voting rights of emerging economies (Jiao 2013). The mismatch between the global economic map and the global economic governance structure is the root-cause of the low efficiency of global economic governance.

3. All the World's Major Economies Face the Problem of Coordinating Internal Reforms with the External Economy

The financial crisis in 2008 had a huge impact on the world economy and its consequences remain with us. This indicates not only the low efficiency of global governance, but also the end of the economic development model that rewarded the major economies with prosperity in the past and thus the need to develop a new model. In the five years since the financial crisis commenced, jointly and individually, the major economies have taken many measures to cope with it, especially at the outset. Some have been effective, while others have yet to show their effects. Currently, therefore, the world economy is characterised by "three-speed recovery": after slower economic growth rates, emerging economies in Asia and developing countries in sub-Saharan Africa are enjoying relatively rapid economic growth; the United States is at medium-speed recovery; but the euro zone and Japan are moving slowly, especially the euro zone, whose economy is continuing to shrink. As recently pointed out by Christine Lagarde, managing director of the IMF, there is still "a long way to go" for the economic recovery of the euro zone and Japan. The first priority task for the euro zone should be to continue to improve the bank system through asset restructuring, structural adjustment and even closing banks when necessary. As regards Japan, its critical task should be to establish an interim plan to cut public debt and push forward with comprehensive structural reform (Asia-Pacific Finance and Development

Center 2013).

However, emerging economies and the United States have many obstacles to overcome, even though their economies are in good momentum. For the United States, due to effective fiscal and monetary policy in the past five years and the stimulating effect of large-scale exploitation of shale gas and shale oil, its economy is recovering well, although many scholars take the view that it is a mirage. The United States also faces challenges, including lack of jobs and income stagnation among broad segments of the workforce. It needs to promote competitiveness in manufacturing industry through tax reform and to increase investment in research, infrastructure, energy, education and training in order to create more jobs and improve job skills. In addition, raising the minimum hourly wage to help workers improve living standards is essential (United States Government Printing Office, 2013). All this involves a series of tough reforms. So far, however, the United States Congress has impeded the resolution of these problems, failing to restore long-term unemployment benefits and food subsidy for the poor or to approve expenditure on new infrastructure. If the US government continues along its dysfunctional path, it may not even be possible to address the abovementioned challenges.[2]

Turning to China, India and other emerging economies, although the speed of economic development has been rapid compared with the developed countries, they have all encountered growth bottlenecks after two or three decades. Therefore, without further reforms, previous achievements may have been in vain. In China, a new breakthrough is needed by means of the following reforms: with regard to the economy and finance, China should gradually liberalize its interest rate, accelerate the convertibility of its currency, seek to increase domestic consumption and reduce economic growth based primarily on exports. In order to boost consumption and thereby reduce bank deposits the Hu Kou system must be reformed and the social security system strengthened. China also needs to combat corruption and do much more in terms of environmental governance, especially with regard to food safety, air and water pollution. China's leaders agree that reform is the only way to promote more sustainable economic growth. The Chinese government is even deliberately lowering the speed of growth for the sake of economic restructuring.

The same applies to India. Many people—including former Prime Minister Manmohan Singh—believe that the Indian economy cannot continue to have high growth until reform is deepened, great efforts are made to improve poor infrastructure and the system of cumbersome administrative assessment and approval is changed. In September 2012, the Singh government announced tough reforms and introduced a package of government orders that reduced fuel subsidies, further opened up the retail, airline and broadcast television industries and increased the share of foreign investment in those areas or companies in response to declining economic growth. Later on, they modified a number of laws related to competitiveness in order to increase foreign investment in the insurance and pension sectors. The purpose of those initiatives is to attract more foreign investment, strengthen the rupee and reverse the trend of slow economic growth in India. Due to India's complicated political system, the reform did not go smoothly. Unsuccessful reform, economic slowdown, price rises and rampant government corruption caused the complete collapse of the Indian National Congress in the 2014 general election of India, and the leader of the BJP, Narendra Modi, was elected as the new prime minister. Modi has made economic development the core task of the new government, with a determination to reform India's economic structure, improve manufacturing industry and enhance infrastructure development. The measures taken by Modi are supported by the middle class and industrial and commercial circles in India, and because the BJP and its allies account for the majority of the congress, it is likely that the reform measures will be approved. However, the current federal and political party systems cast doubt on the actual effects of these measures.

For Japan and Europe, whose economic recovery has been sluggish, reform is even more necessary. On coming to power Shinzo Abe's government started to reform economic policy and implement so-called "Abenomics", whose three pillars are bold monetary policy, flexible fiscal policy and an economic growth strategy involving industrial revitalization, stimulation of private investment, relaxation of administrative controls and expansion of trade liberalisation. Abe's monetary policy based on massive quantitative easing and proactive fiscal policy have boosted the stock market, lowered the exchange rate and pushed up commodity prices, but the effects have started to fade, and the scope for future stimulation of the stock market and depreciation of the yen as a result of quantitative easing is fairly limited. Meanwhile, Japan's tight budget makes new stimulus policies unlikely. Moreover, because wages have not increased in tandem with commodity prices, household consumption will remain sluggish in the long run. The negative impact on domestic demand caused by the increased consumption tax and other anticipated tax increases can also be foreseen. In the international arena, Abe's policies have introduced tensions into Japan's relations with important trade partners, such as China and Korea. The difficulties involved in reopening nuclear power stations and the petroleum price hike due to the problems with regard to Iran have imposed a heavier burden on Japan's imports and have left no room for solving its trade deficit. According to one former US official Abe's "three arrows" are more rhetorical than practical and due to the lack of implementation, how many of the policy's objectives can be achieved remains to be seen. Abe's policies have also been described as "Abe's volley of arrows".[3]

Structural reform of the euro zone may be the most difficult. In the past few years, all the euro zone governments have increased their efforts to deal with the stubborn factors restraining economic growth, including: youth pre-employment training programmes, labour market deregulation and privatising staple industries. The euro zone and the European Central Bank also need to offer a more accessible credit mechanism for small- and medium-sized enterprises, whose development is vital for the economic revival of southern European countries, which have suffered most (Rhodes 2013). As a monetary union, the lack of a unified fiscal policy is the key issue for the euro zone. Thus a fiscal and monetary union framework within the euro zone would be of great benefit to the stability of the euro and economic growth in the euro area. Such a reform goes beyond economics, however, and is important for the EU's political progress. It requires the agreement of all the member states. In 2012, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union—also called the Fiscal Compact—took formal effect, an important step towards a European fiscal union. The euro zone has also been steadily integrating the European banking industry. On 16 April 2014, the European Parliament voted for the last pillar of the European banking union, the Single Resolution

Mechanism (SRM). However, because EU problems such as bad debts and financial liabilities have not yet been solved satisfactorily, issues with banks that are "too big to fail" may emerge. Before the European banking union is realised, however, numerous challenges remain with regard to financial supervision. In the past two years, the plan to establish a European fiscal union has not been concluded. At the European Council summits held in Brussels in March, Angela Merkel's proposal to enter into a restrictive agreement to coordinate efforts on fiscal reforms was put on hold. Currently, the recovery of the EU economy is still weak and unbalanced: challenges such as slow growth, high unemployment, insufficient public and private investment and an unbalanced macro economy still exist. The EU economy needs continuing structural reform and more aggressive measures to accelerate growth, expand investment, create more jobs and enhance competitiveness.[4] When its inflation rate fell below the target of 2 per cent in June, the European Central Bank officially launched its monetary easing policy.

Clearly, all large economies face similar tasks. First of all, both developed and emerging economies have to push ahead with internal reform and economic system adjustment. One might even say that those who reform first, wisely and most deeply will be the final winners. Reform requires great political determination. The competitors have a good idea of where their problems lie, but they need to form a social consensus on reform. China, for example, is being hampered by vested interests. For some Western countries, the task is harder because their political party systems obstruct reform. In the United States, for example, the two-party system has two main problems: first, in the past, the two parties sought compromise rather than take things to the brink. In recent times, however, extremism has developed with the opposition rejecting all the policies of the party in power, come what may, even when they know clearly such policies are the right solution. Mechanisms established to promote balance have been twisted, bringing about institutional paralysis. Second, a kind of "consumer culture" holds sway over domestic politics; voters seem unwilling to wait to see the effects of structural reform and require immediate results. This phenomenon is not peculiar to America, which was long famous for its mature democracy. Emerging economies in which democracy is still developing have the same trouble. The situation is more complicated in the euro zone. Structural reform of the European Union needs all its members' agreement, but party politics poses a stumbling block within member states. This situation imposes enormous costs. Germany, for example, could help solve the present debt crisis but German voters apparently do not agree. The German government has thus tried to force indebted countries to implement austerity policies, leading to further economic recession there. This will inevitably reduce Germany's exports, which no one in Germany wants, but it seems their hands are tied if they want votes.[5]

In parallel with the reform challenge, another crucial task for all large economies is globalization and international economic relations. The financial crisis is clearly a negative effect of globalization. However, globalization cannot be reversed because all the large economies are now interdependent and tend to share one another's joys and sorrows. In the context of globalization, spillover effects are always possible. Economic policies or reforms in any of the large economies may have a positive or negative effect on other countries' economic development. As every country struggles to exit from the financial crisis, their economic policies can easily conflict. Monetary easing in Western countries puts great pressure on developing countries' exchange rate policy. The financial minister of Brazil has called this a "currency war" (Wheatley and Garnham 2010). But halting US monetary easing would also have a major impact on emerging economies. Last year, the United States announced that it would quit quantitative easing, which led to financial market turbulence in India and other countries, as currencies were devalued substantially. As economic growth has slowed worldwide, trade has been a main engine of economic growth. But in order to reduce their trade deficits and unemployment, some countries have resorted protectionism, which benefits themselves at the expense of other countries. Others have pursued exclusive trans-regional investment and trade arrangements to gain an advantage in the global economy, especially with regard to rule-making for the global economic order, thereby restraining the development of emerging economies. All these measures are harmful to economic reform in the large economies, as well as to the recovery and sustainable development of the global economy. Within the framework of global economic integration, enhancing economic cooperation and coordination is the only way to achieve coexistence and co-prosperity for all the large economies. The G20 can and should play a more important role in bringing this about.

4. The G20 Should Play a Greater Role

The G20 was upgraded from a mechanism for ministerial meetings to a summit mechanism during the international financial crisis in 2008. As a crisis response mechanism, the G20 played an important coordinating role for two years after the crisis erupted, during which time there were detailed achievements such as institutionalizing financial supervision, promoting reform of the IMF and IMF financing. However, these achievements are limited. Since the Pittsburgh Summit, along with the slow recovery of the global economy and turmoil in the euro zone, political and economic divergence between the G20 members has been growing and members have found it hard to reach consensus. The agreements reached at the summits in Toronto, Seoul, Cannes and Los Cabos were merely in principle and merely repeated common views on reform of the international financial system without a substantive breakthrough. The St Petersburg summit was almost entirely given over to dealing with political issues, such as Syria. Thus, the G20 is undergoing a difficult transition from a crisis response mechanism to a global economic governance mechanism. Nevertheless, it is irreplaceable and provides a platform for dialogue and cooperation between developed and emerging economies.

4.1 The G20 Should Become a Platform for the Great Powers Enabling Them to Coordinate, Cooperate and Learn from Each Other

As the main forum for discussing the world economy, the G20's success lies in cooperation and compromise between leading nations rather than in the pursuit of benefits at the expense of other countries or shifting troubles onto others. Given that the major economies are focusing on domestic reforms, the G20 should not only be a platform for cooperation, but also for mutual learning. Countries should exchange reform experiences. Against the background of globalization, the imperfections of both economic and political systems constitute the main reason why the financial and economic crisis cannot be curbed effectively. At the same time, some countries were able to exit from the crisis relatively quickly with fewer negative effects, which indicates that their economic or political systems may have something to learn from each other. To avoid the recurrence of such crises in the future, governments must take down ideological barriers and learn from each other. Emerging economies should further improve market transparency and develop and open up their service industry, while developed countries should recognize the limitations of the so-called "invisible hand" of the market and the drawbacks of party politicking. As an informal international platform, the G20 has certain advantages in terms of communication and mutual learning among leaders.

4.2 Promoting International Financial System Reform Will Improve Global Economic Governance

Reform of the international financial system is a G20 priority that would, to some degree, correct for the fact that although the world economic landscape has changed global economic governance is still dominated by Europe and the United States. Emerging economies have already made a major contribution by buying US and EU government bonds, boosting the IMF's capital to help Western countries, while at the same time maintaining economic growth, thereby avoiding recession on a global scale. Thus, the United States and the EU should fulfil their promise to transfer excess shares in the IMF and the World Bank to emerging economies. Only in this way can Western countries expect the emerging economies to make a greater contribution to global economic governance in the future.

International financial system reform is also a powerful way of validating the G20. However, despite some doubts about its legitimacy, the G20 is irreplaceable as the prime platform for discussing world economic problems, given the size of the populations and economies represented. A number of national and regional organizations have been invited to previous G20 summits, which also serves to boost its legitimacy. Nevertheless, the question of validity poses a real threat to the G20's existence and development. As an informal organization, it has neither a secretariat nor executive agencies. Furthermore, resolutions reached by the G20 can only be implemented by members voluntarily or with the help of other international organizations, such as the IMF and the World Bank. In this respect, reform of shares and voting rights in the IMF and the World Bank will also enhance the executive ability and validity of the G20. At the moment, many EU and US scholars regret realizing only late in the day that emerging economies should have a status consistent with their economic scale. Emerging economies should be treated more equally in the G20.[6] Unfortunately, although all the other important shareholders in the IMF ratified this reform plan, the persistent opposition of the United States brought reform to a halt, arousing considerable discontent in many countries. IMF Managing Director Lagarde has even said that the headquarters may one day leave Washington for Beijing, in keeping with China's growing influence on the world economy.[7]

4.3 Promoting International Trade Will Motivate Sustainable Development of the World Economy

Opposing trade protectionism is one of several areas in which the G20 plays a fairly effective role. However, protectionism has not been eliminated, for example, in the EU, which still has poor economic growth and has frequently opted for protectionism. Of course, many EU member states realize the disadvantages of such a policy and object to the EU's protectionist measures against China and other emerging economies. Some European countries outside the euro zone have even signed free trade agreements with China. Theoretically, investing in countries or regions implementing protectionism can help to avoid barriers. China and other emerging economies have considerable foreign exchange reserves seeking investment markets and access to high technology. At the same time, for developed countries, attracting foreign investment is an effective way of overcoming the debt crisis and creating jobs. But because emerging countries such as China are new creditors, their assets overseas and industry security in Europe and America do not have effective guarantees.

Besides protectionism, particular exclusive arrangements with regard to transnational investment and trade also have an adverse effect on the world economy's sustainable development. This includes the Trans-pacific Strategic Economic Partnership Agreement (TPP) and the Transatlantic Trade and Investment Partnership Agreement (TTIP). The upshot may be a new round of negotiations on global economic regulation without and even against the interests of the emerging economies, in an effort to enable the developed economies to contest the rise of the emerging economies and grab the right to make international rules in the post-crisis era (Chen 2013). Some Western scholars are extremely worried about this situation. Former World Bank president and senior visiting fellow at the Peterson Institute for International Economics Robert Zoellick has called on the WTO to continue to promote trade liberalization and the Doha round negotiations. He thinks, like the IMF, the World Bank and other international organizations, that the WTO should also promote multilateralist modernization in order to reflect the changes in the global economic landscape and the increasing influence of developing countries. If the Doha round negotiations are stalled, the WTO risks being marginalized by bilateral and regional trade agreements. The economic recovery in the past few years has been due mainly to the push of fiscal and monetary policies, but trade will be critical in promoting the world economy's sustainable recovery (China Review News 2013). At the end of 2013, the WTO "truly delivered" for the first time in its history after a breakthrough in multilateral trade negotiations was made at its ninth ministerial meeting in Bali, Indonesia, and "the full Bali package" was concluded. But the package is not the end, only a beginning, because trade facilitation is only a basic procedure of trade liberalization. The core of trade liberalization is opening up markets, which is the main focus of conflict in the trade liberalization negotiations. The G20, as a dialogue platform for the main world economies and a mechanism for coordinating different countries' interests, should play an active role in furthering the Doha round negotiations. Moreover, because the aim of the United States in setting up TPP and TTIP is to reach a global free trade agreement with high standards, the G20 should encourage the United States and other countries to discuss TPP and TTIP on the G20 platform. This would motivate progress with the Doha round negotiations.

5. Main Factors that Influence the G20's Role

The G20 may have a significant impact on the fundamental contradictions of world economy, but cooperation between the leading powers, especially the attitude of Western countries to emerging economies, will determine the G20's role.

5.1 Sino-US Cooperation Is the Guarantee of G20 Influence

Some scholars believe that the tensions between China and the United States constitute the reason why the G20 has not achieved too much in the past few years. Although the conflicts between the two countries is not the main factor that has made the G20 lose its momentum, peaceful coexistence and cooperation between them are necessary for world economic development and stability, as well as indispensable conditions enabling the G20 to conclude agreements. In the wake of the financial crisis, the gap between demands for the resolution of global issues and the provision of public goods has widened further. No country can meet the challenges of the global economy and politics alone. In the United States, reform of the international financial institutions is the policy priority of its administrative branch when it comes to global economic governance. However, the whole American government, including Congress, should recognize that reform of the international monetary institutions is necessary if the United States is to maintain dominance in the international financial system. If there is no positive development in this regard, emerging economies will be forced to establish other international financial institutions, such as a BRICS development bank. Then the United States will find it more and more difficult to play a leading international financial role. The United States believes that, by economic size, it has relatively less clout in the IMF and the World Bank and that the voice of Europe is disproportionately louder. Therefore, the United States is trying to reduce Europe's power in these two institutions to what it considers a reasonable level. Both Chinese and American scholars realize that enhancing G20 cooperation would consolidate the organisation and develop a new type of great power relationship at the same time. The G20 must fulfil the promises it made, including the international financial system reform agreed in 2010 (China Institutes of Contemporary International Relations, the Center for American Progress and the Stanley Foundation, 2013). In fact, some American scholars have already suggested that the IMF offer China the same veto power as the United States enjoys (China Review News 2013). The summit between President Xi Jinping and President Obama at Sunnylands in southern California shows that both sides realize that too many problems are likely to arise for both countries without cooperation. By arranging this meeting they tacitly admitted that the basic rules of the game have changed (Chance 2013). Now both the United States and China should face this reality. China should bear more international responsibilities. At the same time, it should concentrate on eliminating the perception gap with the United States on this issue. The whole world should understand China's limited capacity to take more international responsibilities. The United States, in turn, should not "talk down" to China anymore and face the reality of China's developing power. In particular, it should give China more institutional space in the international system. In short, the United States should share power with China, and China should share responsibilities with the United States.

5.2 Equal Treatment of Emerging Economies by Western Countries Is the Key to the G20's Success

Another problem for the G20 that worries many scholars is the risk that caucuses may form. For example, there are G7 members and BRICS countries, which could turn into two antagonistic groups. In fact, BRICS members differ considerably in terms of their political and economic systems, cultures and ideologies. Their union is motivated largely by two things: promoting reform of global governance, including reform of the international financial system; and enhancing South-South cooperation, including cooperation between emerging economies and other developing countries. If the G20 can solve the problem of international financial reform and the BRICS countries obtain a louder voice in the IMF and the World Bank, however, they would have no reason to form a caucus and hinder the G20's proper functioning. Instead, they could fulfil their international responsibilities. On the other hand, the G7 may become a caucus in the G20. Having lost its former influence, the G7 cannot solve global political and economic problems alone, but they have common values and a shared desire to safeguard vested interests in the current international order. After the Crimean crisis, it seemed that the G7 would revive as a Western political alliance, but its imposition of economic sanctions on Russia and threat to prevent it from attending the G20 Brisbane summit were a bad idea. In fact, the majority of agendas in the G20 are still initiated by the G7 and thus the possibility that two antagonistic caucuses—G7 and BRICS—will emerge depends on Western countries' attitude to emerging countries: in other words, whether they abandon their arrogance and treat emerging economies equally. The G20 Brisbane Summit in 2014 should present a comprehensive strategy to lift global growth in which strengthening investment in infrastructure plays a key role.[8] If the Western countries treat emerging countries' investments in infrastructure as on a par with those of the developed countries it would send an important signal.

Notes

[1] Data calculated by the author, based on *Economy Watch*, http://www.economywatch.com/.

[2] "meiguo fusu jingbuqi zheteng (Fragile Recovery of the US)," *Financial Times*, 27 June, 2014, http://www.ftchinese.com/story/001056965#adchannelID=1300.

[3] "riben jingji huanshang 'pilaozheng' (Japanese Economiy Suffers from 'Fatigue')," People's Daily, 26 June, 2014, http://finance.ifeng.com/a/20140626/12609145_0.shtml.

[4] "duochong yinsu zhuli ouzhou jingji fusu tisu (Multiple Factors Help Speed for the European Economic Recovery)," http://jjckb.xinhuanet.com/2014-06/30/content_510645.htm.

[5] From a conversation between the author and Professor Ding Yifan, Vice Director of the Institute of World Development under Development Research Center of the State Council.

[6] Quoted from dialogue between Matthew P. Goodman, Director of Simon Chair in Political Economy CSIS, and the author.

[7] See "Lagarde says not surprised to see Beijing-Based IMF", 12 June, 2014, http://www.ecns.cn/cns-wire/2014/06-12/118791.shtml.

[8] Mike Callaghan AM, "The G20 needs a growth strategy," 13 February, 2014, http://www.lowyinstitute.org/publications/g20-needs-growth-strategy.

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Chapter 3
Reform of International Financial Institutions

B. L. Pandit

1. Introduction

For the past thirty years, the globalization of investment and finance has been vigorously promoted by the World Bank, the International Monetary Fund (IMF) and multi-national corporations. Governments around the world have been persuaded to remove barriers to investment and trade. Advances in telecommunications and computer technology have made it possible for investible funds to zoom around the globe day and night in search of higher returns. The global markets have expanded very rapidly. This expansion has generated prosperity gains around the world. But economic globalization has outpaced the development of the international financial and monetary system. International financial crises have exposed the deficiencies in international financial governance and its basic architecture.

This chapter deals with the issue of reforming the international financial institutions. International financial stability is the primary responsibility of the International Monetary Fund and reforms in the workings of the IMF are examined in particular detail. We shall make particular reference to the global financial crisis that began in 2008 and the role of G20 as a possible steering organization for reforming the international financial architecture. As the international monetary authority, dedicated to maintaining global financial stability, the International Monetary Fund has time and again proved incapable of controlling financial crises. The Asian Crisis of 1997-1998 and the global financial crisis of 2008 are two well researched recent events that prove the inability of the IMF to deal with crises successfully.

Three interrelated issues are taken up in this chapter. (1) What are the current problems in the workings of the international financial institutions? (2) How can these institutions be reformed with a view to increasing their ability to control financial crises? (3) What role can the G20 play in galvanizing the governments of the member countries to pursue financial reforms at G20 leaders' summits? As a rising global economic power and a prominent member of the G20, how does China envisage reform of the Bretton Woods institutions with a view to rendering them capable of promoting and sustaining global financial stability? Before we take up these issues in detail, let us examine the underlying philosophy of government intervention in markets as social institutions.

2. Financial Crises, Markets and Governments

No financial crisis is exactly like any other. Nevertheless, there are common elements. All financial crises start with excess liquidity followed by rampant speculative activity in certain sectors, resulting in bubbles that invariably burst with a market crash.

The function of markets is to trade and exchange goods and services. As Sheng (2010) says, successful markets have three important attributes: (1) protection of property rights, (2) low transaction costs and (3) a high level of transparency. Markets are networks and as more networks evolve, markets become more complex. Shocks in one segment are quickly transmitted to other segments, resulting in contagion. Financial markets are essentially interlocked networks trading in equities, bonds and derivatives and contagion is very rapid.

Neoliberal economic theory considers markets to be self-organizing social institutions. But as Sheng (2010) rightly emphasizes, government is a major partner in markets because it regulates and protects property rights. It is for this reason that quality of governance is important in ensuring economic success through markets. Only good governance can successfully navigate an economy through the rough seas of economic crises. But one cannot say that there is a consensus about the role of government in a market economy.

After the fall of the Berlin Wall in 1989 and in particular after the early 1990s a consensus evolved among the Washington-based institutions—the World Bank, the IMF and the US Treasury—about the economic management of the world economy. Ten recommendations came to be known as the *Washington Consensus*. They are as follows:

(1) maintain prudent fiscal discipline;

(2) remove subsidies and focus on expenditure on infrastructure, health and education;

(3) reform taxation to promote equity and reward enterprise;

(4) interest rates must be market based and positive in real terms;

(5) liberalise trade, reduce tariffs and remove protection;

(6) liberalise international capital flows, especially FDI;

(7) privatise state-owned enterprises and get government out of business;

(8) leave exchange rates to be determined by the market;

(9) deregulate financial markets, imposing only prudential regulations; and

(10) maintain legal protection of property rights.

However, Joseph Stiglitz (2003) Nobel laureate and former Chief Economist of the World Bank has pointed out that the most successful countries, including those in East Asia, have not followed this strategy and government plays an active role in promoting education, capital formation and technology.

Lou Jiwei, China's Deputy Minister for Finance has rightly said that the Washington Consensus confuses the ideal outcome with the process. The hands-off approach underlying the Washington Consensus describes a desirable situation, but does not describe the process by which an economy can reach a situation in which state intervention is superfluous. Also, the "one size fits all" approach is not logical, either. The Mexican Crisis of 1994, the Asian Crisis of 1997-1998 and the global financial crisis of 2008—provide strong evidence against the Washington Consensus. In its Global Financial Development Report (2013) the World Bank seems to have become wiser after the global crisis, emphasizing the role of the state in finance. The World Bank says that the state has a crucial role in the financial sector, where it needs to provide strong prudential regulation, ensure healthy competition and enhance financial infrastructure. The Bank also envisages that the state could help to develop local currency capital markets and long-term financing and play an important role in health care finance and pension schemes.

3. Reforming the IMF—Post-2008 Global Financial Crisis

There are numerous studies on the global financial crisis of 2008. Greenspan (2010), Reinhart and Rogoff (2009), Stiglitz Commission Report (2010), Krugman(2009), Rajan(2010), Sheng(2010), Reserve Bank of India(2010), Reddy (2010) and Pandit (forthcoming) are some of them. The role of the IMF in the crisis has been closely scrutinized in some of the studies and attention has been drawn to the weaknesses in its workings. We shall first take up some of the structural issues related to the working of the IMF during the pre-crisis period. This is followed by a discussion of post-crisis reforms in the IMF. Finally we examine the role of the G20 in highlighting serious problems afflicting the IMF and the reforms it proposes.

3.1 The IMF: Some Structural Features

When evaluating the role of the IMF in resolving international problems we have to take into account some of its structural features. First, the IMF is not a bank of central banks. Second, central banks and other domestic financial authorities normally do not want to share their powers to monitor private sector financial flows with the IMF. Third, the role of the IMF was originally intended for a regime of fixed exchange rates. As a result the entire focus of the IMF was on whether exchange rates were in sync with the external position and domestic fundamentals of an economy. Fourth, prior to the mid-1980s, capital movements were only on the government account and at the global level foreign exchange resources were scarce. Due to transnational immobility of capital, private capital flows were non-existent. As a result, the IMF traditionally worked with a Walrasian mind-set, focusing on "prices" or exchange rates and their misalignments, while assuming that "quantities" or capital flows would adjust to equilibrium levels without any major disruption. Fifth, finance has globalized but governance remains national. This mismatch could ideally be resolved if governance was globalized and comprehensive reforms are needed in the working of the IMF. The agents of globalization are not individual governments with a social welfare function to satisfy but multi-national enterprises guided solely by profit.

3.2 Problems with the Workings of IMF

Apart from the structural problems, the workings of the IMF suffer from serious limitations. In comparison with the huge volume of private foreign capital flows, the foreign exchange reserves available to the IMF are limited.

3.3 Quotas and Voting Power

The IMF gets its resources from the subscriptions of the member countries. When a country joins the IMF, it is assigned an initial quota in the same range as quotas of existing members of broadly comparable size and characteristics. The IMF uses a quota formula to assess a member's relative position. The current quota formula is a weighted average of GDP (weight 50 per cent), openness (weight 30 per cent), economic variability (weight 15 per cent) and international reserves (weight 5 per cent). The GDP measure is a blend of 60 per cent at market exchange rates and 40 per cent at PPP exchange rates. In the formula there is a compression factor which reduces dispersion in the computation of quotas. Quotas are determined in SDR (Special Drawing Rights), the IMF unit of account.

The members' quotas determine three important things.

The first is the member's subscription, that is, the maximum amount of financial resources a member is obliged to subscribe to the IMF.

The subscription has to be paid in full on joining; 25 per cent of the subscription is to be paid in SDR or other widely accepted currencies. The remainder of the subscription is to be paid in the member's own currency. The second thing is the voting power of a member in IMF decision-making. An IMF member's vote comprises basic votes plus one additional vote for each SDR 100,000 of subscription. The IMF reforms in 2008 fixed the number of basic votes at 5.502 per cent of total votes, which amounted to a tripling of their pre-2008 level. The third important thing determined by a member's quota is access to financing. The limit of a member's access to finance by IMF is based on that member's quota. Under stand-by and extended arrangements, a member can borrow up to 200 per cent of its quota annually and 600 per cent cumulatively. In exceptional circumstances access to finance can be even higher.

At present, there are serious anomalies with regard to the quota-based voting rights of the member countries of IMF. The United States has 17 per cent of the voting rights or quota share, which gives it veto power in IMF decision-making. As a result, no reforms in the IMF are possible without the approval of the US Congress. Despite the high growth of emerging market economies and some developing countries, their quotas have not been revised. If quota revisions were carried out, the voting rights and quotas of the BRICS would increase and there would be a corresponding reduction in Europe's voting power and quotas. European countries are overrepresented. Given the problems in the euro zone in recent years, European countries have been prime beneficiaries of IMF support, with unrevised quotas and voting rights. Brazil and Spain have similar voting rights, although the Spanish economy is less than two-thirds the size of the Brazilian economy.

Members' quotas are generally revised every five years. The Fourteenth General Review of Quotas was completed in December 2010. It recommended (1) a doubling of quotas from SDR 238.5 billion to SDR 477 billion; (2) a shift of more than 6 per cent more quota share from overrepresented to underrepresented member countries; (3) a shift of more than 6 per cent quota share to dynamic emerging market economies; (4) realigning quotas in which China shall have the third largest share and Brazil, China, India and Russia shall be among the 10 largest shareholders; and (5) preservation of the quotas and voting rights of the poorest member countries.

On 25 March 2014, IMF Managing Director Christine Lagarde, made a statement about governance reforms and IMF quotas. She said that she was very disappointed that the necessary legislative steps had not been taken by the US Congress to allow these important reforms to be implemented without further delay. She further said that these reforms would both strengthen the IMF's capacity to respond to members' needs and help to make its governance more representative of its dynamic membership.

For the quota increases under the Fourteenth General Review of Quotas to become effective, the adoption of the proposed amendment to reform the Executive Board is required, as well as the consent to the quota increase by members having not less than 70 per cent of the total quotas (as on 5 November 2010). As of 19 June 2014, 160 members with 79.43 per cent of total quotas had consented to the quota increase.

However, in order for the proposed amendment on reform of the Executive

Board to enter into force, acceptance by three-fifths of the IMF's 188 members having 85 per cent of the total voting power is required. As of 23 April 2014, 145 members having 76.97 per cent of the voting power had accepted the amendment. The Obama administration, however, could not obtain the majority vote in Congress needed for the IMF quota amendments because Republicans have a majority in that House. This is how the IMF decision on quota amendments was blocked by the intransigence of US legislators. Upcoming Congressional elections in November 2014 will make it even more difficult for the US administration to obtain approval for revision of IMF quotas and governance reform in the coming months.

3.4 Surveillance by the IMF

A core activity of the IMF is surveillance, that is, monitoring global regional and national economies to assess whether the policies being pursued are in the interests of the country concerned and whether they are also consistent with the broad interests of the international community. The IMF publishes such analyses in the *World Economic Outlook*, the *Global Financial Stability Report* and the *Regional Economic Outlook*. Bilateral surveillance under Article IV of the IMF is normally carried out annually with member countries assessing policies related to exchange rates, monetary, fiscal and financial policies and assessment of risks and vulnerabilities.

In June 2007 surveillance policy was updated to focus on whether a country's policies promote external stability, covering exchange rates, monetary, fiscal and financial policies and assessment of risks. The Financial Sector Assessment Programme (FSAP), which started in May 1999, is a joint IMF and World Bank effort which seeks to identify the strengths and vulnerabilities of a country's financial system to determine how key sources of risk of a country are being managed. The 2008 global financial crisis pushed macro-financial sector issues centre stage in IMF surveillance programme work.

IMF surveillance has come in for serious criticism for its lapses. For example, the Article IV Report on the Surveillance of the United States, dated 11 July 2007 said "core commercial and investment banks are in a sound financial position and systemic risk appears low" (Report, p.14). The advent of the sub-prime crisis in the US housing sector in August 2007 clearly proves that the IMF surveillance reports were wide of the mark and did not sound any alarms about the huge international macroeconomic imbalances which ignited the 2008 global financial crisis. Surveillance has therefore been a failure not only in assessing potential risks but also in drawing attention to visible systemic risks.

4. The IMF's Post-Crisis Policy Initiatives

After the global financial crisis, some important policy initiatives were taken by the IMF:

(1) IMF conditionality for loan disbursements was revamped, making it more focused and tailored to the varying policies and fundamentals of the borrowing countries. Although structural reforms will continue to be integral to the IMF programme, countries that fail to comply with structural reform will not need to obtain formal waivers.

(2) The Flexible Credit Line (FCL) was extended to countries with strong fundamentals and a track record of policy implementation. The duration of credit and the amount of credit available were increased after August 2010. A separate Precautionary Credit Line (PCL) was established for members with sound economic policies but who may not be able to meet the higher requirements of FCL. PCL is now available to a larger number of members than FCL.

(3) Stand-by arrangements, a widely used instrument for extending IMF credit during crisis, were reformed.

(4) Access to non-concessional loans was doubled.

(5) Cost computation of loans and their maturity structures were simplified.

(6) Structural conditionality was reformed for low income member countries. The IMF provides two primary types of financial assistance to low income countries. Low interest loans are provided under the Poverty Reduction and Growth Facility (PRGF) and the Exogenous Shocks Facility (ESF). Further debt relief is given to heavily indebted poor countries under the initiative of the same name and multilateral debt relief initiative. These resources come from members' contributions rather than from their quotas. In July 2009 the IMF approved far-reaching reforms of the concessional facilities in which the PRGF-ESF Trust was replaced by the Poverty Reduction and Growth Trust (PRGT). In exceptional cases zero interest loans were to be given to low income countries to help them to

cope with the crisis. These reforms will become effective when all current lenders and bilateral subsidy contributors to the PRGT have consented to the reforms and IMF resources actually increase.

(7) A substantial increase in the IMF's resources has been planned. Under Bilateral Borrowing, Japan, the European Union, Norway, Canada, Switzerland, the United States, Korea, Australia, Russia, China, India, Singapore and Chile have agreed to commit financial resources to the IMF.

(8) In September 2010, the Financial Stability Assessment Programme (FSAP) was launched. For countries with systemically important financial sectors, FSAP has been made mandatory under IMF surveillance. A total of 25 member countries have been identified under FSAP for whom assessment will have to be made every five years. FSAP will have three elements: first, potential impact of main risk to macro-financial stability in the near term; second, country's financial stability policy and evaluation of financial supervision in comparison with international standards; and third, the authorities' capacity to manage and resolve financial crises.

5. Role of the G20 in Facilitating International Financial Stability

The G20 is a group of finance ministers and central bank governors from 20 major economies comprising of the G8 (United States, Japan, Germany, France, United Kingdom, Italy, Canada, Russia) and ten large emerging economies (China, India, Brazil, Indonesia, Mexico, Korea, Turkey, Saudi Arabia, South Africa and Argentina). The European Union and Australia were also included in the G20. In the wake of the Asian Crisis, the G20 was proposed by Canadian Prime Minister Paul Martin and was formally inaugurated in September 1999. The first meeting was held in December 1999 with the objective of promoting international financial stability. When the global financial crisis assumed a virulent form, after the fall of Lehman Brothers in the United States in September 2008, the first G20 Summit of World Leaders was held in Washington in November 2008. In September 2009 it was announced that the G20 Summit of World Leaders would replace the G8.[1] The high table of global governance was thus created to resolve international economic problems. The eighth G20 Summit was held in Russia in September 2013 and the ninth Summit is slated for November 2014, to be held in Australia.

The G20 Working Group on Enhancing Sound Regulation and Strengthening Transparency recommended that the Financial Sector Assessment Programme (FSAP), a joint IMF and World Bank effort, and IMF Article IV consultations should be used to monitor systemic risks and financial stability. Macro-prudential tools must be deployed along with a globally coordinated mechanism to detect spillover effects on other countries. Authorities can enforce compliance by rating agencies to changes in practices and procedures or managing conflicts of interest and sharing of information with authorities overseeing rating agencies. G20 members should commit to undertake an FSAP and publish its conclusions.

The G20 Working Group on Reinforcing International Cooperation and Promoting Integrity in Financial Markets recommended that the IMF, with its focus on surveillance, and the FSB, with its focus on standard-setting, should strengthen their collaboration and conduct Early Warning Exercises (EWEs). A pilot EWE was conducted for the IMF Spring meeting of 2009.

G20 summits have been held regularly. The agenda for each summit has always been based on the three core priorities of the G20, namely, (1) global economic growth, (2) promoting financial stability and (3) governance reform of the international financial institutions. The summit meetings have achieved notable successes in respect of the following:

- High level of coordinated response to the financial crisis: (1) combating trade protectionism; (2) coordinating fiscal stimuli; (3) reduction of fiscal deficits of emerging economies; (4) the IMF has been assigned the job of assessing the influence of policies on other countries.
- The G20 has initiated efforts to transfer voting rights in the IMF and the World Bank to developing countries to reflect their shares of world GDP.
- The G20 has made efforts to strengthen international financial supervision. The Financial Stability Forum (FSF) was created in 1999 on the recommendation of the G7. At the G20 Leaders' Summit in November 2008 it was decided to increase the membership of the FSF. This is how the Financial Stability Board (FSB) was established. The objectives of the FSB are threefold: first, to strengthen its effectiveness as a mechanism for national authorities, standard-setting bodies and international financial institutions; second, to address

vulnerabilities with regard to financial stability; and third, to develop and implement strong regulatory supervision and other policies.

- The G20 has institutionalized a regular mechanism of Annual Summits in which future action on international economic issues is outlined and progress on the decisions of the previous Summit is assessed.
- Based on G20 initiatives, shadow banking activities in financial derivatives, hedge funds and offshore financial centres are being brought under financial supervision.

5.1 Evaluation of the G20

Evaluating the role of the G20 Y. Tiberghien and X. Hongcai (2013) say that although the G20 was created to facilitate a coordinated response to the global financial crisis, it has gradually evolved into a setting for the international community to coordinate economic decisions. The international economic context has not been easy for the G20 process. As the two authors say, post 2010, global recovery has been strong enough to allow a weakening of the sense of urgency, but also not strong enough to promote a sense of solidarity and security. The European debt crisis looms large over the global economy, creating added uncertainty. Trade protection is posing a threat. Uneven recovery and global imbalances are threatening global cooperation through G20 initiatives.

The G20 is facing challenges in taking initiatives on international economic cooperation. The first problem is how to reconcile national interests with global ones. There is a perennial conflict of interest between rich advanced economies and large emerging economies. The second challenge is that the G20 lacks authority and has no power of sanction. Furthermore, since the outbreak of the 2008 global crisis, the world order has been multi-polar, leading to strains in the international financial architecture, which continues to be dominated by the US dollar. As of 2011, 85 per cent of international transactions involved the US dollar as one currency in the transaction and 61 per cent of international reserves were in dollars.

5.2 Financial Reforms and the Role of the G20: China's View

For a long time, China was outside the international financial system. It joined the IMF and the World Bank in 1979. Initially the World Bank was quite a success in China. In 1997-1998, during the Asian Crisis, the IMF proved to be incapable of pulling out East Asian countries out of the crisis, however. In China's view the Asian Crisis happened despite the fact that the East Asian economies were complying with the Washington Consensus. The China Institutes of Contemporary International Relations, the Centre for American Progress and the Stanley Foundation formed a study group in late 2011 to evaluate the role of the G20 in US-China bilateral relations and to propose recommendations that would improve the efficacy of the G20.

The Study Group views the G20 as an important forum for addressing key global challenges. Following the global crisis of 2008, with the G20 initiative, China, the United States and other major players joined hands to contain the damage. After some early success, the G20 appears to have lost momentum. Probably excessive expectations bred cynicism. Nevertheless, the G20 has a comparative advantage in seeking solutions to important international economic issues in a relatively informal way at its Summit meetings of world leaders. China has participated in all the Summit meetings of the G20. President Hu Jintao attended the first Summit in Washington in November 2008. In his speech the Chinese president, outlined the Chinese approach in detail. He asked, first, for comprehensive reforms of the international financial system; second, for a balance be created among the interests of all countries; and finally for reforms of the international monetary and financial system yielding practical results. Deputy Premier Wang Qishan and Central Bank Governor Zhou Xiaochuan outlined Chinese policy and emphasized that the G20 should focus on the interests of the developing economies. China's Deputy Finance Minister, Li Yong, suggested that the G20 should take care of development financing and advance international poverty reduction. Furthermore, the Minister suggested that international trade and economic cooperation ought to be deepened and that the G20 can play a decisive role in attaining this important objective.

6. Reforming the World Bank

At the time of its establishment in 1944, the International Bank for Reconstruction and Development (IBRD), generally called the World Bank, was charged with the reconstruction of war-ravaged economies by developing their infrastructure and helping the development of the corporate sector. During the seventy years of its existence the World Bank has broadly pursued two long-term goals: first, ending extreme poverty and second, promoting shared prosperity. The Bank has provided low interest loans, interest free credits and grants to developing countries in sectors such as education, health care and infrastructure.

There is no room here to evaluate the huge amount of development financing by the World Bank nor to outline all the different types of reform of the Bank suggested by different schools of thought. As the World Bank claims, multiple reforms are in progress concerning inclusiveness, innovation, efficiency, effectiveness and accountability.

As result of the 2008 global economic crisis, according to World Bank estimates, 100 million people were pushed back into poverty. Second, since the crisis, donor countries have revised their aid policies. These developments necessitate examining the working of the World Bank and suggesting possible reforms. David Shaman (2010) says that as of 2010, over one and a half billion people were living in abject poverty. The Millennium Development Goals set in 2002 will not be met by 2015. Aid from donor countries, which was planned to increase to 0.7 per cent of donor nations' gross national income, has not been achieved; for example, the US share is only 0.17 per cent.

Why did the World Bank fail to convince donors to try to eradicate poverty? In the first place, experts have claimed that World Bank lending has not been fully effective. Weak portfolio performance undermined the appeals by the Bank to rich nations for more aid. Second, borrower countries find the lending conditions of the Bank stringent and a number of borrowers have shied away. This resulted in the World Bank financing more projects in emerging market economies than in countries that need development finance more urgently. Third, the Bank is viewed by donors, borrowers and stakeholders alike as a monolithic organization with a culture of secrecy, lack of transparency and lack of accountability.

Mexican President, Ernesto Zedillo headed a Commission in 2009 on reforming the internal governance of the World Bank, which made important recommendations. The Zedillo Commission recommended that the size and composition of the Board of Directors of the Bank should be changed and expertise in operational affairs in the Board should increase. Further, public access to Board meetings and documents should increase. An important recommendation is that emerging market economies and developing countries must get a greater voice and vote. The Commission declared that project evaluation should not be done within the Bank but by an outside agency. Furthermore, the Commission says that the resettlement of people displaced due to land acquisitions for Bank projects is a matter of concern. In some projects the number of people displaced is very large. Evictions may be necessary but forced evictions and land grabbing have reached crisis proportions in the Global South. Many projects causing population displacement are reported to have questionable development merits, according to the Zedillo Commission.

David Phillips (2011) has an interesting suggestion for reforming the organizational structure of the Bank. Phillips says that the Bank is supposed to provide public goods in the twenty-first century. Working backwards one can define the type of organization needed to deliver those goods. Clearly, the need is for a major simplification in the organizational structure of the World Bank.

7. Concluding Remarks

In the past thirty years, market globalization has outpaced the development of the international monetary and financial institutions, such as the IMF and the World Bank. The Asian Crisis and the global financial crisis have exposed the weaknesses in the workings of the IMF, which proved incapable of detecting signs of crisis through its surveillance, not to mention controlling the crises. The deliberations of the G20 and its Leadership Summits have played a useful role in identifying the problems in the international financial architecture and suggesting policy initiatives to the IMF. The G20 took the initiative to establish the Financial Stability Board and charged it with maintaining global financial stability. Another important initiative in this context is the Financial Stability Assessment Programme. The G20 has also urged the United States to take legislative measures to enhancing the quotas and voting power of developing countries in the IMF. After some early success, however, the G20 seems to have lost its momentum. Nevertheless, it is clear that the G20 is broader-based than the G8.

The World Bank is a unique global institution with the twin agenda of eliminating poverty and developing infrastructure. However, there are problems, including the Bank's monolithic organizational set-up, lack of transparency, forced eviction of people for Bank projects and "internal" project evaluation. The recommendations of the Zedillo Commission ought to be implemented and G20 Summit Meetings must follow China's suggestion that the G20 oversee development finance for poverty reduction.

Notes

[1] After attending the first G20 Summit meeting at Washington D.C. along with the then Prime minister Manmohan Singh in November 2008, P.Chidambaram, the then Finance Minister of India, made the following statement in New Delhi, "G7 has recognized belatedly that they alone do not have all the solutions. G20 has come to stay as the single most important forum to address the financial and economic issues of the world".

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Chapter 4
Regulating International Financial Markets[1]

Stephany Griffith-Jones

1. Introduction

This paper will focus on regulatory changes in terms of their capacity to stabilize financial markets; indeed, a financial sector should serve the real economy, by stimulating savings and keeping them safe, channeling efficiently savings to productive investment, by providing short and long term credit to enterprises, and it should fund households. At the same time, the financial sector should "do no harm", to the rest of the economy, avoiding causing developmentally costly financial crises. It is this latter aspect that this paper will focus on.

While this paper emphasizes more regulatory reform agreed internationally and that implemented by developed countries, the strong linkages between the financial systems of developed and developing countries means a crisis in the former can seriously impact the latter. An example is the effect of the global financial crisis (or more precisely the North Atlantic crisis) of 2007 and 2008 on emerging economies. The paper will focus on three of the priority areas of regulatory reform the Financial Stability Board has outlined in its most recent address to the Group of 20 (G20), "the Basel capital framework; policy measures for global SIFIs,[2] and shadow banking" (FSB 2013a:7).

The paper will first assess the agreed and proposed further content of internationally coordinated policies aiming to reduce the risks of financial collapse that emanate from commercial banks, in particular, "Basel III", and those policies addressing the "too big to fail" problem ("SIFIs"), asking if and in how far they properly address the main sources of the build-up of systemic risk. Next, we address aspects of the increased regulation post crisis of financial markets often called "shadow banking", looking in particular at the "repo" market, evaluating not only how much progress has been made in terms of actual regulation, but also policy efforts to combat "regulatory arbitrage", which is to say moving financial activities to less-tightly regulated jurisdictions or transforming them into new and less regulated activities, the detection of which is a financial oversight responsibility.

The paper tries to contribute to answer the following questions, but focusing especially on financial stability: How do we get the changes needed so that finance can serve the needs of the real economy, thus being a good servant, instead of a bad master? How can we place the changes desirable from a sustainable and inclusive growth perspective, as well as financial stability?

2. The Broad Context

Market economies cannot function without banks, and more broadly without an efficient financial system.

A well-functioning financial sector, both national and international, needs to play important roles to achieve the aims of supporting inclusive and sustainable growth. To achieve this key positive role, the financial sector needs to encourage and mobilise savings, intermediate these savings at low cost, ensure savings are channelled into efficient investment, as well as helping manage the risks for individuals and enterprises. Because the financial sector has such important effects throughout the economy it also needs to adhere to a key principle of the Hippocratic oath that medical doctors swear to, which is to do no harm to the rest of the economy. Therefore there should be as few and as small crises that stem from the financial sector, as these have huge costs, both fiscal and on growth, employment and investment.

It could be argued that the financial sector performed these functions relatively well both in developing and developed countries in the post-World War II era. Domestic financial sectors were relatively small and tightly regulated, partly because after the Great Depression a number of regulatory measures were applied, including the Glass-Steagall Act that separated investment and commercial banking as well as the existence of requirements for liquidity. At the same time, capital accounts were relatively closed, especially in developing countries.

However, from a policy perspective there were concerns that "financially repressed" systems, as they were then called, did not deliver sufficient finance to important sectors at low enough cost and at long enough maturity. From a more theoretical perspective, the idea that financial markets were efficient encouraged financial liberalization, with light or no regulation. This covered both domestic and external liberalization. Latin America was a first mover on liberalization in the late seventies. This process was followed by frequent and costly crises, including the major Latin American debt crisis, which led to the "lost decade" of the 1980s, in terms of growth and development. Diaz-Alejandro (1985) already then perceptively synthesized this as: "Good-bye financial repression, hello financial crisis." Increasingly frequent crises in different parts of the developing and emerging world followed, including the East Asian crisis which involved some of the most successful developing countries. Only India and China, which had liberalized much more prudently, seemed exempt of financial crises, amongst the emerging economies. The idea that these crises were transitory problems, which would be overcome once these financial markets matured and deepened(and became more like those of the developed countries, especially the US and the UK one) was profoundly challenged when such a major crisis hit the developed countries, starting in 2007 in the US, which had the most liquid and deepest financial market in the world. As a result, a new emphasis on regulation and prudent liberalization, both domestic and international, has emerged since the global financial crisis.

Even before, as banks increasingly engaged in cross-border activity in the 1960s and 1970s, national regulators became concerned that stability of their own system increasingly depended on the stability of others. Hence the Basel Committee on Banking Supervision (BCBS) was established in 1974 becoming the central international forum for bank regulation.

However, the non-bank financial system grew to huge size, complementing the banks by mobilizing long-term credit and equity finance in an increasing global marketplace, but also competing with the banks in intermediating finance ("shadow banking"). While there had been some harmonization among national non-bank financial regulators (e. g., International Organization of Securities Commissions, International Association of Insurance Supervisors) it became clear after the financial crises and near-meltdowns of the late 1990s that there was no overall oversight of the international financial system. To remedy that, the Financial Stability Forum, FSF, (since 2009, enlarged to become the Financial Stability Board, and expanding its' membership to the G20 countries in 2008) was created, whose members represent the finance ministries, central banks and main national regulators, along with the main official international standard-setting bodies(such as BCBS).

On the eve of the most recent global financial crisis, this was the institutional structure of global financial system oversight. The Basel Committees and the FSF were developed countries' bodies. Moreover, in a policy world that had great faith in the efficiency of financial markets and distrust of regulation, international regulatory policy was relatively passive, focused more on opening global access to financial markets in developing and transition economies than on protecting markets from international instability. That worldview suddenly became obsolete in the fall of 2008, as the world's financial markets and institutions seized up and the Group of 20, a finance ministers' discussion forum that had been established along with the FSB in the wake of the late 1990s crises, was transformed into the premier leaders' forum for oversight of global financial reform.

Manifold initiatives at the national, regional and global level were undertaken to stabilize international financial markets, reduce the likelihood of future (banking) crises and make crises, if they were to occur, more manageable for public budgets. The most important initiatives in this respect were the revision of the Basel Accord(Basel III). It also included the Dodd-Frank Wall Street Reform and Consumer Protection Act, adopted in the United States in 2010, and equivalent regulatory initiatives in the European Union, notably those concerning the regulation of derivatives markets under the European Market Infrastructure Regulation (EMIR). There have also been attempts in the United States and United Kingdom (only partially implemented) at separation of commercial banking from the more risky financial market activities of investment banks and hedge funds. Moreover, under G20 guidance, the FSB has pursued a more stringent and global regulation of the shadow banking sector.

These initiatives seek to address what were identified as the main shortcomings of the financial system pre-crisis: banks which were too big to fail, overleveraged, under-capitalized and incentivized to take on too much risk (Admati and Hellwig 2013), the "pro-cyclicality" of the financial system as a whole, which made credit easier to obtain in good times and harder to obtain in bad times (Griffith-Jones and Ocampo 2010; BCBS 2011: 5); further problems identified included an over-reliance on short-term funding and an increasing complexity and opacity of the financial system exemplified by the growth of the shadow banking system, which in the crisis had negative spill-over effects on the real banking system (Gorton 2010; Gabor 2013).

The Basel reform, to which we turn first, seeks to address these points from the vantage point of coordinated national banking regulation, setting global minimum standards for capital and liquidity requirements for banks (we discuss here only capital requirements). Most of the BCBS measures in Basel III are now in the crucial implementation phase (BCBS 2013a, 12ff.), which the financial industry seeks to weaken as detailed implementing rules are written, trying to regain regulatory advantages that it lost in the negotiation phase.

3. Reducing Systemic Risk from the Banking System

A great deal of attention has been directed to better discouraging banks from taking excessive risks, in particular from excessively borrowing money to lend money (leverage).

3.1 Addressing the Problems of Too Much Leverage and Pro-cyclicality

Research confirms that the more leveraged banks are, the greater the probability of excessive risk-taking (Perotti and Martynova 2012). This makes the reduction of excessive leverage in good times key in creating a more stable financial system (called "good deleveraging"), in order to avoid "bad deleveraging" in crisis times, where deleveraging processes via credit contraction exacerbates the feedback loop between losses, falling bank capital, and shrinking credit availability (Thiemann and Griffith-Jones 2014). The primary regulatory means to forestall excessive leverage has been to require each bank maintain equity capital equal to or greater than a specified fraction of the bank's total assets outstanding.

By raising core capital requirements Basel III goes some way in forcing banks to reduce their leverage. The new requirements will fully come into force in 2019, by when minimum common equity capital (the purest form of core capital) is supposed to reach 4.5% of "risk-weighted" assets. In conjunction with the capital conservation buffer (explained below), it will reach 7%. The minimum total capital buffer will reach 10.5% (from 8% in Basel II). These numerical changes go hand in hand with changes in stricter criteria for defining capital, increasing the reliability of core capital in times of crisis.

Despite being an undeniable progress with respect to Basel II, this increase in core capital requirements should only be seen as a first step in a long battle to raise core capital. How high optimal equity would be is a discussion that should not distract from the fact that it is currently too low and needs to be raised beyond Basel III (Admati and Hellwig 2013 for the most radical proposal, see also Miles et al 2011). This need for higher core capital requirements not only concerns the capital requirements for risk-weighted assets, but also a new simple "leverage ratio".

Given the large variation in the risk-weighting of assets, which can still be observed today (BCBS 2013a, 2), the BCBS regulators introduced a simple leverage ratio in Basel III, which is not dependent on the risk-weighting of assets but simply sets a minimum ratio of the equity of banks to the face value of their assets (loans and securities held). This is a step in the right direction. It may be more difficult for the banks to game the two measures of leverage at the same time, but what is important in this respect is that the simple leverage ratio is indeed a binding constraint.

The simple leverage ratio of 3% tier 1 core capital to un-weighted assets, as is currently proposed by the Basel Committee (BCBS 2013b) may be too low. It is noteworthy the Federal Reserve Bank has set the US leverage ratio at 4% and is considering the proposal by Fed Governor Daniel Tarullo to raise it to 6% for globally systemically important banks. This is important because it shows that the most important national banking regulator sees the measure as too lenient. An important policy question is the extent to which developing countries should also adopt the leverage ratio in their bank regulations, and what would be its appropriate level, to balance the needs of financial stability with those of sustained growth.

Basel III also contains counter-cyclical elements, including rules requiring the maintenance of "capital conservation" and "countercyclical capital" buffers. The capital conservation buffer comes into play when a bank's portfolio of loans grows relatively rapidly so that the bank begins to approach the minimum capital ratio. It then requires that the bank use its profits to rebuild the buffer rather than distribute them to shareholders or as staff bonuses. The buffer will apply when the capital ratio enters a range that is 2.5% above the actual minimum allowed.

In addition to the global conservation buffer, there will be national countercyclical capital buffers, which will be set by authorities in each country according to domestic analyses of the credit cycle (BCBS 2011, 57ff). The intention is to slow the growth of lending during booms by requiring banks to hold additional equity capital at those times and encourage lending during bad times by reducing the required capital buffer.

The Basel Committee is furthermore encouraging the development of an accounting standard which allows forward-looking loan loss provisioning (BCBS 2011:5). The International Accounting Standards Board (IASB) is currently developing such a standard. What will be important is the degree of consistency between the American Accounting Rules and the International Accounting Rules. Differences in accounting rules had been a major impediment to better harmonized prudential regulation before the crisis (Thiemann 2014).

These measures in particular seek to be counter-cyclical. Allowing national regulators to adjust their capital requirements to national circumstances is positive. However, it will be faced with the problem of competitiveness concerns across countries (as in the earliest days of the BCBS) as well as the problematic of dampening economic growth spurts (Thiemann and Griffith-Jones, op cit.). Therefore, application of these national counter-cyclical measures should ideally be based on ex-ante rules, which could be tightened if credit expands too much, but should not be allowed to be watered down, thus avoiding regulators being captured either by financial interests or by over-enthusiasm during booms.

3.2 Addressing "too big to fail"

It is widely believed that key governments and central banks had no alternative to bailing out the huge banks in the recent global crisis. It is also believed next time should be different. In this regard, the Financial Stability Board in cooperation with the BCBS has been seeking disincentives to hugeness in banking. One strategy has been to penalize size and remove the confidence of bankers that they would be bailed out.

Bank debt is indirectly subsidized due to depositor insurance and lender of last resort agreements, a subsidy that increases with size, favoring an expansion of the balance sheet of banks to reach the too-big-to-fail status (CGFS 2010). The too-big-to-fail status generates lower funding costs "and adversely affects market discipline, competition, systemic risk and public finances" (FSB 2013b: 23). The Financial Stability Board in conjunction with the BCBS is seeking to make the too-big-to-fail status globally less attractive by adding surcharges to the required capital ratios to take into account the externality costs if taxpayers have to overcome the failure of "globally systemic financial institutions" or G-SIFIs. Additional loss absorbency requirements will thus be imposed on these banks, which they will have to meet with additional common equity tier 1 capital, raising their capital ratios by 1 to 2.5 percentage points according to their systemic importance. The most systemically important banks could be forced to hold a further 1% in order to discourage further growth. In November 2012, 28 banks were characterized as G-SIFIs by the FSB, with four banks of a size requiring the 2.5% additional surcharge.

Furthermore, the FSB has developed a bank insolvency resolution regime that is supposed to be a template for national resolution regimes. Globally important banks and other financial institutions need to develop resolution and recovery plans in collaboration with host and home supervisors, called "living wills".

What has not been addressed to date is the question of systemically important foreign subsidiaries in developing countries, especially those which are neither G-SIFIs nor D-SIFIs in their home country, but may be of systemic importance to the developing countries in which they operate. The FSB should also envision regulation for such subsidiaries, in order to reduce the probability of a collapse of financial markets in developing countries in case of a crisis in developed countries. Financial stability in emerging and developing countries, so important for poor people living there, must be safeguarded.

The sobering empirical reality over the course of the last five years, however, is that despite the announcements of future surcharges on large institutions and promises that no bank is any longer "too big to fail", the trend towards concentration and growth in the American and European banking sector continues unabated. These trends underline the importance of resolution mechanisms that are effective in crises.

As the FSB remarks, national initiatives, should further contribute to limit too big to fail (FSB 2013b, 22). But it cannot be assumed that the problem is solved with the current initiatives or that future initiatives will necessarily be forthcoming. In September 2013, the Financial Stability Board wrote: "G-20 Leaders are urged to renew their commitment to addressing TBTF, and the FSB and other international bodies also need to take further action, with the support of G-20 countries, to end the TBTF problem," (FSB 2013b, 7).

Therefore, a general reduction in the size of large banking conglomerates and their risk-taking activity may be in order. For this reason, national initiatives, such as the Volcker rule in the Dodd-Frank Act in the US, that seeks to separate proprietary trading from market-making activity by banks or the Vickers Commissions proposal in the UK to "ring fence" certain retail-oriented commercial banks or parts of large bank groups from undertaking investment banking activity are very valuable. The final decision on these issues by the European Union has still not been taken, but the high-level expert group of the EU favors the idea of ring-fencing (Liikanen report 2012, 86).

4. Reducing Systemic Risk from Shadow Banking

The 2007/2008 financial crisis was first and foremost a banking crisis, but policy makers also found themselves offering rescues to non-bank financial institutions, like money market mutual funds, and ensuring that contingent payments on different derivative securities were not triggered or defaulted, as through central bank purchases of potentially compromised securities or by nationalizing the world's largest insurance company, American International Group. It is not possible today to disentangle buying and selling securities on financial markets from the banking system, especially at the short-run end of the security market spectrum. While the proposals mentioned above to separate traditional commercial banking from financial market activity may be attractive, they are not the current reality or have not gone far enough. Thus, the G20 and FSB regulatory agendas have had to address these markets as sources of systemic risk, which in this context has led them to be called "shadow banks".

4.1 Addressing Spill-over Dangers

The Financial Stability Board has pointed out that shadow banking poses great potential for an additional supply of credit to the economy, and therefore should not be suppressed. However, it should be ensured that all the risks these entities carry and pose to the financial system as a whole are reflected in risk-provisioning by these actors (for the European attempts to regulate shadow banking on a common basis, see EC 2012).

The reduction of potential direct spill-over effects of shadow banks to banks through what has been called the "bank-based shadow banking system" (Pozsar et al. 2010) can be seen as the greatest success of the regulatory measures regarding shadow banking taken after the crisis. One lesson of the crisis was that the non-bank financial businesses of bank holding companies could threaten the solvency, let alone liquidity, of the banks in the conglomerates. Greater attention thus had to be paid to the capital backing not only of the component businesses of the conglomerate but of the conglomerate as a whole. The BCBS work is addressing the different requirements for banking conglomerates around the globe to consolidate their balance sheets for banking and financial-market activities and apply appropriate capital ratios (Thiemann forthcoming). Given that the direct linkages between banks and shadow banks started the crisis in 2007 (Acharya and Schnabl 2010) it is not a big surprise to see that this channel for transmitting a financial shock to banks was largely eliminated.

However, that does not mean that the problems of shadow banking itself have been resolved. The unresolved problems of the "repo" market, which is a main source of funding for all non-banks engaged in bank-like activity, is crucial.

There is an additional problem, however, in that financial market agents can be expected to react to new regulation by seeking unconstrained new avenues for investment, which will bring about new forms of shadow banking. A focus on activity, rather than form, as envisioned by the FSB will be helpful (FSB 2013c).

In this respect, the FSB is also seeking to learn the structural lessons of the last crisis. The need to quickly extend the regulatory perimeter in response to regulatory arbitrage had been vividly demonstrated before the last financial crisis. Recent research has shown that the problems shadow banking posed to the banking system were partially known well before 2008 (e.g. Jackson et al. 1999), but that in the interim period of eight years before the crisis only few countries acted upon the information due to national competitiveness concerns (Thiemann forthcoming), namely, that domestic financial institutions would oppose regulatory limits that did not also apply to foreign competitors. These experiences suggest that the focus on a level playing field (such as in the Regulatory Consistency Assessment Program of the BCBS) needs to be supplemented with an analysis of developments at the margin of Basel regulation, an analysis that is followed up by action. Therefore, the FSB has proposed a high-level policy framework for assessing and mitigating systemic risks posed by shadow banking entities and activities. As the FSB describes it:

> By focusing on economic functions(or activities) rather than legal forms, this framework is intended to allow authorities to capture innovations and adaptations that occur at or outside the bounds of bank regulation [...], it is expected that the framework will provide a structured process to assess the need for extending the regulatory perimeter (FSB 2013c:6f).

The problem is that such policy action is supposed to occur at the national level, where it will again be faced with national competitiveness concerns. In order to overcome these problems, such action should either be taken at the international level or the extent of home country regulation of internationally active banks should be reduced, allowing host regulators to regulate activity of all banks operating in their country, not only domestic banks (Pistor 2011; Thiemann 2014).

Such limits on the dominance of home country regulation on host country financial markets would allow countries to move ahead on their own, without fearing for the competitiveness of their banks, at least on domestic grounds.

Such a shift would also harmonize well with macro-prudential tools such as credit growth limits in case of credit booms, which all need to be implemented on a national level, applying to all banks that operate in that country.

Putting the operations of branches of foreign banks more under the oversight of the host regulators in emerging and developing countries may better shield these countries.

4.2 Addressing the "repo" Market

One of the biggest "shadow banking" markets is that for "repos". The market for Sale and Repurchase Agreements (repo-markets) is, in effect, a market in which loans are granted against collateral in case the borrower defaults. The loans last from one night up to one year and the collateral is typically government bonds or notes. Repos are large-scale, customized transactions (albeit with a standardized contract), many of which are not centrally cleared. Thus, information about the market is not complete. Banks have been heavy users of repo financing (both bank-to-bank and bank-to-non-bank), but not the exclusive users. Customers in the repo market include institutional money managers, insurance companies, hedge funds, and non-financial corporations. It is usual in a repo for the lender to ask for more collateral than the value of the loan to reduce its risk of loss in case of default. The difference between the value of the collateral and the loan being extended is called the "haircut", the size of which the lender adjusts according to the perceived market value of the assets (and risk of their decline) and the perceived riskiness of the borrower (Thiemann and Griffith-Jones 2014).

One concern about the repo market which has not yet been sufficiently addressed is that it appears to reinforce crisis dynamics. The haircuts that counterparties demand in order to accept collateral and make the loan are pro-cyclical, "tending to be compressed in the upswing of a cycle as financial institutions become increasingly exuberant" (Gai et al. 2011:455) and tending to become very large in moments of crisis, leading to liquidity shortfalls of all those institutions relying on the repo-market for financing. In order to deal with the pro-cyclicality of haircuts, the Financial Stability Board is working on proposing minimum haircuts for securities financing transactions by spring 2014 (FSB

2013c:2), thereby dampening the pro-cyclicality of repos in the upswing. Again, as in the case of the leverage ratio, Governor Tarullo of the Federal Reserve has criticized current proposals by the FSB (FSB 2013d) and come out in favor of much higher requirements (Tarullo 2013). This project is fiercely opposed by industry as it decreases the availability of funding in good times.

The proposal, however, does not address the problem of the negative feedback loop in times of crisis, despite the fact that the specter of "fire sales" remains an issue for regulators (Perotti 2012). That is, counterparties in repo-markets do not seek to hold the collateral they would take ownership of on default, but rather will seek to immediately sell it if the borrower goes bankrupt. This implies that counterparties pay close attention to changes in the market prices of the securities offered as collateral. Therefore, in a moment of crisis, often characterized by declines of asset prizes, they will increase haircuts on new loans, offering less cash to the borrowers. This puts pressure on the borrowers, leads to worsening liquidity shortages, possibly ending in bankruptcy. In case of bankruptcy, counterparties will flood the market with these assets, leading to further price declines. This self-reinforcing disastrous feedback loop is even facilitated by a clause in repo contracts, known as the "safe harbor" clause which, exempts collateral from bankruptcy proceedings. Whereas common lenders have their claims frozen in case of borrower bankruptcy until the bankruptcy proceedings are finished, those to whom collateral has been pledged "jump the queue", immediately seize full ownership of the pledged collateral and sell it.

5. The Financial Stability Board summarized it thus:

> Since the financial crisis, a number of academics have argued that the "safe harbour" status of repos may in fact increase systemic risk, because it can: (1) increase the "money-likeness" of repos and result in a rapid growth in cheap and potentially unstable short-term funding; (2) facilitate the fire sales of collateral upon default; and (3) reduce creditors' incentives to monitor the credit quality of repo counterparties (FSB 2013a).

But while the FSB admits that these considerations and options developed to deal with this problem make sense theoretically, the FSB points out that their implementation would be too difficult, which is why the FSB stopped to further pursue the idea of altering the standard "safe harbor" clause. The argument of the difficulty of implementation rather points more to the amount of opposition than technical difficulties. This defeat is an important drawback for any attempt to reduce the dangers that emanate from the repo-market on the financial system as a whole.

But there are still some other initiatives to reduce the dangers stemming from the repo-market. The FSB has announced that it will

> ... develop proposals for contractual or statutory approaches to prevent large-scale early termination of financial contracts. ... G-20 authorities can encourage ISDA (International Swaps and Derivatives Association) and other industry bodies to review contract provisions to prevent large-scale early termination of financial contracts (FSB 2013b, 15f).

This initiative, which is still very vague, directly addresses the dangers of "safe harbor" and should be supported, as it is very likely to encounter large-scale resistance. In addition, regulators need more knowledge about the repo-market, in particular the bilateral repo-market, a market of USD 3 to 5 trillion, where the lack of custodians leads to dangerous data gaps. The data initiative by the FSB is of major importance to grant regulators the knowledge that must lie at the basis of any fruitful regulation in the repo-market.

Notes

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[2] SIFI = Systemically important financial institution.

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Chapter 5
The Plight of the G20 as Coordinator of International Monetary Policy

Zhou Yu[1]

Since 2008, reform of the international monetary system has been a heated issue for the international community. This is because many people believe that the internal contradictions of the international monetary system constitute one of the main causes of the global financial crisis. Unfortunately, although this issue is very important, the relevant reforms are not making obvious progress. From the standpoint of future development trends, the G20 has limited influence on the international monetary system and thus "the markets" will still be the leading factor in the evolution of the system.

1. Emergence of Contradictions in the International Monetary System after the Financial Crisis

The current US dollar-dominated international monetary system is characterized by three major contradictions (Table 1): (1) between deficit output (deficit export, e.g, US export deficit to the world) and currency stability; (2) between the interests of the international reserve currency issuing country (United States) and that of the rest of the world; and (3) between economic strength and currency strength. In the second half of 2008, the global financial crisis triggered by the US subprime mortgage crisis brought these contradictions to the surface in some degree, and thus initiated a great debate on reform of the international monetary system.

1.1 Contradiction between Deficit Outputand Stability of the Currency Value

In his book *Gold and Dollar Crisis—The Future of Convertibility*, US economist Robert Triffin pointed out that the US dollar-dominated international monetary system is characterised by a serious defect, namely that the United States uses its trade deficit to issue US dollars and increases in international currency liquidity are premised on expansion of the trade deficit; however, such expansions of the US trade deficit will surely increasingly lead to a decline of confidence in the US dollar, which thus will no longer be able to function efficiently as the international currency. This paradox has become known as the "Triffin dilemma".

The "Triffin dilemma" reveals a serious defect in the US dollar-dominated international monetary system, but the US subprime mortgage crisis shows, besides the risk of a crisis of confidence in the US dollar, that there are global economic imbalances that may lead to financial crisis. One of the main reasons for the subprime mortgage crisis was that the US dollar-dominated international monetary system encourages unlimited low-cost financing by expanding the trade deficit, which results in asset bubbles. The bursting of such bubbles eventually lead to global financial crises.

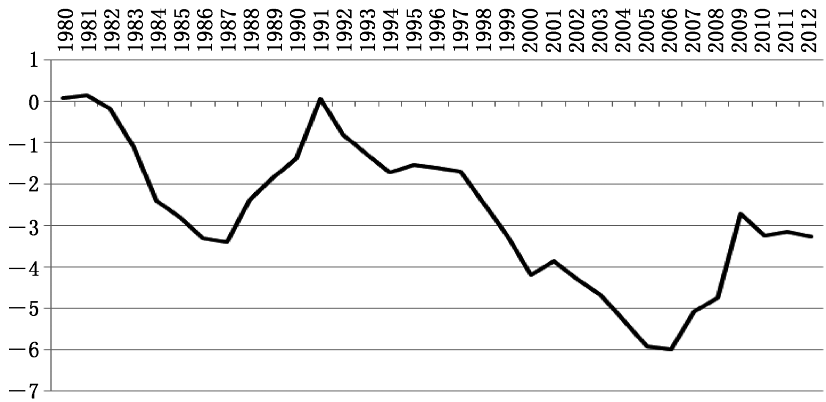
Figure 1 shows fluctuations in the US current account as a percentage of GDP. We can see that, in the 1990s, US trade deficits increased. In the twenty-first century, the United States' current account as a percentage of GDP has exceeded 4 per cent. In 2006, before the subprime mortgage crisis, the percentage was 6 per cent. Generally, when this index reaches 4 per cent it is seen as a warning of potential economic danger; the fact that the US figure rose to as much as 6 per cent indicates that financial crisis was even more likely. This was borne out by the outbreak of the subprime mortgage crisis.

Figure 2 shows the fluctuations of the nominal effective exchange rate and the real effective exchange rate of the US dollar. The nominal effective exchange rate is the integrated nominal effective exchange rate calculated according to the trade weight of different countries, and this exchange rate can fully reflect the exchange rate fluctuations of a given country. The real effective exchange rate is the nominal effective exchange rate adjusted for the price of commodities; this exchange rate fully reflects the fluctuations in a given country's competitiveness.

Table 1 Three Major Contradictions of the Current International Monetary System

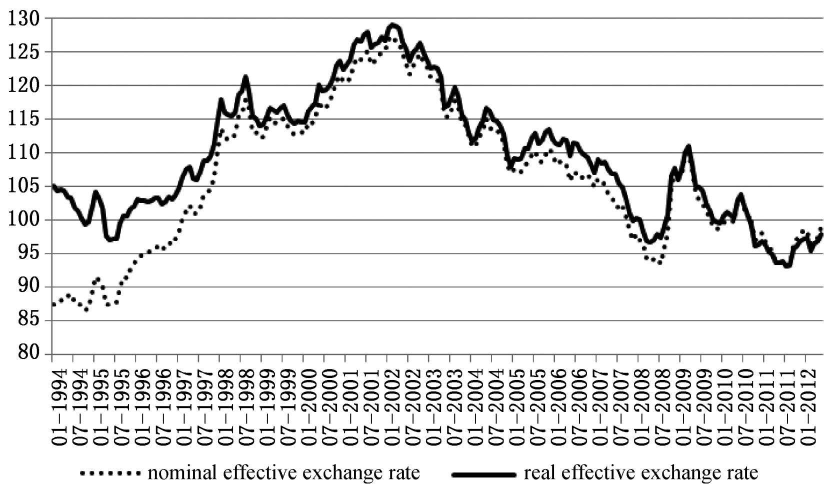
Three major contradictions	Nature	Corresponding reform demands
Between deficit output and currency stability	The international reserve currency issuing country normally needs to issue domestic currency by creating a trade deficit; such an expansion of the trade deficit will result in a devaluation of the domestic currency, thus reducing confidence in the international currency, which cannot then efficiently perform its functions. Besides, an excessive increase in the trade deficit may also cause a financial crisis, and thus damage the stability of the global economy.	First, replace the US dollar with a super-sovereign international reserve currency or gold as the international currency. Second, use quantified indices to restrict the US trade deficit.
Between the interests of the international reserve currency issuing country and those of the rest of the world.	When the interests of the international reserve currency issuing country clash with those of the global economy, the stability of the global economy is threatened.	First, use a pluralist monetary system to restrict US monetary policy. Second, replace the US dollar with a super-sovereign international reserve currency or gold. Third, set quantified indexes to restrict self-interested policymaking by the international reserve currency issuing country.
Between economic strength and currency strength	The currency strength of the US dollar has far exceeded US economic strength, and thus the United States has been the major beneficiary of the current international monetary system. The rise of the emerging market economies demands a change.	First, facilitate a pluralist international monetary system that reflects economic strength. Second, promote the RMB in the international monetary system.

Comparing Figure 1 and Figure 2, it is clear that since the start of the twenty-first century, as the US current-account deficit has increased, the US dollar has commenced a long-term trend of depreciation. The links between the US current account deficit and US dollar devaluation reflect the Triffin dilemma.



Source: IMF database.

Figure 1 US Current Account Balance as a Percentage of GDP



Source: Database of Bank for International Settlements.

Figure 2 Fluctuations of US Dollar Exchange Rate (2010 average = 100)

Although the relationship between the US current account deficit and US dollar movements confirms the Triffin dilemma, the difference is that the increase in the US balance of trade deficit is not caused by the need of the global economy for US dollar liquidity, but by the structural imbalance of the US economy; that is, US investment exceeds its deposits, its needs exceed its supply capacity. The gap can be closed only by a balance of trade deficit. A country whose currency is not an international currency cannot use it to address external payments, so the level of its trade deficit is restricted by its capacity to acquire foreign exchange. By contrast, the United States, as issuer of the international reserve currency, can directly use US dollars for external payments, which contributes to its balance of trade deficit, leading to long-term US dollar depreciation.

Furthermore, the US dollars exported overseas by way of the trade deficit return to US financial markets in the form of investment, and thus cause excess liquidity. Excessive money supply causes a decline of the exchange rate, the low-cost financing leads to the formation of an asset bubble and the bursting of the bubble eventually results in events of the kind exemplified by the subprime mortgage crisis. Ultimately, the subprime mortgage crisis increased the devaluation pressure on the US dollar, the risk of which threatens the stability of the global international monetary system.

Because of all this, in the wake of the US subprime mortgage crisis, reforming the US dollar-dominated international monetary system has become a key issue for the international community.

1.2 Contradiction between the Interests of the International Reserve Currency Issuing Country and Global Interests

Since the US subprime mortgage crisis, reform of the international monetary system has become increasingly urgent not only because of the failure of this system expressed by the subprime mortgage crisis, but also because in response to it the United States adopted the quantitative easing policy, which may cause a sharp devaluation of the US dollar. This policy puts the foreign reserve holdings of other countries at risk of shrinking. It is therefore opposed by the international community.

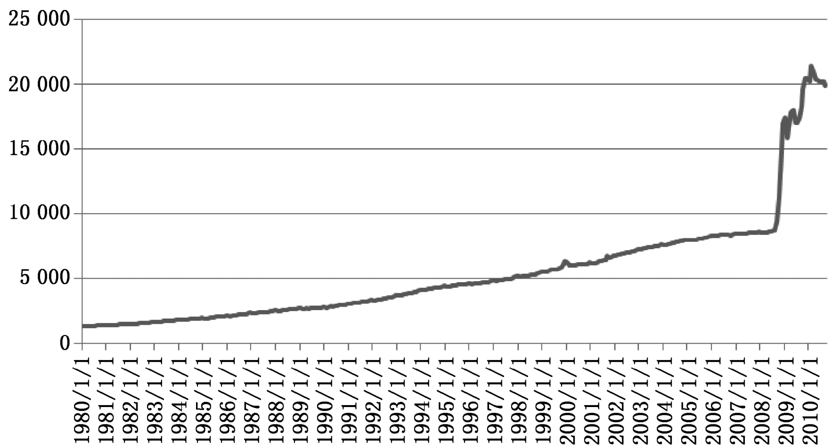
The divergence between the United States and other countries caused by the quantitative easing policy reflects, to some degree, the contradiction between the interests of the currency issuing country and those of the rest of the world. The US dollar is both the American domestic currency and the international reserve currency. As the American currency, it must necessarily serve the interests of the United States, while as the international currency it has to serve the interests of the international community. When US interests clash with global ones, the former will naturally take priority. In this situation, US currency policy damages global interests and thus is not in a position to exercise its international currency function effectively.

The United States is not the only country to have adopted quantitative easing (QE). Among developing countries, it is common that the central bank buys treasury bonds. Even among developed countries, the Bank of Japan, the European Central Bank and the central banks of other countries also have adopted QE to different degrees and in different forms. This is a sovereign right and other countries have no right to intervene or attempt to lay blame. However, the US dollar is different. It is the dominant international currency and thus has the nature of a public good. In view of this, when US interests clash with those of the rest of the world, US currency policy inevitably damages the interests of other countries and provokes opposition. This is the main reason why other countries can adopt QE while the United States must take extreme care. This situation reveals two things: first, the self-interest of the issuing country of an international reserve currency may damage the stability of the global economy, and this is one of the main defects of a sovereign currency acting as international currency; second, the issuing country of the international currency cannot casually adopt a self-interested currency policy—this is one of the costs it has to bear.

Table 2 The QE Policy of the US Federal Reserve and "Operation Twist"

	Launch time and contents
First round of QE policy	In March 2009, the Federal Reserve announced that it would buy a total volume of 300 billion US dollars' worth of long-term treasury bonds and officially declared implementation of the quantitative easing policy (QE 1). The Federal Reserve bought a total of 1.7 trillion dollars in assets, including medium- and long-term treasury bonds and mortgage backed securities.
Second round of QE policy	In October 2010, the Federal Reserve announced that it would buy a total of 600 billion dollars' worth of medium- and long-term treasury bonds by the end of June 2011 (QE 2). It bought 75 billion dollars' worth of long-term treasury bonds every month and was supposed to complete this measure within eight months.
Implement Operation Twist	In September 2011, the Federal Reserve announced that it would launch Operation Twist, involving 400 billion dollars, to sell short-term bonds and buy long-term bonds to lower the long-term interest rate. This plan ended in June 2012.
Extend Operation Twist	In June 2012, the Federal Reserve announced that it would extend the deadline of Operation Twist by six months. It would buy 267 billion dollars' worth of medium- and long-term treasury bonds from 6 years to 30 years and sell the same amount of treasury bonds with a time limit of 3 years or less.

The aim of the Federal Reserve in adopting QE was to stimulate the domestic economy and increase job opportunities. In the second half of 2008, after the subprime mortgage crash, the Federal Reserve adopted a zero interest rate policy to stimulate the domestic economy, but this failed to prevent recession. In response, as Table 2 shows, in March 2009 the Federal Reserve announced that it would buy 300 billion dollars' worth of long-term treasury bonds within six months (QE 1). The intervention of the Federal Reserve was not confined to buying long-term treasury bonds. During this period, it also bought 1.7 trillion dollars' worth of treasury assets, including medium- and long-term treasury bonds and mortgage-backed securities. In October 2010, given the weak economic recovery and high unemployment, the Federal Reserve launched a second round of quantitative easing (QE 2), announcing that it would buy a total of 600 billion dollars' worth of medium- and long-term treasury bonds by the end of June 2011, and 75 billion dollars' worth of long-term treasury bonds every month. The plan was to wrap the measure up within eight months. These two rounds of QE amounted to more than 2.3 trillion dollars.



Source: Federal Reserve database.

Figure 3 American Monetary Base Changes (trillion dollars)

From the view of the global economy, the US QE policy adds the risk of global US dollar assets shrinking, and thus when it launched the policy it ran into intense opposition from the international community. A total of 60 per cent of global foreign exchange reserves are held in US dollars, and US dollar assets are virtually the main part of all countries' foreign exchange reserves. Given this situation, the US QE policy may damage the interests of all countries.

Source: New York Cotton Exchange (NYCE).

Figure 4 US Dollar Index Changes

Another negative effect of the US QE policy on the global economy is that it will cause the depreciation of the US dollar and the appreciation of other countries' currencies, which will result in the deterioration of other countries' balances of trade. In order to prevent this situation, other countries intervene through the foreign exchange market to prevent their domestic currency's appreciation. After the launch of QE policy in 2009, the game of depreciation and appreciation of domestic currencies has become the blasting fuse of a currency war.

Given the intense opposition of the international community, in the second half of 2011 the Federal Reserve stopped the QE policy and adopted Operation Twist instead in order to lower long-term interest rates by selling short-term treasury bonds and buying long-term treasury bonds, with the aim of making use of long-term interest rates to stimulate domestic investment and consumption. In September 2011, the Federal Reserve announced Operation Twist which would involve 400 billion dollars. This plan was to have ended in June 2012, but the Federal Reserve announced that it would extend the deadline of Operation Twist by six months. It would buy 267 billion dollars' worth of medium- and long-term treasury bonds from 6-year to 30-year maturities and sell the same amount of treasury bonds with a maturity of three years or less. This means that the

Federal Reserve will buy 667 billion dollars' worth of long-term treasury bonds.

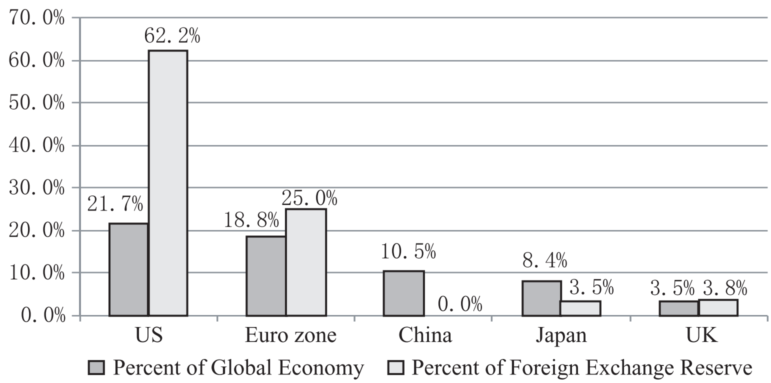
The direct impact of the Federal Reserve's QE policy is an increase in the monetary base by a large margin. Figure 2 shows this change, and we can see that, after 2009, the monetary base of the United States increased greatly. This change has contributed to the prospect of inflation and depreciation of the US dollar.

Figure 4 presents US dollar index data. The US dollar index is similar to a nominal effective exchange rate, and reflects multilateral exchange rate relations. Thus this index is widely used to measure the changes of the US dollar exchange rate. Through changes in this index, we can to some degree observe the impact of the US QE policy on the US dollar exchange rate. The first round of US QE policy started in early 2009. In Figure 4, we can see that the US dollar index started to fall. The second round of QE policy started at the end of 2010. In this period, the US dollar index also appeared to follow a depreciating trend, but the beginning of the depreciation appeared in mid-2010, which was earlier than the launch of the second round of the QE policy. One reason for this is that US dollar depreciation pressure had already formed before the launch of the second round of QE policy.

1.3 The Contradiction between Economic Strength and Currency Strength

In the international monetary system, the currency status of a country is usually correlated with its economic strength. The currency of strong economies should enjoy higher international status. However, the US dollar's status in the international monetary system is far higher than US economic strength in the global economy, while the currency status of other economies and countries is far lower than their economic strength. This imbalance goes against the stability of the international monetary system and does not comply with the principle of equally sharing benefits and risks. This is one of the main reasons for demands for reform of the present international monetary system by the international community.

If one country's currency acts as the international reserve currency, this country can enjoy many economic benefits that other countries cannot enjoy. The benefits include, first, coinage tax income. The second benefit is the interest margins of short-term debts and long-term investments. That is, to meet liquidity needs, other countries usually buy the assets of the currency issuing country in the form of short-term investments, and the currency issuing country can make use of this part of capital to make long-term foreign investments. The benefits of long-term investment are greater than those of short-term investments, and thus the currency issuing country obtains the marginal interest between these two parts. The third benefit is a lower risk of exchange rate changes affecting domestic trade and investment; besides, using domestic currency to settle foreign trade obligations can lower the cost of exchange rate transactions. The fourth benefit is the ability to increase the international business of domestic financial institutions and financial markets, thus contributing to their development.



Source: IMF database.

Figure 5 The Share of Major Economic Powers and Economies in the Global Economy

Considering the benefits of the internationalization of a domestic currency, those countries and regions whose domestic currency's international status is apparently lower than their economic strength are likely to demand reform of the international monetary system. In the second half of 2008, with the onset of the global financial crisis, euro zone countries and China first proposed reforming the international monetary system, and emerging market economics, such as Russia, also support this. This is because euro zone countries and emerging market economies, such as China, all confront the mismatch of the international status of their domestic currency and their economic strength, and hope to raise the status of the domestic currency in the international monetary system.

In Figure 5, we can see that the US economy accounts for only 21.7 per cent of the global economy, while the US dollar accounts for as much as 62.2 per cent of foreign exchange reserves; in other words, the latter is three times the former. The euro zone is the second biggest economic area in the world, almost on a par with the United States in terms of scale. However, the share of euros among global reserve currencies is far less than that of the US dollar. China is the second biggest economic power in the world, its share in the global economy exceeding 10 per cent, but the share of the RMB in global foreign exchange reserves is almost zero. Given this situation, after the US subprime mortgage crisis, in order to raise the euro's status, heads of government of the euro zone countries actively proposed to reform the US dollar-dominated international monetary system, and the Chinese government launched a policy to actively promote the internationalization of the RMB.

2. Prospect and Reality of Reform of the International Monetary System

As mentioned above, in the second half of 2008 the global financial crisis triggered by the US subprime mortgage crisis dealt a huge shock to the global economy. Against the background of this crisis, reform of the international monetary system became a heated issue, reflecting broad concerns among the international community. This is because people generally believe that the defects of the present international monetary system are an important factor in the crisis. The US dollar-dominated international monetary system provides the United States with favourable conditions for unlimited low-cost financing, which contributed to the subprime mortgage crisis. Subsequent to the subprime crisis, in order to stimulate the domestic economy, the Federal Reserve adopted the QE policy, which raises the prospect of US dollar depreciation and a shrinking of the reserve assets of countries all over the world. But what would be the features of a reform of the international monetary system?

2.1 Debate on Reform of the International Monetary System

Domestic and overseas proposals concerning reform of the international monetary system include: the creation of a super-sovereign reserve currency; restoration of a link to gold in the international monetary system; a multiple monetary system; and retaining but restructuring the US dollar-dominated international monetary system. The focus of the current debate is the first proposal, namely establishment of a super-sovereign reserve currency system.

After the outbreak of the global financial crisis in 2008, Zhou Xiaochuan (2009), Joseph Stiglitz (2009), Eisuke Sakakibara (2009) and UN (2009) proposed the creation of a super-sovereign reserve currency. This triggered wide discussion in academic circles.

Table 3 Comparison of Different Reserve Currency Modes

Reserve currency mode	Advantages	Disadvantages
Unitary sovereign currency	First, compared with a multiple system, it can reduce trade costs and give full play to scale advantages. Second, compared with the unitary super-sovereign mode, it has realistic operability.	First, there are conflicts of interest and a sovereign currency policy may damage the stability of the global economy. Second, there is an asymmetry problem between reserve currency and non-reserve currency.
Unitary super-sovereign currency	First, compared with a unitary sovereign currency, it can avoid conflicts of interest and the non-symmetry problem. Second, compared with the multiple currency, it can reduce trade costs and give full play of the scale advantage.	First, lack of operability. Lack of assurance and hard to generalize among personal sectors. Second, lack of an interest group willing to actively propel a super-sovereign currency.
Multiple sovereign currency	First, compared with a unitary sovereign currency, it can ease conflicts of interest and the non-symmetry problem. Second, compared with a unitary sovereign currency, it is much easier to implement.	First, compared with a unitary currency system, there are problems of high trade costs and difficulty in exercising scale advantage. Second, it adds the risk of exchange rate changes. Third, compared with a unitary sovereign currency, it can reduce conflicts of interest and the non-symmetry problem, but cannot eradicate them.
Gold-dominated mode	It would help: first, to dampen inflation; second, to correct the non-symmetry problem; third, to prevent unlimited US policy leeway; fourth, to avoid competitive currency depreciation.	It may cause: first, a shortage of liquidity; second, restriction of the effectiveness of currency policy; third, trade shrinkage; fourth, pronounced fluctuations of commodity prices.

In academic circles, many noted scholars and experts in international finance are active participants in the debate. Rodrik (2009) and Williamson (2009) have a positive attitude towards Zhou Xiaochuan's proposal. Rodrik (2009) thinks that the defect of adding special drawing rights is that it contributes to the inflation risk, but during a financial crisis, this helps to reduce the deflation risk. However, Aiyar (2009) doubts the function of special drawing rights and thinks that China could hardly benefit from Zhou Xiaochuan's proposal.

Subramanian (2009) also thinks that China is the main beneficiary of the present US dollar-dominated system and thus that it does not really intend to give up this system. Cooper (2009) and Barry Eichengreen (2009) think that the requirement of raising SDR's function is to generalize it among private sectors. However, this method will meet difficulties that would be hard to overcome in the real world.

In the view of Chinese scholars Li Yang (2008) and Guan Tao (2009), among others, from the view point of historical experience, special drawing rights is hard to win its development space. Yu Yongding (2009), Huang Yiping (2009) and Huang Haibo (2009) claim that in order to overcome the difficulty of generalizing special drawing rights, the practice of replacing account with SDR as the breakout. However, Cao Honghui (2009) thinks that, considering the difficulty involved in generalizing special drawing rights, we should take the diversification of international currency as the main goal of the reform. Most Chinese scholars think that the discussion of an international super-sovereign reserve currency is a theoretical rather than a policy problem, and thus is rather part of a gaming strategy rather than of a development strategy.

Apart from the proposal of a sovereign reserve currency, there has also been a proposal to restore the function of gold in the international monetary system. Former World Bank President Robert Zoellick is a representative of this view. In November 2010 Zoellick published an article in the *Financial Times* that put forward a reform proposal for establishing a coordinated currency system. This article was extremely controversial.[2] Some think that Zoellick was suggesting restoring gold domination, but he denies it. He was merely suggesting that gold should be used as the international reference criterion with regard to inflation, deflation and the market prospects of future currency values.

Many scholars support reinforcing the function of gold, but the issue is controversial. Robert Skidelsky, emeritus professor at Warwick University and biographer of Keynes, points out that, if we take gold as reserve currency, the accumulation of foreign reserves will trigger deflation and thus prevent countries such as China from accumulating massive foreign currency reserves.[3] Former Malaysian Prime Minister Mahathir also proposes to establish an international monetary system based on gold. He points out that "this system should consider establishing a trade currency based on gold, and other currencies should set their exchange rate in accord with this currency. The gold price would fluctuate slightly. Enterprises would face less uncertainty. National governments should fix exchange rates in accordance with the gold price or economy indication". However, Mahathir did not state whether the currency based on gold would be the US dollar or a super-sovereign currency. On this issue, other scholars suggest restoring the Bretton Woods system in which the US dollar was linked to gold. In this system, the expansion of an American current account deficit would lead to an outflow of US gold. To avoid this, the US government would adopt a policy to control the level of the current account deficit. This system would thus help to restrict increases in the US current account deficit.

In contrast to these two views, most people advocate taking the road of multiple international currency reform. With regard to the selection of multiple currencies, the mainstream idea is that, in the short term, the euro is the only currency that could compete with the US dollar. For example, Chin and Frankel (2008) thought that the euro would replace the US dollar as the reserve currency by 2020. In the long term, many scholars think that the RMB is very promising; in other words, the US dollar, the euro and the RMB will become the core of a multiple currency system. Some other people think that for a long time to come US dollar domination will still be the best international monetary system: a super-sovereign currency, gold or multiple currencies cannot replace the US dollar's status in the international monetary system.

There are thus four possibilities for the future development of the international monetary system: (1) a super-sovereign international currency system; (2) a system in which the US dollar is linked to gold; (3) a multiple currency system; and (4) maintaining the US dollar-dominated system. Table 3 compares the advantages and disadvantages of these possibilities. It is clear that there is no perfect international monetary system. Even the most widely advocated has obvious defects. The main problem is that it would add trade costs and risks of exchange rate changes; even if the future international monetary system is a multiple currency system, it will not be the final international monetary system. If effectiveness and equality represent the development goals of the international monetary system, ultimately a super-sovereign international currency must be the aim.

If this judgement is correct, the first, third and fourth options may adopted at different stages. That is, in the first stage the US dollar-dominated international monetary system would be retained; the second stage would see a transition to a multiple currency system; and the final stage would see the creation of a super-sovereign international currency.

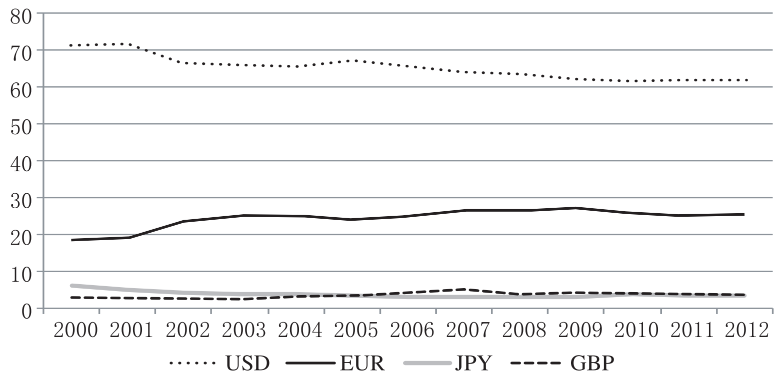
2.2 Reality of Reform of the International Monetary System

Although there has been a broad debate in academic circles on reform of the international monetary system, in reality, it is clear that, at present, reform has made little progress. The debate continues to focus on particular prospects and suggestions. No G20 summit has put forward a detailed plan for reforming the international monetary system; no willingness to engage in such reform has been indicated. The IMF, furthermore, has done no serious research on the issue. As the global economy gets out of recession, discussion of reform of the international monetary system is gradually fading from view.

Many factors influence this state of affairs.

First, although the present international monetary system has a number of defects, there are still no substitutable reform plans. Although in academia, some scholars propose replacing the US dollar with a super-sovereign reserve currency or linking the international monetary system to gold, due to a lack of operability these suggestions have received no attention from the G20 and thus cannot be turned into real reform. Furthermore, although a diversified international monetary system is seen as a practical choice, strictly speaking, such a thing could not really be brought about by reforms, but ultimately be decided by the markets.

Second, at the global level, the political powers are lacking to push reform of the international monetary system. The United States is the biggest beneficiary of the present international monetary system and thus the US government has a negative attitude to reform. At no G20 summit has the US government put forward even a suggestion of reforming the present international monetary system. Calls for such reform come mainly from Europe and some emerging economies. However, proposals by European governments and emerging economies are mainly concerned with diversifying the international monetary system.



Source: Database of the Bank for International Settlements.

Figure 6 Components of the International Reserve Currency (%)

Third, as the European debt crisis continues to spread from Greece to other euro zone countries, the exchange rate of the US dollar against the euro continues to appreciate. This has weakened appeals for reform of the international monetary system. From late 2008, against the background of the US subprime mortgage crisis, the Federal Reserve implemented QE, which contributed to the depreciation pressure on the US dollar, and thus raised the prospect of diversification of international currencies. Figure 4 shows that can see that, from mid-2011, the US dollar index bounced back to 74, a trend that extended to mid-2012. By July 2012, the US dollar index had risen to 84, 10 per cent up on mid-2011. Corresponding to the change in the US dollar exchange rate, the status of the US dollar as international reserve currency was reinforced. Figure 6 shows that the US dollar, as the international reserve currency, continues to exhibit a falling trend. However, after 2011, this trend appears to show signs of reversal. In 2010, the share of US dollar holdings in global foreign exchange reserves declined to 61.8 per cent, a historic low, bouncing back to 62.2 per cent in 2011 and 2012. In 2009 the share of euro holdings in global foreign exchange reserves rose to 27.4 per cent, a historic high. Due to the European debt crisis, however, this share now appears to be on a downward trend, falling to 24.9 per cent in the first quarter of 2012.

As already mentioned, influenced by these three factors, discussion of reform of the international monetary system is gradually fading from view. The situation is similar to that after the Asian financial crisis. At that time, too, there was much discussion of reform, but as the crisis receded nothing was done.

3. Prospects of Development of the International Monetary System

As the economic situation cools and calls for reform recede it is important to emphasise that, in any case, the G20's influence over the international monetary system is very limited, and market selection will still be the leading factor in how the system develops.

Shaped by the market, the international monetary system is likely to develop in a pluralist direction. However, the pace at which change will occur will be determined by pluralist trends in the global economy. In terms of the history of international currency, many factors may influence developments. Economic power is likely to be decisive, however. Changes in the international monetary system will thus be determined in terms of both their nature and their speed by the development of a pluralist global economy.

Notes

[1] The article was translated by Chen Xue, research fellow at the Shanghai Institutes for International Studies.

[2] Robert Zoellick, "The G20 must look beyond Bretton Woods," *Financial Times*, 8 November 2010.

[3] Robert Skidelsky, "A Golden Opportunity for Monetary Reform," *Financial Times*, 9 November 2010.

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Chapter 6
International Monetary System Reform: The Renminbi Issue[1]

Gunther Schnabl

1. Introduction

The world monetary system is asymmetric (McKinnon 2004). There is a very small number of currencies in the centre and a large number of countries use these currencies for their international trade and financial transactions. The present prominent role of the dollar as international money is rooted in the post-war political and economic hegemony of the United States under the Bretton Woods system (McKinnon 2010). It persists due to network externalities and economies of scale, which determine the currency habitat of emerging markets and developing countries with underdeveloped and fragile capital and goods markets. Backed by the large size of US goods and financial markets—outside of Europe—the dollar is the dominant international means of payment, unit of account and store of value.

However, the lingering financial crisis has highlighted the instability of the dollar-centered international monetary system. The crisis has triggered demands for a new international system that is less dependent on the monetary policy decisions of the Federal Reserve System (Zhou 2009; UNCTAD 2010). The G20 is committed to gradual reform to enhance global macroeconomic stability, international macroeconomic coordination and international financial supervision (Tiberghien and Hongcai 2013). One aspect of the reform is to increase the weight of developing countries in the international monetary system. In this context, the G20 is promoting expansion of cross-border use of the renminbi, gradual reform of the exchange rate regime and an increase in the renminbi's share in the IMF's Special Drawing Rights (G20 2011).

This chapter shows, however, that any attempt to make the renminbi an international currency and to unlink the renminbi from the dollar would be obstructed as long as low interest policies and quantitative easing in the large industrialized countries persist. Externally imposed financial repression constitutes an insurmountable impediment to the renminbi becoming an international currency. The second best solution is to keep the renminbi tightly pegged to the dollar and to keep inflation and financial market exuberance under administrative control.

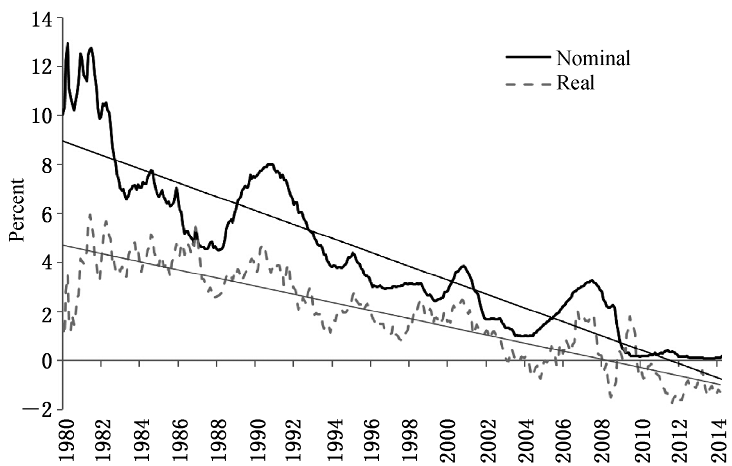
2. Asymmetric Monetary Policy in the United States and other Industrialized Countries

At the core of the informal dollar standard, the Federal Reserve Bank as the issuer of the dominating anchor, reserve and invoicing currency has tended to pursue an asymmetric interest path since the early 1990s. With consumer price inflation remaining low in a period dubbed the Great Moderation (Bernanke 2004), interest rates tended to converge towards zero. Domestic financial market booms were regarded as outside the responsibility of central banks, as central banks were considered unable to spot bubbles and/or to target price developments in specific financial market segments (Blinder and Reis 2005). Bernanke and Gertler (2001: 253) argued that central banks should respond to asset prices only to the extent that they affect the central bank's inflation forecasts. As a result, central banks tended to keep interest rates low during financial market booms, with low-cost liquidity contributing to exuberance (Hoffmann and Schnabl 2011).

By contrast, given the experience with tight monetary policies pursued by the Federal Reserve in the early years of the 1930s' Great Depression, interest rates came to be slashed in the face of financial crisis and recession. In early 1987 Fed chairman Greenspan pioneered a policy that aimed to address financial market crisis by decisive interest rate cuts (Woodward 2000). After the turn of the millennium, in the so-called Jackson Hole Consensus, US central bankers agreed that central banks do not have sufficient information to spot bubbles, but should intervene in times of financial turmoil (Blinder and Reis 2005). This created a situation in which financial markets could expect in times of crisis a quasi-bailout via interest rate cuts, the so-called "Greenspan Put" (Stiglitz 2010).

As a result interest rates were cut fast during a crisis and were kept low during the recovery. This pattern was transmitted to other industrialized countries such as Japan and the euro area via exchange rates. As experienced most evidently in Japan, interest rate cuts in the United States triggered appreciation pressure on the Japanese yen, which initiated dollar purchases (yen sales) and interest rate cuts by the Bank of Japan.[2] In contrast, Japanese monetary authorities did not intervene in foreign exchange markets in times of yen depreciation and tended to increase interest rate slowly during the recoveries after crises.

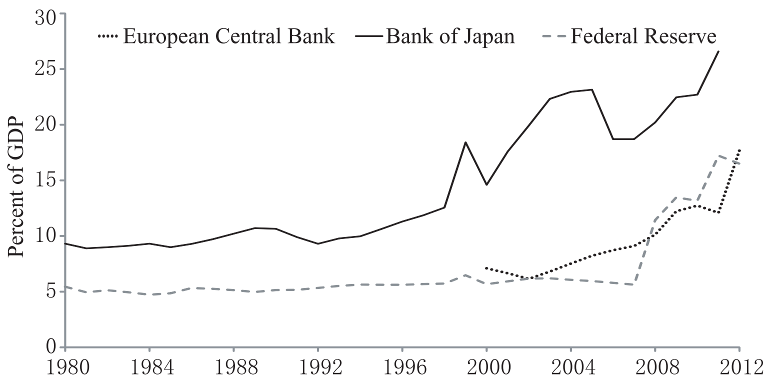
The outcome of such asymmetric interest rate policies (Hoffmann and Schnabl 2011) has been the convergence of short-term and long-term interest rates towards zero, as shown in Figure 1. The average nominal short-term interest rate in the United States, Japan and Germany/euro area declined gradually from about 12 per cent in the early 1980s to close to zero since the outbreak of the US subprime crisis. In real terms the interest dropped from about 6 per cent in the early 1980s to negative realms by 2014.



Source: IMF, via Datastream. G3=US, Japan and Germany (up to 1998)/euro area.

Figure 1 G3 Short-term Interest Rates (arithmetic average)

After the limit for interest cuts was reached at zero, the balance sheets of the largest central banks have been inflated by unconventional monetary policy measures. These measures focus on purchases of government bonds (to further depress interest rates at the long end of the yield curve) and of bad assets from ailing financial institutions. Figure 2 shows the inflating of the Federal Reserve Bank's balance sheet, which was preceded by a dramatic growth of the balance sheet of the Bank of Japan and accompanied by an strong expansion of the balance sheet of the European Central Bank since the start of the European financial and debt crisis in 2008.

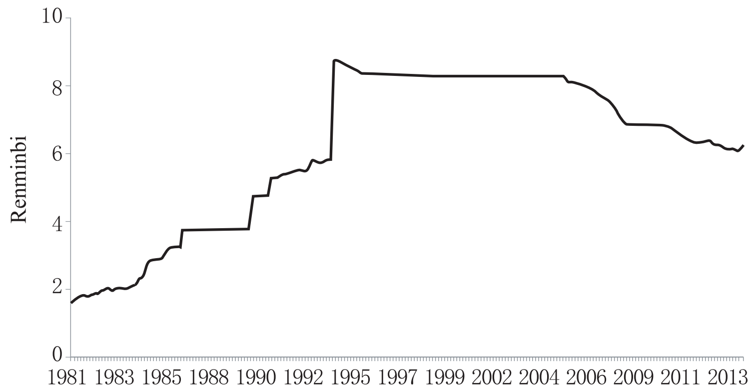


Source: IMF, IFS and WEO, European Central Bank and Eurostat.

Figure 2 G3 Central Banks' Monetary Bases As A Percentage of GDP

The structural decline of interest rates in the large industrialized countries has been a source of buoyant capital inflows into the emerging market economies, where interest rates tend to be higher (Hoffmann and Schnabl 2014). China became the target destination of particularly large capital inflows for three main reasons. First, market-oriented reforms and China's large supply of low-cost, motivated labour attracted giant FDI inflows, which have boosted the global partition of labor and trade. Secondly, the low interest rate policies in the United States and other (large) industrialized countries can be seen as an important source of hot money inflows into China because the interest rate gap between the industrialized world and China widened. This encouraged carry trades, which aim to realize arbitrage profits by raising credit in low-interest rate, highly developed capital markets and by investing in emerging markets with higher interest rate levels.

Thirdly, the profitability of carry trades hinges not only on interest rate differentials, but also on exchange rate movements. If the exchange rate of the target currency can be expected to appreciate during the investment period additional arbitrage profits are realized. From July 2005 to 2013—with a temporary interruption between July 2008 and June 2010—the Chinese monetary authorities established a widely predictable gradual appreciation path of the renminbi against the dollar (Figure 3). This provided the basis for one-way bets on the appreciation of the Chinese currency (McKinnon and Schnabl 2009).[3]



Source: IMF, Federal Reserve Bank of St. Louis FRED.

Figure 3 Renminbi Exchange Rate Against the Dollar

3. China's Response to Buoyant Capital Inflows

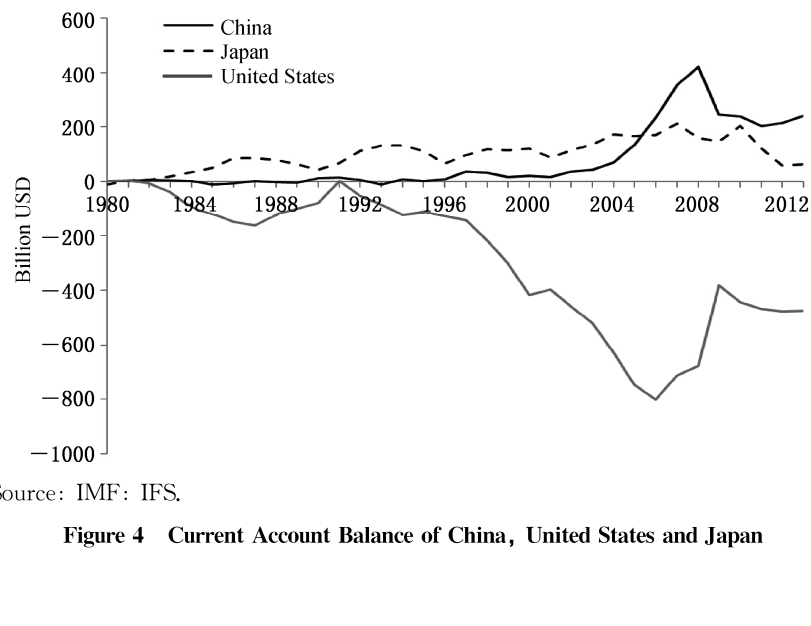
In the face of buoyant capital inflows, China has been keeping the renminbi tightly pegged to the dollar. Because the resulting reserve accumulation constituted an inherent source of inflationary pressure and uncontrolled credit growth, the People's Bank of China has been forced into extensive sterilization measures, which have become the breeding ground for shadow banking.

3.1 Exchange Rate Stabilization and Reserve Accumulation

The People's Bank of China responded to large-scale capital inflows by exchange rate stabilization for two main reasons. From a goods market perspective, China's outstanding growth performance remains export-led. With

China stepwise becoming the hub of the sophisticated East Asian production system (Thorbecke and Smith 2010), exchange stability against the dollar remains the basis for stable exports to the United States as the most important single export target market (Schnabl 2012). Because the common dollar peg of all East Asian countries (excluding Japan) is also the backbone for a high degree of intra-regional exchange rate stability, also from the perspective of intensive intra-East Asian trade China's growth remains strongly dependent on exchange rate stability against the dollar (Schnabl and Spantig 2014).

From a financial market perspective, the combination of large current account surpluses (as shown in Figure 4) with underdeveloped capital markets constitutes a strong incentive to keep the renminbi tightly pegged to the dollar (McKinnon and Schnabl 2004). Since the turn of the millennium, based on sustained current account surpluses, China has built up large net foreign assets against the world in general and the United States in particular. With developed capital markets, a creditor country could have a capital outflow in the form of portfolio investment and FDI that finances (matches) its current account (saving) surplus. With the capital outflow and the resulting buildup of claims on foreigners being denominated in the currency of the creditor country, domestic financial institutions such as banks, pension funds and insurance companies do not face any foreign exchange risk.



Source: IMF: IFS.

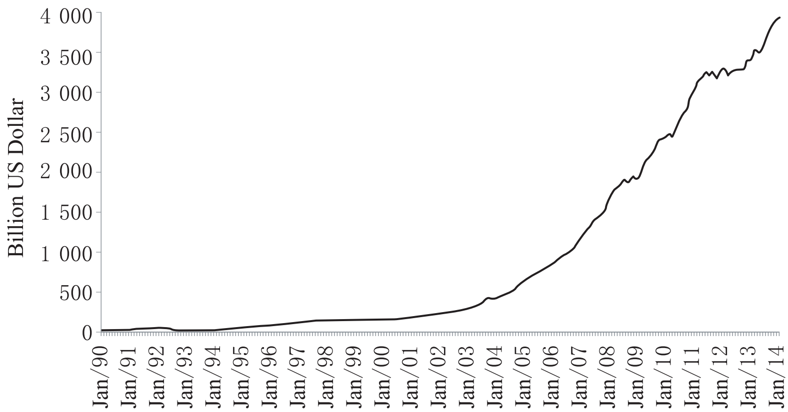
Figure 4 Current Account Balance of China, United States and Japan

However, China as an immature creditor country cannot lend to foreigners in its own currency. Because the US dollar is the dominant international currency and China's financial markets are underdeveloped—their development being impeded by interest rate and capital controls—Chinese financial institutions cannot lend in international capital markets in renminbi. The acquisition of large foreign currency denominated assets would make Chinese financial institutions vulnerable to exchange rate appreciation, because a strong appreciation of the renminbi against the dollar would erode the net worth of the ever-rising dollar assets in terms of domestic currency.

The upshot is that China finances its current account surpluses via the public sector, that is, foreign reserve accumulation. The People's Bank of China has accumulated a large stock of foreign reserves, which had grown to 3.85 trillion dollars by spring 2014 (Figure 5). In addition to these large liquid dollar claims foreign direct investments, mostly to countries producing primary products as inputs for Chinese industry, are being piled up by the Chinese government. The gradual rise of—mainly—dollar denominated international assets constitutes a strong incentive to soften the appreciation of the renminbi against the dollar.

If China ceased its exchange rate stabilization efforts against the dollar, the buoyant liquidity conditions in the United States, combined with large foreign currency denominated assets, would signal appreciation of the renminbi. The quasi-riskless anticipation of renminbi appreciation would encourage one-way bets on appreciation and therefore additional speculative capital inflows into China. In an extreme scenario the renminbi/dollar exchange rate would spiral upwards without limit, with the exchange rate becoming indeterminate because of the positive unfinanced gap between saving and investment (McKinnon and Schnabl 2014).

Therefore to keep appreciation expectations under control, the People's Bank of China sets the central renminbi/dollar rate in the morning of every trading day close to the rate prevailing at the end of the previous day. It maintains a narrow band of about 1 per cent (since early 2014, 2 per cent) between bid and ask prices throughout the day to facilitate international payment transactions of commercial banks. As a result the renminbi exchange rate remains tightly pegged to the dollar (since 2005) allowing for a controlled appreciation path versus the dollar (Figure 3).[4]



Source: IMF: IFS.

Figure 5 Chinese Foreign Reserve Holdings

3.2 Sterilization, Externally Imposed Financial Repression and Shadow Banking

If unsterilized, the tremendous accumulation of foreign reserves by the People's Bank of China would constitute a breeding ground for inflationary pressure and uncontrolled credit growth, as experienced by several Southeast Asian countries in the run up to the Asian crisis (Corsetti et al. 1999). Given that open interest rate parity holds, with the US money market rate close to zero and the renminbi tightly pegged to the dollar, the money market interest rate for China would be zero as well. This would be far too low for a fast growing economy, where real output expands by 7 to 10 per cent a year. For this reason the People's Bank of China is forced to mop up—in other words, to sterilize—large amounts of (potential) liquidity in the domestic financial system to prevent inflation from rising and to forestall an unsustainable credit boom.

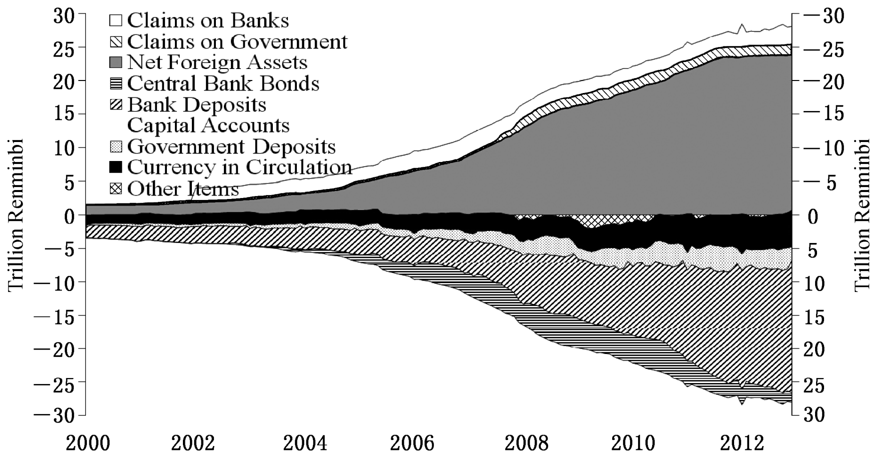
There are two main sterilization techniques (Löffler et al. 2013). With market-based sterilization the central bank sells domestic-currency (central bank) bonds to the commercial banks and other financial entities, which reduces the amount of liquidity in the domestic financial sector. Because these bonds are remunerated at market rates, the market mechanism remains in place. The disadvantage is—often substantial—sterilization costs and upward pressure on interest rates, which would ceteris paribus attract even more hot money inflows.

In contrast, with non-market-based sterilization the central bank raises reserve requirements on commercial bank deposits so that less bank credit can be issued for any given increase in base money. Because reserve requirements tend to be remunerated at low interest rates or not at all, sterilization costs are kept low. The disadvantage is that commercial banks become restricted as financial intermediaries, because sterilization costs are shifted to them. To maintain profit margins, commercial banks have to increase interest rates on credit provision and/or lower deposit rates.

If commercial banks shift the sterilization costs to depositors in form of lower deposit rates, this encourages the emergence of a less regulated "shadow" banking sector, which offers better deposit conditions. As the sterilization process aims to keep credit provision tight, non-market-based sterilization is usually combined with capital controls. Inward-bound capital controls aim to reduce speculative capital inflows, which are attracted by the domestic credit tightening. Outward capital controls can be necessary, if the costs of non-market-based sterilization are shifted to depositors in the form of lower deposit rates.

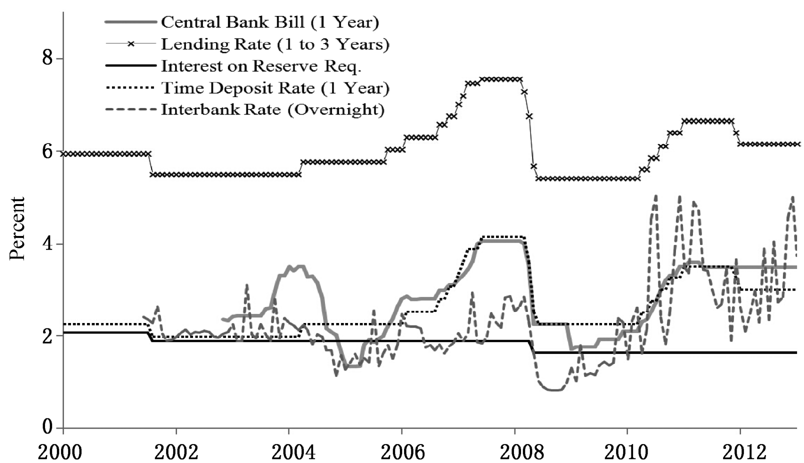
In practice, the People's Bank of China has resorted to both techniques for sterilizing foreign exchange intervention, with a rising tendency to use non-market-based instruments. Figure 6 shows that on the asset side of the balance sheet of the People's Bank of China (with positive sign) foreign reserves have grown massively. On the liability side (with negative sign) the sterilization instruments are shown. Starting from 2003, the People's Bank of China issued central bank bonds to absorb liquidity from Chinese capital markets. Starting from 2006 increasingly the reserve requirement ratio was raised and the reserve requirement basis was widened, which is reflected in the steep rise of (commercial) bank deposits at the People's Bank of China. Whereas interest rates paid on the People's Bank of China's bonds tended to follow closely the interbank rate (which can be assumed to be mainly market-determined), the remuneration rate on required reserves is at around 2 per cent, substantially below the inflation rate (Figure 7).

The consequence is *financial repression*, a concept developed by McKinnon (1973) and Shaw (1973). During the 1960s and 1970s high reserve requirements, interest rate ceilings, tight bank regulation, consumer price inflation and restrictions to international capital flows led to negative real interest rates in many Latin American and East Asian countries. This financial repression was imposed internally by national governments to cover fiscal deficits. The modern form of financial repression in emerging markets and developing countries is externally imposed (McKinnon and Schnabl 2014). As the centre countries of the asymmetric world monetary system keep short-term rates close to zero and hold long-term interest rates low by quantitative easing, the countries at the periphery of the world monetary system are forced into capital and interest rate controls.



Source: IMF.

Figure 6 People's Bank of China Balance Sheet



Source: People's Bank of China.

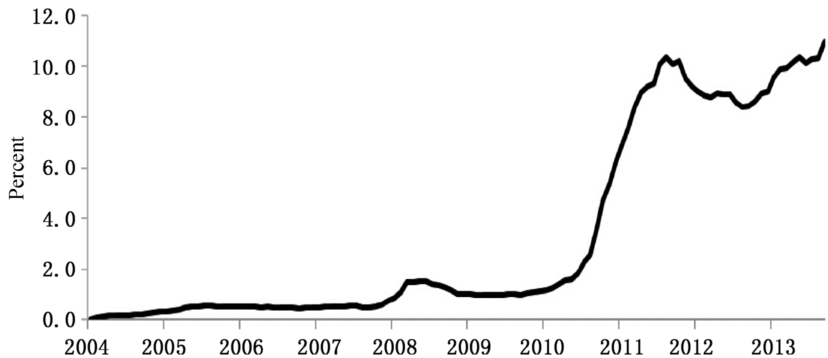
Figure 7 Fragmented Interest Rate Structure in China

The government of China has introduced controls on capital inflows and outflows, as well as ceilings on domestic deposit and lending rates as forms of financial repression. Reserve requirements of banks at the central bank are remunerated at (less than) 2 per cent, as shown in Figure 7. At the same time commercial banks are forced to keep interest rates on credit provision low; for a fast growing country bank lending rates of about of 6.5 per cent are certainly low. Excess demand for domestic bank credit has emerged, which allows state-owned banks to direct credit allocation to the large state-owned enterprises and export enterprises (McKinnon and Schnabl 2012; Bai 2013).

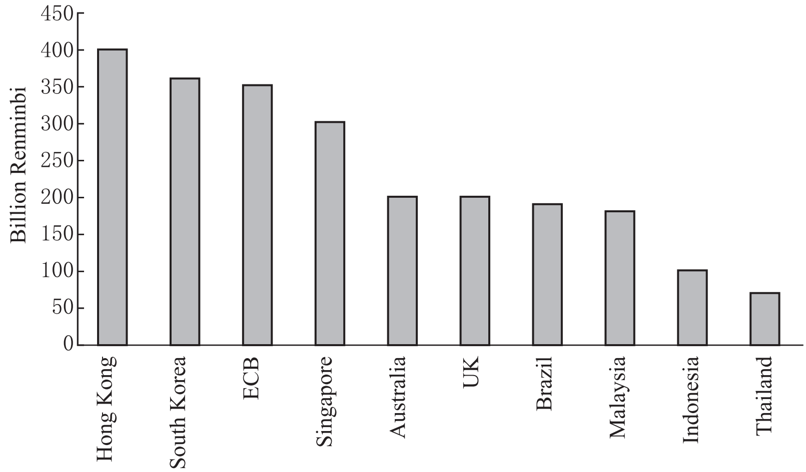
Because small and medium sized enterprises are risky and credit provision to them is expensive (per renminbi lent), China's banks have become unwilling to lend at the low, controlled interest rates. Therefore, small and medium-sized enterprises, as well as local governments,[5] have to rely on credit provision by shadow banks, which offer it at a substantially higher interest rate than the state-owned banking sector. In practice, state-owned banks may provide funding to informal (off-book) affiliates. Large customers may be guided to deposit their savings in trust funds, which pay higher deposit rates and make high-interest—but also riskier—loans. The consequence is the growth of a shadow banking sector that covers credit market segments that are not covered by state-owned banks.

4. Limits to Renminbi Internationalization

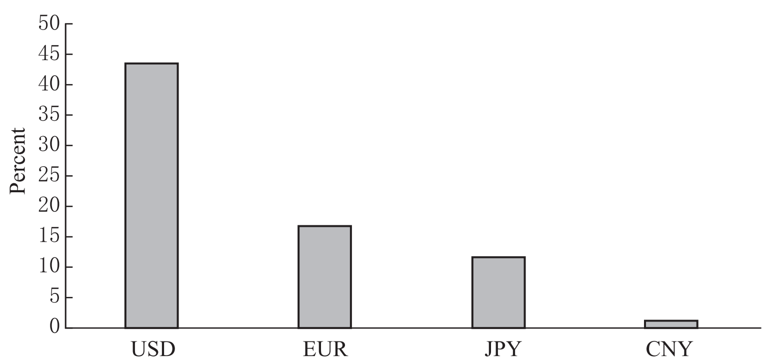
To escape from externally imposed financial repression China must internationalize its currency to be able to become a mature international creditor with a freely floating exchange rate. Then, Chinese banks and insurance companies could lend to foreign enterprises and governments in renminbi without foreign exchange risk. Similarly, international bonds denominated in renminbi could be sold in Shanghai (or other Chinese cities) to foreigners. China's private financial sector could finance its current account surpluses without the People's Bank of China intermediating international capital outflows. The liberalization-at both national and international level—would allow China's capital market to thrive, an indispensable prerequisite for the renminbi to challenge the dollar as an international currency.



Ⅰ Renminbi Deposits As Share of Overall Deposits in Hong Kong



Ⅱ Top Ten Renminbi Cross Currency Swap Lines by End 2013



Ⅲ Shares in Global Foreign Exchange Market Turnover by December 2013

Source: People's Bank of China and Bank of International Settlements.

Figure 8 Internationalization of the Renminbi

China's government has taken several steps to liberalize domestic capital markets and to make the renminbi convertible by supporting offshore renminbi trading in Hong Kong and other financial centres, including London and Frankfurt. Chinese and foreigners can now open renminbi deposits in authorized foreign banks, which can be used to make offshore renminbi loans or other payments. Indeed renminbi deposits in Hong Kong and the issuance of renminbi-denominated so-called Dim Sum bonds have grown fast since 2010 (upper panel of Figure 8). Swap lines with other central banks were initiated to encourage more renminbi-based trade at lower exchange rate risk(centre panel of Figure 8). These swap lines remain, however, very small compared with the partners' dollar reserves. In particular the share of the renminbi in the overall turnover in global foreign exchange markets is still miniscule (lower panel of Figure 8).

To promote the renminbi as an international currency, the Chinese government is to introduce the Shanghai Free Trade Zone for international financial flows, where the access for foreign investors to this renminbi capital market will be facilitated. Chinese investors can use the capital free trade zone as a platform for overseas investments. However, capital controls between the Shanghai Free Trade Zone and the rest of China have to remain in place. Otherwise, as long as appreciation expectations persist, dollars will be converted into renminbi and hot money inflows into China would accelerate, pushing Chinese interest rates towards zero. This rate would be far too low for fast growing China.

The upshot is, that the US zero interest rate policy and quantitative easing have become an insurmountable impediment to the national and international liberalization of China's capital market as a prerequisite for the renminbi to become a freely floating international currency. While the Federal Reserve Bank has signaled a prudent exit from quantitative easing, other large central banks (European Central Bank, Bank of England and Bank of Japan) are expected to perpetuate very benign liquidity conditions. As the first announcements of US monetary tightening have caused financial turmoil in major emerging markets the future path of US monetary policy remains uncertain. The benign liquidity conditions in the large industrialized countries, combined with pressure on China to let the renminbi appreciate, constitute an external constraint on China's ability to liberalize its domestic capital market and to remove international capital controls. China must remain an immature creditor and the renminbi cannot be fully internationalized. The second best solution is to keep the renminbi pegged to the dollar, to minimize speculative capital inflows and to boost international and intra-regional trade flows.

5. Prospects for Renminbi Internationalization

The international monetary system is at a crossroads. The very expansionary monetary policies in the United States and other large industrialized countries have contributed to growing hot money inflows into China (and many other emerging market economies) that constitute a risk to macroeconomic, financial and political stability at the periphery of the international monetary system. So far the G20 has not succeeded in transforming the dollar-dominated international monetary system into a more balanced and stable system. Neither the promotion of a wider use of SDRs nor the push to a quadripolar system with the dollar, euro, RMB and SDRs seem realizable in the near to medium future (Tiberghien and Hongcai 2013).

In China, any appreciation of the renminbi versus the dollar is not only equivalent to a drag on Chinese exports, growth and employment. It also devalues China's giant international dollar assets—both liquid and illiquid—in terms of domestic currency.

Any announced and therefore predictable appreciation of the renminbi, combined with a dismantling or circumventing of capital controls, will generate even larger inflows of hot money and therefore uncontrolled appreciation of the renminbi. The People's Bank of China would be forced again into an unprecedented level of foreign reserve accumulation and interest rate cuts towards zero. The resulting significant increase in inflation could cause political discontent. Further inflation of the already large real estate bubble and its final bursting could lead China—as happened in Japan—into a lasting recession.

Given the destabilizing effect of US monetary policy on China (and its neighboring countries) independent monetary integration with the renminbi as the leading regional anchor currency would help to gain monetary independence in East Asia. As China is the largest economy in East Asia, building the hub of the sophisticated intra-regional system of division of labor, the renminbi would qualify as anchor currency of an independent East Asian monetary integration process, given that the renminbi capital market would be liberalized. East Asia would be able to adjust its monetary policy to the specific needs of a region in an economic catch-up process. A monetary decoupling of East Asia from the dollar would probably also constitute a disciplining mechanism for monetary expansion in the United States, as inflationary pressure originating there would become more visible in the country itself.

However, as shown above, the very expansive US monetary policy (which is transmitted to other large industrialized countries) constitutes an insurmountable constraint on liberalizing Chinese capital markets, both domestically and internationally. Very benign liquidity conditions in the industrialized world force China into inward-bound capital controls, interest rates controls and distorted allocation of credit. The fast growth of the shadow-banking sector in China can be understood as a direct consequence of this externally imposed financial repression.

Because the necessary dismantling of capital and interest rate controls would be equivalent to a decline of Chinese interest rates towards zero—which would be far too low for this fast growing economy—China has no alternative other than to maintain such controls. The persistence of financial repression is, however, the most important impediment to a lasting renminbi internationalization, which itself is the prerequisite for the renminbi to challenge the dollar as an international currency. Therefore, the second-best solution is to keep the renminbi tightly pegged to the dollar (to minimize speculative capital inflows) and keep domestic inflation and asset price (real estate) bubble under administrative control. The leading role of the dollar in the international monetary system is likely to persist.

Notes

[1] This chapter is based on joint research with Ronald McKinnon, as published in McKinnon and Schnabl 2014. I thank Kristina Spantig and Hannes Böhm for excellent research assistance.

[2] The zero interest rate bound was first hit by Japan in the late 1990s. This does not

necessarily imply that Japan was a forerunner in interest rate cuts towards zero. Goyal and McKinnon (2003) argue that the Federal Reserve had the largest degree of freedom in monetary policy decision-making and that the US monetary policy stance was transmitted via the exchange rate to Japanese monetary policy. Since the early 1980s Japan's interest rate level has tended to remain lower than the US interest rate level, because Japan's structural current account surpluses and rising foreign currency denominated net international assets were the source of persistent appreciation expectations of the Japanese yen. Because of this, a structural decline of the US interest rate would push Japanese interest rates towards zero.

[3] Currently, for instance the average yield on low-risk renminbi assets in China is 4 per cent, whereas the deposit rate in the large industrialized countries is close to zero. Shifting a portfolio from the United States to China would ensure an additional profit of 4 per cent. If the People's Bank of China continued to let the renminbi crawl predictably upward at about 3 per cent per year, a dollar-based investor could earn a return of 7 per cent, if he is able to circumvent inward Chinese capital controls.

[4] From January 2014 to June 2014 the renminbi started to depreciate against the dollar, which was seen as a move by the People's Bank of China to deter speculators. The depreciation of renminbi against the dollar could also be due, however, to rising instability in the Chinese (shadow) financial sector.

[5] Local governments are restricted by law to issue own bonds.

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Chapter 7
The G20's Institutional Weakness and RMB Internationalization

Zha Xiaogang

1. Introduction

Since the eruption of the great financial crisis, the world has tried almost every means to reinvigorate the world economy and, if possible, to stave off future crises. With regard to global economic governance, the G20 summit was established as the premium international economic forum, at which the leaders of the 20 largest economies sit down together, talk about the world's economic problems and give political guidance to the international economic institutions. As the result, the IMF, the World Bank and the Financial Stability Forum (FSF) have undergone their most far-reaching reform to date. At regional/trans-regional level, there are many initiatives for crisis prevention and promoting economic growth: the Trans-Pacific Partnership (TPP) being pushed aggressively by the United States, the Regional Comprehensive Economic Partnership (RCEP) and the Chiang Mai Initiative Multilateralization (CMIM) in East Asia. At national level, almost all major economies have taken numerous policy measures to rebalance and maintain their economic momentum.

However, one phenomenon stand out from the various stimulatory and crisis prevention measures, namely the RMB internationalization strategy adopted by China. Looking across the globe, in the shadow of the global financial crisis, only China has used its currency as a tool not only to counter the negative effects of the crisis but also to consolidate the basis for even greater economic success in the future. Why did China decide to promote the internationalization of the RMB? What has been the influence of the G20?

2. The G20's Institutional Weakness as One Factor Stimulating the Reform of the International Monetary System

Although the broad view among academics and policymakers is that the current international monetary system has many shortcomings, especially in the wake of the global financial crisis of 2008-2009, the G20 has done little to promote reform, due mainly to the weakness of the institution itself.

To date, out of the eight G20 summit declarations, four have mentioned the need to build a more stable and resilient international monetary system: the London summit of 2009, the Toronto summit of 2010, the Seoul summit of 2010 and the Cannas summit of 2011. However, only the Cannas summit addressed more than briefly, offering specific measures and suggestions. The Cannas Summit Leaders' Declaration calls in some detail for the reform of the international monetary system. First, it seeks an increase in the benefits from financial integration and more resilience to volatile capital flows to foster growth and development; secondly, it wants to strengthen capacities to cope with crisis by providing more financial resources to the international financial institutions, such as the IMF; and thirdly, it wants the IMF's surveillance role to be enhanced.[1] This is all to be welcomed, but the results have been mixed. Capital flows are still very volatile and many emerging countries have suffered as a consequence of the changing monetary policies of the countries issuing the major reserve currencies. More financial resources have been pledged to the IMF, but reform has been delayed again and again. The important of IMF surveillance is stressed, but in fact it can do nothing in relation to the macroeconomic policies of major Western countries, especially the United States.

It should be recognized that, as G20 chair, France has been serious about reforming the international monetary system. In order to make some progress at the Cannas summit, it held a very high profile seminar on the topic in Nanjing, China on 31 March 2011. All the G20 finance ministers and central bank governors, many well-known scholars and think tank members, and then

President of France Nicolas Sarkozy attended. Disappointingly, however, although the seminar has achieved a broad consensus on the importance of IMF surveillance, global financial safety nets and capital flow volatility, it has led to few specific measures to reform the international monetary system. This disappointment foretold the frustration that France would encounter in its efforts to use the Cannas summit as an opportunity to promote international financial reform.

The informality of the G20 as an international institution is one fundamental reason why it cannot promote international monetary reform effectively. As an informal institution, it is easy for the G20 to coordinate its member countries on urgent and short-term issues, such as government economic stimulus policies and measures to combat the crisis, but informality also makes it difficult to reach consensus on long-term, strategic and rule-changing issues, never mind to make measures mandatory. As a result, the G20 has been ineffective in reforming the international monetary system.[2]

3. Why Is China Pushing Forward the Internationalization of the RMB

Clearly, the status of international currency not only brings the issuing country many benefits, but also many constraints. For this reason, even inside China, views differ widely with regard to RMB internationalization: some strongly advocate it, while others think that it is foolish. Nevertheless, the Chinese government seems determined to push ahead. Many signs indicate that, in large part, the government has been compelled by circumstances rather than having an ambitious strategy at the outset.

First and foremost, as already discussed, China has little confidence that the multilateral institutions, including the G20, can achieve substantial progress in promoting reform of the international monetary system. Before the great financial crisis, the shortcomings of current international monetary system had already been discussed and were well recognized, but no multilateral institutions had taken serious measures. In the wake of the crisis, the G20 was established, but this has even reduced China's confidence in the multilateral institutions' ability for reform. In this context, China has to find its own unilateral way to deal with the challenges it faces due to the international monetary system.

Secondly, RMB internationalization is intended to offset the negative effects of the current international economic order. The shortcomings of the current international monetary system represent a major threat to the Chinese economy. Since its accession to the WTO, China became the second largest trader in the world before the financial crisis, exporting and importing huge amount of goods and services. Most of these goods and services are priced and settled with US dollars, some with euros and a smaller share with yen or pounds. The substantial fluctuations of the major international currencies seriously affect China's foreign trade and investments, imposing significant uncertainties on China's exporters and importers, and thus increasing the cost of currency hedging. Furthermore, China imports almost half the oil it needs. With oil priced almost entirely in US dollars, China is strategically at risk when the US dollar devalues and oil prices rise. In 2011, although China's oil import volume increased only by 6 per cent China paid 45.3 per cent more due to the devaluation of the US dollar and the appreciation of the RMB.[3]

The third inconvenience for China is US dollar reserve accumulation and its unintentional consequences. Before the crisis, China depended mainly on exports and investments for economic growth. In order to prevent the RMB from becoming too strong and adversely influencing China's export competitiveness, China buys the foreign exchange income from exporters, while restricting overseas investment. As the result, the Central Bank of China has accumulated huge foreign exchange reserves, most of which are invested in US treasury bonds and other US assets. The Chinese government is worried about possible losses from US dollar devaluation. Domestic public opinion has also criticized the government for endangering the hard-earned savings of ordinary people.

In fact, by accumulating US dollar assets, the Chinese government has developed a deeper economic interdependence between China and the United States, which will broaden their common interests in cooperating in many areas, thereby stabilizing bilateral relations. On the other hand, there is also the risk of mutual financial destruction: if the United States pushes China too hard, China might stop buying US treasuries, pushing the yield higher, while if China's actions adversely affect the United States, the latter can devaluate the dollar to reduce the value of China's state-owned overseas assets. Whether one characterises the situation in terms of deeper economic interdependence or weapons of mutual financial destruction, China and the United States are indeed bound together, which was certainly in China's strategic interest when its economic growth was still in the initial stages. However, when the volume of dollar reserves seems to be too high, thereby putting Chinese asset values in danger, it will recalculate the necessity for such practices.

The combination of too high a trade surplus, a de facto fixed exchange rate and huge foreign exchange reserves has led to another very serious problem. The Central Bank of China is forced to print a lot of money to buy foreign exchange as exporters are required to sell it to the central bank, leading to huge inflationary pressure and an asset bubble. China's economic resources are wrongly priced and its economic structure has been distorted. Alongside inflation and the asset bubble there is substantial social discontent in China, as indicated by numerous incidents. The government is afraid that if the trend continues, society could sink into turmoil. That is the main reason China has eased its control over the RMB exchange rate since July 2005, although US pressure has certainly played a role.

In the diplomatic arena, China wants to use RMB internationalization to reduce the need to keep fixed rates to maintain export competitiveness, which has been the biggest economic flashpoint between China and the United States since the early 2000s. China wants to reduce the conflict, depending more on its own currency for international transactions and achieving a balanced exchange rate between the RMB and the US dollar.

Of course, the huge potential economic and strategic interests of being an international currency issuer have also encouraged Chinese leaders to promote the internationalization of the RMB.

Currently, the most attractive side of RMB internationalization is the potential facilitation role that an internationalized RMB could play in reducing the cost of China's overseas investments and importing goods from other countries. This will be very important within the framework of transforming China's economic growth model from its dependence on exports and FDI to the expansion of domestic consumption and outbound direct and portfolio investment in the coming years. In the past 30 years or so, with opening up and liberalization, China has greatly increased its efficiency in utilizing its economic resources. Although there is still a considerable margin to squeeze, the marginal return would be much less if China continues to open up to foreign investors. With this in mind, and with the huge capital it has accumulated in recent decades, China realizes the importance of utilizing not only its own economic resources but also those of the rest of the world. China is thus endeavouring to start a new phase of its opening-up strategy, namely the "Going Out Strategy", which encourages Chinese enterprises to invest abroad. Simultaneously, China is also encouraging the import of necessary goods and resources to enable the Chinese people to further improve their living standards. But overseas investments and imports made using the US dollar as the pricing and settlement currency will continue to subject China's investment and import capability and stability to the policies of the United States and will have higher transaction costs. If these investments and imports can be priced and transacted with the RMB, however, China can provide an almost unlimited capacity for investment and import financing, thereby reducing transaction costs for Chinese enterprises too. One possible area in this regard is Africa. China can import goods and resources by paying in RMB, and African countries can import Chinese goods and services by paying their RMB income back to China. There is indeed huge potential.

RMB internationalization will also be instrumental in promoting the reform of China's financial system. In contrast to the real economy (manufacturing), which has been extremely liberalized with accession to the WTO, China's financial system remains largely state controlled and not particularly efficient, which underlies so many economic distortions in China. Internationalization will bring external pressure and competition to bear to accelerate financial reform, including liberalization of domestic bond markets, stock markets, the interest rate formation mechanism and so on.

With regard to geopolitics/geoeconomics, the internationalization of the RMB, especially in East Asia, will strengthen China's economic links with its neighbours and its influence over regional economic and financial cooperation (intraregional trade, Asian regional capital markets, crisis prevention and management), which is critical for China in developing a stable backyard.

Globally, RMB internationalization will to some extent offset the strategic advantage enjoyed by the United States as the dominant international currency owner and pave the way for China to play a bigger role in the world economy. The international status of the US dollar has been crucial in enabling the United States to run trade deficits for more than 30 years while still remaining competitive in the world economy.

China wants to see a more comprehensive and balanced international monetary system consisting at least of the US dollar, the euro and the RMB, perhaps even some other major currencies, such as the yen and the rupee. This will give the world economy more choices in terms of investment and trade; competition among the major international currency issuers will produce better results for the world in general.

4. The Basis of RMB Internationalization

The issuer nation of an international currency must have substantial economic and political power. Few countries in the world are able to play this role. However, after more than 30 years of rapid economic growth and political stability, China is now approaching the summit.

China is now among the leading world investors and traders and the quantity of international transactions involving China is huge. Therefore, China's preferences with regard to international transactions should have a strong influence on means and methods. Some people argue that the US dollar became the international currency only after almost 60 years of the United States having the largest GDP in the world. However, as Professor Arvind Subramanian (2011) says, although China is still only the second largest economy in the world, it has much larger share of international trade and investment than the United States had in the late nineteenth century.

The most important factor, however, should be China's domestic market and thus its capacity to import. China's economy is already enormous; although the share of domestic consumption in GDP is still very low compared with other nations, its domestic market is on course to become the second largest in the world after the United States (not counting the EU as a single entity). More importantly, thanks to the booming middle class in China, the market is predicted to be No. 1 in the world in less than 10 years. China's growing domestic market will provide huge scope for absorbing overseas products and services, thereby forming the basis for RMB outflows while importing foreign goods and services, just as the United States has been doing with the dollar for decades.

China's financial system has made considerable progress, especially in terms of infrastructure. It now has fairly sound regulatory institutions, commercial banking system, security transaction brokers and many listed companies. What is more, as the result of recent efforts, China's financial system has accumulated much international experience and talented personnel, which is a crucial basis for further financial reform and for coping with RMB internationalization's spillover effects.

Besides, China's politics and society in general are very stable. In China, the collective leadership helps to maintain this stability and to avoid serious policy mistakes. Militarily, too, China is a major power. The political stability, the established macroeconomic policy framework, the ability to maintain domestic, cross-border and even international security give China strong credentials to be an international currency issuer.

5. The Main Channels and Progress of RMB Internationalization

5.1 RMB outflows from China

To maintain an international currency, the issuing nation needs to be able to manage the outflow of the currency beyond its borders and to recycle the currency through many mechanisms, which can insure liquidity. Although the Chinese government is very cautious about the possible negative effects of RMB internationalization, it has established a number of channels to promote the cross-border use of the RMB.

Currency swap agreements are paving the way for RMB internationalization. China now has currency swap agreements with more 20 countries.[4] Recently, China said that it would like a swap agreement with India, having already reached agreement with Brazil and Russia.[5] These swap agreements have different functions: Argentina uses the RMB mainly in trade payments; Belarus uses the RMB as a reserve; Korea uses the RMB to finance its enterprises in China; Hong Kong uses it to satisfy RMB demand in offshore RMB business. In general, RMB swap agreements are helpful in dealing with short-term liquidity problems and maintaining financial stability, while China uses them to promote use of the RMB.[6]

In order to promote use of the RMB as a trade settlement currency, China is actively seeking to reach agreements with its trade partners on bilateral trade settlement with their own currencies (for example, China/Belarus March 2010, China/Russia June 2011, China/Japan December 2011, BRICS March 2012, SCO June 2012 and China/Argentina June 2012).

In April 2009, the Chinese government launched pilot programmes for cross-border RMB settlement in five major cities (Shanghai, Guangzhou, Zhuhai, Shenzhen and Dongguan), which was a crucial step for RMB internationalization. In August 2011, the programme was expanded across China. The programme has made significant progress: before June 2009, the RMB trade settlement volume was close to zero, but in 2010 RMB trade settlement accounted for 2 per cent of all China's international trade, rising to 10 per cent by 2011.

In May 2014, it was reported that Iran was willing to accept the RMB as the trade currency for its oil sales to China.[7] This has not been confirmed by the authorities in either Iran or China, but from the perspective of Iran, it does make sense because of the US sanctions; China also has a strong incentives because, as already mentioned, using the RMB to buy oil will reduce much of the exchange rate risks it has been running. There is also an internet rumour that China and Russia will use the RMB as the transaction currency for their oil trading. As in the case of Iran, however, there has been no confirmation yet. However, this speculation shows China's potential to replace the US dollar in this very sensitive area.

The RMB could also play a very important role in China's foreign direct investment or portfolio investment. In recent years, China's foreign direct investment has increased rapidly. In the first half of 2012, China's non-financial outbound direct investment was 44.2 billion US dollars, increasing by around 53 per cent on the first half of 2011. Given this huge volume, there is major potential for RMB direct investment, especially in developing countries.

China is becoming one of the most important development assistance providers, providing more assistance to developing countries than the World

Bank during 2009-2010.[8] China can provide RMB loans, assistance and import credit to developing countries, which will help the latter to obtain funding for their needs and also promote the utilization of RMB; even more importantly, it can inculcate the habit of using a new international currency in the developing world.

The international financial institutions need more financial resources. This provides China with an opportunity to promote the use of the RMB in the programmes of prestigious multilateral institutions, such as the IMF. In September 2009, China agreed to use RMB to buy 50 billion US dollars in IMF bonds. This could become a special but effective channel for China to both provide more resources to international institutions and expand the influence of the RMB in the world.

RMB assets will be adopted by more and more countries as foreign exchange reserve. In the past, only a few countries accumulated a limited volume of RMB as reserves, mainly from trade transactions. Recently, however, Japan has decided to buy Chinese treasury bonds as one component of its reserve assets. Saudi Arabia is also said to use RMB assets as a reserve.[9] Korea, Indonesia, Malaysia and Cambodia are all doing it as well. Although currently the RMB assets in total foreign exchange reserve pools are relatively modest, the rapid growth in countries using RMB as reserve currency shows its strength.

During Chinese Premier Li Keqiang's visit to Britain in June 2014, it is declared that the Great Britain Pound will be directly exchanged with RMB. This means China has made progress in reducing its reliance on US Dollar as the mediatory role. Before that, China has reached similar agreements with Russia, Canada, Japan, Australia, New Zealand, Malaysia and some other countries. The direct exchange with UK, Japan, Russia and Australia's currencies are very important. UK is very important in terms of its special status as international financial centre; Japan is the third largest economy and the main trade partner of China; Russia and Australia are the two main resource trade partners of China. The direct currency exchange between China and these countries will substantially reduce the exchange rate risk through the mediatory use of US dollar and be helpful to promote trade and investment relationship between them. Their practice in terms of currency relations will soon be copied by many countries. If the trend continues, the RMB's status will climb, while the US dollar will decline in relative terms.

5.2 RMB Inflows Back to China

The most important way to obtain RMB inflows is for other countries to import China's goods and services and pay with RMB. This would reflect the outside world's belief in the RMB.

The second important channel is offshore yuan bonds (so-called "Dimsum Bonds") in Hong Kong (2.3 billion US dollars in 2009, 5.4 billion in 2010, 14 billion in 2011) and in London (HSBC, 2012 April, 2 billion RMB) and possibly in Taiwan and other financial centres.

The third channel is onshore yuan bonds (so-called "Panda Bonds") in mainland China since 2005 (IFC, ADB), mainly used to support business inside China.

The Chinese government has launched a programme to promote the recycling of RMB depositing outside China, while maintaining control over the capital account. This innovation is known as the RQFII (RMB-qualified foreign institutional investors) programme, which allows qualified foreign financial institutions to invest in China's financial markets up to a certain quota.

Furthermore, the Chinese government is allowing foreign central banks and treasuries to buy China's national debt as foreign exchange reserves (Japan, Korea and so on), which is also limited to a quota and based on mutual agreement.

5.3 The Main Financial Centres for RMB Internationalization

For RMB business, the onshore centre will be located in Shanghai. China has decided to establish Shanghai as an international financial centre, but the legal environment, financial derivatives and regulatory expertise are not yet fully in place. The next decade will see profound reform (the 12th Five Year Plan on Development and Reform of the Financial Sector).

Offshore centres will probably include Hong Kong, London, Singapore, Taiwan and Dubai. These cities/places are competing for the status of offshore RMB business centre. Hong Kong has a number of special advantages, including geographical position, more familiarity with the mainland legal and social environment, strong support from the Chinese government, while London has a high international reputation for offshore finance and expertise.

6. Regional and Global Impacts of RMB Internationalization

Regionally, the RMB could function as a de facto common currency in the near future; given China's economic scale it could become at least twice the size of Japan's currency in around ten years, increasing intra-Asian trade and investment, developing China's fast growing domestic market to integrate regional economic resources and further developing intra-Asian capital markets.

East Asia could become the second largest monetary and financial cooperation area in the world, after the euro zone, which will further promote regional macroeconomic policy cooperation and coordination, while mechanisms such as the CMIM (Chiang Mai Initiative Multilateralisation) will get more institutionalized and political support.

A more economically and financially integrated East Asia will naturally produce a more consensus-oriented regional voice in international affairs, with regard to economic affairs, the environment and security.

The international monetary system could become more diversified and balanced, which will not only give the world more choices to do business, but also force the major economies to be more responsible in policymaking in order to maintain their international currency status.

Commodity prices will not be influenced so easily by the exchange rate of the US dollar. To date, most commodity prices have been linked to the US dollar. As the US dollar exchange rate fluctuates, so do commodity prices, which causes many troubles and uncertainties for the development of the world economy.

The global macroeconomic environment could become more stable. Currently, the US dollar is the dominant international currency, but the US monetary authority (the Fed) is responsible only for domestic concerns and ignores possible spillover effects for the rest of the world. There have been suggestions that the Fed has intentionally manipulated its so-called independent status to transfer the cost of US economic restructuring to the rest of the world. If there are more international currencies, especially when the other two (the euro and the RMB) almost a similar economic basis to the United States, it would not be so easy for any one currency to exert influence for the benefit of its domestic macroeconomic/monetary policies.

The US power basis could be weakened. The international currency status of the dollar provides the United States with great potential. The US can finance its overseas actions (military, aid, investment) at very low cost. With more alternatives, the margin for the United States would be greatly narrowed.

With US monetary power weakened, the RMB's status rising and the euro recovering to its normal status, the world power structure would adjust accordingly. Because the financial sector now plays a very important role in the economy, the realignment of international currencies will have a major impact on the distribution of international financial clout. The power structure adjustment could be even bigger.

Relations between the EU, the United States and China relations will become more uncertain. As the current crisis clearly shows, the United States does not have a strong interest in supporting the stability and status of the euro, which reveals the fragility of transatlantic relations. Simultaneously, China is playing a positive role in helping the euro zone, which the core European countries—including Germany and France—are very clear about. If the RMB becomes more internationalized, trilateral relations could be more subtle and subject to many political and economic interactions.

7. The Prospect of RMB Internationalization

In the economic dimension, optimism is called for: as long as China can maintain internal stability and normal economic growth, sooner or later the RMB will become a major international currency, based on economic scale and high level of international interdependence.

However, the further development and reform of a modern financial system is the precondition for the RMB to become a real international reserve currency. In this sense, China does have a long way to go. But it is moving quite rapidly. The interest rate formation mechanism is changing; private capital is allowed to enter the banking sector; an international board at the Shanghai Stock Exchange is under serious discussion; and more flexible management of foreign participants in China's bond markets is taking shape.

Moreover, the outside factors are important as well. There are a number of uncertainties concerning how the United States will respond to the possible loss of the dominance of the US dollar. We cannot be sure that the transformation of the international monetary system will take place smoothly and peacefully.

Notes

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[2] Li and Feng, "guoji huobi tixi gaige de jiti xingdong yu ershiguo jituan de zuoyong (The Collective Actions on the Reform of International Monetary System and the Role of the G20)," *shijie jingji yu zhengzhi*, February 2012.

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Chapter 8
China's G20 Membership and Quest for Leadership in East Asian Regional Architecture

Sunghoon Park

1. Introduction

China outpaced the United States as the largest trading nation in 2013, having already become the largest exporting nation in 2009. China's remarkable economic rise has turned it into a global power. Its increasingly influential voice is heard in many international forums, including the WTO, APEC and ASEM, to name only a few. More recently, as a member of the G20, China actively participated in the discussion of global economic issues, such as a global and regional financial safety net and international development. Having already emerged as a regional superpower, as Breslin (2006) noted, China now appears ready to play a more significant and responsible international role.

However, China is not yet prepared to assume the role of initiator and director of global issues. Also, China has not yet fully unfolded its leadership role in East Asia. More specifically, in the intensified regionalism of East Asian countries, China has not yet been effective in taking a leading role. In fact, China appears to be in competition for leadership with Japan on a number of regional issues. However, with the emergence of the Trans-Pacific Partnership (TPP) as an influential regional initiative for Asia-Pacific, China is now involved in a new leadership rivalry with the United States. The accelerated negotiations on the RCEP (Regional Comprehensive Economic Partnership) are China's response to the US attempt to increase its economic and geopolitical influence in East Asia. The future of East Asian regional architecture will largely be shaped by the outcome of this leadership competition between the two major global powers.

Against this backdrop, we attempt to identify ways in which China can attain the leadership role in the developments towards an East Asian regional architecture. The paper is organized as follows. After this introduction, Section 2 sketches the current state of play as regards the regionalist tendency in both the world economy and East Asia. It discusses the major trends and main features of East Asian regionalism. Section 3 analyzes mainly China's strategic ideas about regionalism. Considering the more recent development of TPP and RCEP as competing regional institutions for both East Asia and Asia-Pacific, Section 4 is devoted to a thorough analysis of this phenomenon. China's strategic approach to TPP and RCEP is considered in Section 5 and Section 6, which is the concluding part of the paper, presents three alternative ways in which China can secure the leadership role in the East Asian regional architecture.

2. Increasing Regional and Global Leadership

China's remarkable economic growth and social and political development, which has been achieved continuously since the country opened up at the end of 1970s, has had a number of significant impacts on the world economy and politics. Increasingly, however, the world community has accepted China as a fixed variable, whose influence has increased over the decades. Despite several disputes, such as the global imbalances caused by Chinas growing trade surpluses vis-à-vis the United States, China has become a member of important international organizations and forums. For example, China joined the World Trade Organization (WTO) in 2001 and soon became one of most influential members of the world trading community, reflecting its increased weight as the largest trading nation. More recently, when the 2008 global economic crisis was at its peak, China was invited to become a member of G20, which has assumed the position of premier economic forum for discussing global economic issues and governance. With this, China has effectively become "one of the leaders of global governance", as noted by Alexandroff (2010). Furthermore, China is regarded by many analysts as forming a "G2" with the United States. Although unofficial, the discussion of the G2 symbolizes China's global economic and political power which is comparable to that of the United States.

Assessments of China's global behaviour are divided. For a number of Western scholars and policymakers, China has shown renewed leadership ambitions in Asia (Breslin 2006) and has assumed a position of global power comparable to that of the United States. It therefore deserves its position in the G2. The G20 would also, some expect, be dominated by the G2 (Garrett 2010). As Paulson (2010) has noted, many American observers view the G20 as a welcome venue for the United States and China to form strong leadership cooperation for the governance of global issues. These assessments to some extent reflect the concerns of some Western countries were once influential players in the world economy and politics, but are currently on the verge of being marginalized with the emergence of China as an alternative power.

However, Chinese scholars and policymakers appear still hesitant to assume the role of one pole of the global bipolar power structure. For many, China is not yet ready to take responsibility for forming a new global order. As analyzed by Ji (2010), most leading Chinese academics are sceptical about any proactive role for China, and the country is rather prepared to accept the leading role of the United States and its allied developed countries in actively shaping the global order. As stated by Breslin (2006), China appears to have already emerged as a "regional super power", but is not prepared to assume the role of global power comparable to the United States.

It is more appropriate to analyze the country's strategy with regard to one of most compelling regional issues today, the East Asian regional architecture. This issue has gained in importance through the accelerated negotiation of the Trans-Pacific Partnership (TPP) under the strong leadership of the United States. Furthermore, the TPP negotiations have become an increasing threat to China's economic interests due to Japan's participation in March 2013. As a number of other important countries in East Asia have already declared their interest in TPP, including Korea and Indonesia, China had to react with its own initiative in cooperation with ASEAN: the Regional Comprehensive Economic Partnership (RCEP). Through this process, the rivalry between the United States and China has become more pronounced on the issue of the East Asian regional architecture. The future shape of East Asia, therefore, is expected to be largely influenced by the outcome of the two countries' relations on this matter.

3. Regionalism in East Asia: Trends and Characteristics

3.1 Recent Trends in East Asian Regionalism

East Asian countries, which were long immune to the intensifying regionalist tendencies of the world economy until the mid-1990s, have now become active participants. Especially since the late 1990s they have paid ever closer attention to intra-regional and trans-regional FTAs. As discussed by many analysts, the 1997 Asian financial crisis was one of the triggers of this new policy direction on the part of East Asian countries.

This intensified participation of East Asia in increasing regionalism is one of the most notable features of today's worldwide regionalism.

Propelled by the need to strengthen regional solidarity within East Asia,[1] East Asian countries started to embrace regionalism as a policy alternative, in contrast to the multilateralism favoured since the Second World War. In fact, East Asia's aversion to regionalism has now turned into a very strong activism, especially since the mid-2000s. Since then, an increasing number of FTA initiatives have been discussed, studied for feasibility and even negotiated among East Asian countries. Some have already come into force, as Kawai (2013) noted recently. East Asian countries are also involved in numerous FTA negotiations with countries outside the region. Table 1 shows the intensity of the RTA activities of East Asian countries as of July 2013.

Table 1 RTA Activities of East Asian Countries: Number of RTAs Notified to the WTO

Country/ Territory	Goods notifications (RTAs)	Goods notifications (Accessions)	Services notifications (EIAs)	Services notifications (Accessions)	Physical RTAs
Brunei Darussalam	8	0	5	0	8
Cambodia	6	0	3	0	6
China	10	1	9	0	10
Indonesia	8	0	4	0	8
Japan	13	0	12	0	13
Korea	12	1	8	0	12
Laos	8	1	3	0	8

Continued

Country/ Territory	Goods notifications (RTAs)	Goods notifications (Accessions)	Services notifications (EIAs)	Services notifications (Accessions)	Physical RTAs
Malaysia	13	0	8	0	13
Myanmar	7	0	3	0	7
Philippines	9	0	4	0	9
Singapore	19	0	15	0	19
Thailand	11	0	6	0	11
Vietnam	8	0	4	0	8
Total	132	3	84	0	132

Source: WTO RTA Database.

Korea, for instance, has been one of most active participants in regionalism since the country adopted its FTA roadmap in 2003, and currently operates twelve FTAs with more than forty countries. Japan and China have also been extremely active in making their own FTA networks, with the current number of successfully negotiated FTAs standing at 13 and 10, respectively. Also, a non-negligible number of ASEAN member countries, such as Singapore (19 FTAs), Malaysia (13 FTAs) and Thailand (11 FTAs), have concluded FTA agreements with non-ASEAN countries recently, in addition to the existing ASEAN Free Trade Area (AFTA). As a consequence of this recent rapid increase in regionalism by individual East Asian countries, East Asia has today become one of most dynamic venues of regionalism in the world economy. While there were only a handful of FTAs in East Asia at the end of the 1990s, the number concluded by East Asian countries had increased to more than 130 by mid-2013(Kawai 2013).

3.2 Main Characteristics of East Asian Regional Integration

Despite—although in a sense also due to—the relatively short history of East Asian regionalism, its pattern displays a number of peculiar features compared with other major regions in the world. The most notable characteristics (and challenges) of East Asian regionalism are: (1) the overlap of FTA networks (overlapping membership) and (2) the absence of leading countries (leadership vacuum).

Overlapping Membership

Due to the proliferation of bilateral and minilateral FTAs involving East Asian countries, the FTA network there has become increasingly complex. In particular, East Asian countries are members of many FTAs both with each other and with non-East Asian countries. Korea, for example, already has FTAs with ASEAN and Singapore, and has been negotiating FTA agreements with China, Indonesia and Viet Nam. An FTA negotiation with Japan went on for a year in 2003-2004.[2]

One of the main characteristics of East Asian economic regionalism is that, in addition to three minilateral FTAs dubbed ASEAN + 1s—ASEAN's FTA agreements with China, Japan and Korea—many individual ASEAN member countries have successfully negotiated an FTA with individual North-East Asian countries. Japan is most active in this regard, and has an FTA with seven of the ten ASEAN member countries: Singapore, Malaysia, Indonesia, Thailand, Philippines, Vietnam and Brunei.[3] China has an FTA only with Singapore in addition to its FTA with ASEAN,[4] and the central government has concluded FTA agreements with Hong Kong and Macao. Through these aggressive FTA activities of all the East Asian countries, the FTA network within Asia has become increasingly dense.

An important question in this context is whether or not the increasingly overlapping FTA network within East Asia will contribute to the establishment of region-wide economic integration, as recommended by the East Asia Vision Group (EAVG) in its final report. There are two opposing views.[5] One view sees the increasing bilateral FTAs and the overlapping FTA membership within East Asia as an obstacle to region-wide economic integration. The main argument is that it leads to increasing costs mainly due to complexities with the application of effective rules of origin. An opposing group observes the same as contributing factors to regional integration, as they reduce the intellectual and policy-relevant hindrances related to trade liberalization. Like the similar debate on the relationship between regionalism and multilateralism, the matter is not decided yet and can be expected to continue for a while. Considering the increasing number of wider-regional initiatives, such as the Trans-Pacific Partnership (TPP) and the Regional Comprehensive Economic Partnership (RCEP), the author tends to support the "building-block" argument more than the "stumbling-block" argument.

Leadership Vacuum

The leadership vacuum in East Asian regionalism appears due mainly to the fierce leadership competition between China and Japan. In fact, the leadership rivalry between the two major regional powers in East Asia has been caused by a number of factors, such as the historical legacy of Japanese imperialism, the resurgence of China as a regional and global power and the waning of Japan's economic and political leadership in the region due to the lost decades since the early 1990s. While European integration was for the most part driven and accelerated by bilateral relations between France and Germany (the so-called "Franco-German Tandem"), the leadership vacuum in East Asia appears to have been a critical obstacle to regional integration. Park (2011) states in this regard that East Asia appears not to have fulfilled one very important precondition for successful regional integration.[6]

East Asian countries have so far attempted to mitigate the negative impact of the leadership vacuum by assigning the Association of Southeast Asian Nations (ASEAN) as the (temporary) driver of East Asian regionalism. So to speak, ASEAN has been sitting in the driver's seat of regional integration, leading the countries of East Asia on the road to region-wide integration. Considering that ASEAN was established in the late 1960s and has been pursuing its own economic integration since the early 1990s, the temporary leadership role delegated to ASEAN by major East Asian countries is realistic. As noted by Zhang (2010), it was also made possible by the implicit tolerance of the Chinese government.

More careful observation, however, reveals some limitations attached to the role of ASEAN as a leading coordinator of East Asian economic integration. First, as ASEAN was established first for political cooperation and started economic integration only at the beginning of the 1990s, its track record is relatively short. Also, reflecting ASEAN's relatively low economic weight in East Asia, with the major economies located in the northern part of the region, ASEAN's role has been more limited than originally anticipated. In contrast to the wishful expectation of its larger brothers in Northeast Asia, ASEAN was more interested in obtaining concessions than providing them in international trade negotiations at the regional and global levels. As a consequence, East

Asia's approach to regionalism so far leaves much room for rethinking and improvement. The proliferation of bilateral FTAs involving East Asian countries and the active participation of most ASEAN countries in it are the symbolic manifestation of ASEAN's inability to play the leadership role in East Asian economic integration. In fact, there is strong divergence between expectations and reality.

The leadership vacuum in East Asian regionalism, therefore, is a looming task for East Asia in a near future. In this regard, the role of Korea and ASEAN deserves some attention. Korea as a latecomer in regionalism has successfully transformed itself into a regional FTA hub, which can be judged by the country's 12 FTA agreements notified to the WTO (Table 1). Korea, in fact, is the only East Asian country that has successfully negotiated an FTA with both the United States and the European Union. In addition to Korea's very aggressive regionalism, its upgraded international status over the past decade also has to be added to the list of elements that have contributed to enhancing its regional leadership role. As host of a series of important international summit meetings, such as the ASEM Summit in 2000, the APEC Summit in 2005 and the G20 Summit in 2010, as well as the Nuclear Safety Summit in 2011, Korea's regional leadership and global profile has been upgraded greatly, as Park (2012a) observes. From the perspective of East Asian regionalism, the establishment in Seoul of the Trilateral Cooperation Secretariat (TCS) in 2011 can be regarded as an additional factor enhancing Korea's role in East Asian economic integration. The Secretary General of the TCS asserted the intention to develop the TCS into an organization like the European Commission, once the Northeast Asian regionalism begins to take shape. In this regard, there is increasing support for Korea's leadership role as an "international political economic entrepreneur" in the regional integration process of East Asia.[7] Therefore, Korea seems to have been contending the temporary leadership role played by the ASEAN members in the name of "ASEAN-centrality".

The leadership vacuum, the temporary driver's-seat role of ASEAN and the increasing aspiration of Korea to play a leadership role are factors that have led to the emergence of two apparent leadership rivalries currently observed in East Asian regionalism: the one between China and Japan and the other between ASEAN and Korea. The future of East Asian regional integration, therefore, will be strongly affected by the outcomes of these two leadership competitions. China, which has emerged as a major global power and become a member of such influential international forums as the G20, will exercise enormous influence in shaping the future of East Asia's regional architecture.

4. China in the Emerging East Asian Regional Architecture

As illustrated in the previous section, East Asia has embarked on its own regionalism since the late 1990s. An increasing number of bilateral FTAs have been negotiated and implemented and several other multilateral agreements are already in force. Also, a number of region-wide FTA initiatives with different membership compositions are on the table for either official negotiations or further elaboration. The apparent competition between the TPP initiative led by the United States and the RCEP initiative led by China is one outstanding example of the increasing complexity of the East Asian regional architecture. In short, the geopolitical constellations of and thus the environment for East Asian regional integration have changed substantively compared with 15 years ago.

The economic integration attempts mentioned above have largely been influenced by the evolving regional production network. In particular, Japanese and Korean multinational corporations have assembled a vast and dynamic network of production facilities in the region, thereby making the most efficient use of the natural, human and other resources available in the region. Alongside this enhanced regional production network, countries in the region have been making supportive efforts through institutional arrangements, as discussed in the previous section. The vision to establish an "East Asian Economic Community", as proposed by the East Asia Vision Group (EAVG) in its final report published in 2001 (EAVG: 2001), is one of the most prominent examples of this kind.

In contrast to economic integration attempts, cooperation programmes in the political and security areas are still a rarity. The ASEAN Regional Forum (ARF), which has existed since the 1980s, has not yet reached the stage of providing mechanisms for avoiding disputes and/or achieving peaceful co-existence in the region. What is lacking in the East Asian region is a multilateral security framework, as noted by Sohn (2010). The Six Party Talks in the

Northeast Asian region, too, have not yet been able to secure the strategic status of a multilateral security arrangement. In fact, the security constellations in East Asia are still dominated by some East Asian countries' cobweb of bilateral arrangements with the United States as the most important security partner, which in turn has been confronted by the China-Russia axis.

Correspondingly, the geopolitical constellations in East Asia are still relatively vulnerable (Christensen 2004). In addition to the background factors mentioned above, the leadership rivalry between China and Japan, the ups-and-downs of Korea's international role, and the ineffectiveness of ASEAN are hindering East Asia's journey towards regional cooperation and integration. Some observers point to these deficiencies to conclude that the future of East Asia is not optimistic (Friedberg 2000) or that the idea of an East Asian community is a myth (Ha 2008). These rather pessimistic evaluations notwithstanding, a careful investigation of both more recent developments in East Asian regional integration and the respective national strategies of the countries involved reveals some constructive pathways, through which East Asian regional integration could be realized at some point in the future. Especially, increased Chinese participation in both the regional and global production network and in the discussion of the regional architecture in East Asia is a new and remarkable phenomenon, and therefore deserves special attention in this context.

5. China's Regionalism Strategy and Policy Choice between TPP and RCEP

As argued by a number of Chinese and international scholars, policymakers and journalists, US participation and leadership in the negotiations on the Trans-Pacific Partnership (TPP) agreement has faced China with a new set of policy challenges. The more recent decision by the Japanese government to participate in the TPP negotiations has been an additional factor that has challenged China to take a new strategic decision to accelerate the process of launching the Regional Comprehensive Economic Partnership (RCEP) agreement. In fact, competition seems to be intensifying between the TPP supported by the United States and the RCEP promoted by China as a regional economic architecture for East Asia and Asia-Pacific.

5.1 Basic Direction of China's Regionalism Strategy

Like many other East Asian countries, China started its regionalist journey relatively late but has since been increasingly active. Yang (2010) and Wang (2011) argue that the change in Chinese regionalist strategy from a passive to an active approach has largely been influenced by the 1997 Asian financial crisis, which is in line with the analysis conducted in the previous section of this paper. This more proactive participation of China in both the discourses and the practices of East Asia's regional architecture has often been analyzed in the context of China's rise. One of the most pressing questions in this context is whether this increasingly active regionalism strategy on the part of China has (forcefully) led neighbouring countries to follow China's route or to seek alternative partners within and/or outside the region, such as Japan, the United States and even the European Union.

China's basic strategic direction with regard to Asian regional integration has been analyzed by a number of international and Chinese scholars over the past decade. An influential perspective was provided by Shambaugh (2004) early on. He argued that China is pursuing regionalism and an East Asian regional architecture based on the following four guiding principles: (1) active participation in regional cooperation dialogues; (2) establishing strategic partnerships and strengthening of bilateral relationships; (3) expansion of regional economic cooperation; and (4) reduction of distrust and concerns with regard to the security issues of countries in the region. In other words, China's traditionally pragmatic and reality-based foreign policy is also being applied to East Asian regional integration, with these four strategic considerations forming the core principles. This regionalism strategy may be regarded as an outcome of the shift in China's overall foreign policy from a passive stance, until the 1990s, to a more active stance since the early 2000s. Lee (2008) argues in this context that the recent change in China's strategic approach towards regionalism manifests China's political intention to (1) tone down the fears of its neighbours about a Chinese threat; (2) show the emergence of China as a more responsible regional and global power; and (3) foster the image of China as a benevolent neighbour that pursues co-prosperity with its neighbours through active participation in regional architecture issues. A number of Chinese scholars and policymakers, such as Yang (2010) and Zhang (2010) cite similar strategic considerations as the main principles of China's regionalism strategy.

In particular, Yang (2010) argues that China's regionalism strategy has been basically guided by the following two factors. First, China felt, like many of its neighbours in East Asia after the 1997 Asian financial crisis, the need for regional cooperation and even integration bodies as insurance against a potential future financial crisis. Second, the Chinese government intends to use the shaping of the East Asian regional architecture and the consequent trade and investment liberalization as instruments to enable the domestic reforms needed for securing sustainable development. Therefore, it would not be wrong to argue that China's regionalism strategy appears to ride on the existing international order, rather than seeking to dismantle it, and is an attempt to participate in regional and global efforts to shape a new East Asian regional order. This more open and positive strategic decision on the part of China seems to have been influenced by the improvement of Chinese-US bilateral relations since the beginning of the 2000s, which has encouraged China to accept the vested strategic interests of the United States to some extent and to accommodate the built-in US presence and influence in the region when shaping national strategy (Lee 2008). Ha (2008) looks beyond this bilateral relationship and suggests that China's regionalism strategy is pragmatic enough to pursue the important ultimate goal of securing persistent and sustainable economic growth by providing a favourable environment.

This basically open-minded regionalism strategy notwithstanding, China sporadically attempts to play a more proactive role in the making of a new international order. Considering China's ever-growing economic and political weight both in the world economy and world politics, this can be understood as China's ambition to position itself as a responsible regional and global power able to play a leadership role in the international arena. From the perspective of Chinese leaders, it may form an integral component of internal policies to foster national prestige in the minds of the Chinese public.

As for the future shape of East Asia's regional architecture, China appears to picture an integrated East Asian community not as an EU-like regional architecture with a strong integrated and unified system, but as a regional construct that evolves gradually from the current multi-layered structure (Zhang 2010). Based on this basic vision of the future of East Asia, China accepts the potential positive role of ASEAN centrality, which should play a leadership role in East Asia's road towards regional integration.[8] It is China's basic strategic consideration that East Asian regionalism eventually has to be constructed as an integrated system. In the process, however, China is keen to accommodate the already-existing diverse systems for a gradual transformation, as Zhang (2010), Yang (2010) and Song and Yuan (2012) suggest.

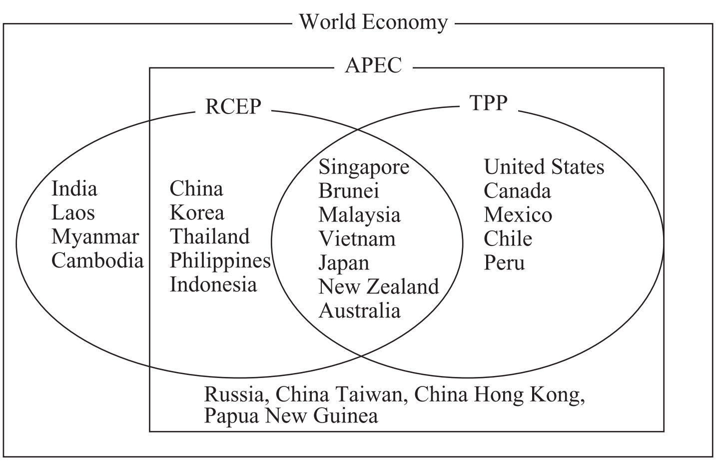
In the context of ongoing discussions on participation in East Asian regionalism, China originally favoured strengthening ties within the framework of "ASEAN + 3", which is envisaging the establishment of an East Asian FTA,[9] rather than expanding membership to wider East Asia, as preferred by Japan.[10] It was only after US participation in the TPP negotiations that China started efforts to promote the RCEP (Regional Comprehensive Economic Partnership), which encompasses three non-East Asian countries—Australia, New Zealand and India—in addition to the member countries of the ASEAN+3 framework.[11]

As for the coverage of East Asian regional integration, China appears to be focusing on economic integration and views the integration of other areas, such as diplomacy and security, as well as culture and society, as too premature at the moment (Zhang 2010). Despite the greater confidence and influence in the regional and global arena that China gained from the recent remarkable economic performance, this relatively cautious policy line might have been influenced by the domestic politics.

5.2 Current State of TPP and RCEP

The TPP was launched as a high-standard FTA for four small and open economies within the APEC process. Established by Brunei, Chile, New Zealand and Singapore in 2005 as a four-country FTA, to be known as the P4 (Pacific Four), the original TPP process did not attract much attention, mainly due to its small size and correspondingly minimal economic impact on neighbouring non-member countries. The decision by the United States in 2009 to participate in the TPP as a full-fledged member has changed the picture substantially. First, the participation of the United States played the role of a magnet, and has since then attracted a number of additional members of APEC to participate in the negotiations. The four-country FTA has been expanded to become a twelve-country FTA, and shows potential to expand further.[12] Second, some analysts view the high standards that the TPP negotiators are pursuing to be a covert effort by the United States to contain China economically and politically (Park 2014). From the perspective of some Chinese scholars, including Song and Yuan (2012) and Jin (2012), the TPP initiative also has the potential to rip the entire project of East Asian regional integration apart.

TPP negotiations accelerated throughout 2009-2013 and the 12 participating countries have convened a total of 19 negotiation rounds. Even though their ambitious plan to conclude the official negotiations by the end of 2013 failed and the negotiating countries face some difficulties due to diverging interests in a number of policy areas, there is a relatively high probability that the TPP negotiations will be concluded successfully in 2014.[13] As already noted, a number of other APEC member economies would like to join the negotiations, and this provides potential ground for greater competition vis-à-vis the RCEP framework.



Source: Author's own figure.

Figure 1 Membership Structure of TPP and RCEP

One distinguishing feature of the RCEP initiative vis-à-vis the TPP is that it comprises those countries in the Asia-Pacific that have already implemented an

FTA agreement with ASEAN, thus giving ASEAN the role of facilitator. Given the ever-stronger economic and political weight of China, many observers expect the RCEP initiative to be "dominated" by China, whereas ASEAN would play the leadership role based on the concept of "ASEAN centrality". In fact, China would like to use the RCEP as a counter-weight to the US-dominated TPP, which has created rivalry between the United States and China for leadership in an East Asian and/or Asia-Pacific regional architecture.

Currently, seven countries are participating in the negotiations on both TPP and RCEP, including four ASEAN members (Singapore, Brunei, Malaysia, Vietnam). From the Northeast Asian region, only Japan participates in the TPP, whereas China and Korea[14] participate only in the RCEP negotiations. Careful examination of the TPP the membership structure reveals another interesting feature: ASEAN centrality is endangered because the ASEAN countries are now scattered into three groups: (1) four TPP-RCEP participants; (2) three RCEP-only participants; and (3) three outsiders with regard to both TPP and RCEP. In this context it appears that the split of ASEAN's membership into three separate groups, which is apparently caused by the TPP initiative, may lead to a nullification of ASEAN centrality. This concern may have mobilized ASEAN members to pursue, in parallel with the TPP negotiations, the RCEP negotiations, in which they can preserve the effective operation of ASEAN centrality and achieve geopolitical balance between the two global powers, the United States and China.

This strategic consideration on the part of ASEAN coincided with the strategic interests of China, as well. Ironically, the start of RCEP negotiations in early 2013 was strongly influenced by the acceleration and expansion of the TPP negotiations, mainly due to the participation of the United States and Japan. Before TPP and RCEP began to function as two competing concepts of regional architecture for East Asia and Asia-Pacific, there were two competing regionalism initiatives in East Asia. On one hand, "ASEAN+3" adopted the East Asian FTA as a long-term goal, which was strongly supported by China. On the other hand, Japan supported the idea of a Comprehensive Economic Partnership for East Asia (CEPEA), which is supposed to comprise Australia, New Zealand and India in addition to the 13 countries belonging to the "ASEAN

+ 3" group. After the TPP initiative gained new impetus through the participation of the United States in 2009 and Japan in 2013, the CEPEA initiative has been favoured by China and ASEAN, thereby providing a competing institutional arrangement against the TPP, albeit under a different name (RCEP). The Chinese support for the RCEP initiative can be viewed as in line with the increasing calls among Chinese scholars and policymakers for China's own FTA strategy, as argued by Hu (2013).

5.3 China's Strategic Choice with regard to TPP and RCEP

As noted in the previous sub-section, the RCEP initiative has been strongly promoted by China since early 2013. According to Hu (2013), China found in RCEP a welcomed opportunity to play a leadership role in shaping the East Asian regional architecture. Especially, setting the pace of negotiation much slower and the coverage and depth of liberalization much lower than the TPP, China is interested in gaining the support of developing East Asian countries. In addition to this more affirmative pursuit of its own FTA strategy with the RCEP negotiations, China has also been trying to use "its monetary resources through different channels" to attract ASEAN member countries (Song and Yuan 2012: 113). The very fact that China recently emerged as the most important destination of exports of almost all East Asian countries, including Japan and Korea, is another factor that might support China's aspiration to compared with the US-dominated TPP initiative through RCEP.

Though showing no strong opposition to the TPP officially, China is expected not to be able to join the TPP negotiations in the near future, mainly due to difficulties fulfilling the strict requirements set by the TPP negotiators.[15] Such negotiation issues and areas as the protection of intellectual property rights, competition policy including state-owned enterprises (SOEs), and liberalization of services, as well as the liberalization of investment regimes, including the investor-state dispute (ISD), are quoted as potentially painful areas for China. Although some Chinese scholars and policymakers have argued that China needs to join the TPP negotiations at a later stage, the great majority of analysts observe that it is merely political rhetoric rather than their genuine intention. Instead, China is expected to promote the RCEP more vehemently, with the final view of constructing a counter-weight against the TPP group, as Hu (2013) argues.

In this context, China's strategic approach towards the APEC's long-term goal of establishing the Free Trade Area of Asia-Pacific (FTAAP) deserves some attention, too. Several APEC meetings since the mid-2000s have adopted strategic decisions that make the increasing sub-regionalism initiatives look like pathways on APEC's road towards FTAAP. At the beginning, the APEC community intended to use sub-regional FTAs as an interim step towards greater APEC-level FTA agreement through merging and docking (APEC 2006). However, APEC adopted a more pragmatic approach of using the successful conclusion of the TPP and RCEP negotiations as pathways towards the FTAAP[16] (APEC 2010). Whereas the earlier approach was focused on limiting and discouraging the proliferation of sub-regional FTAs, the more recent approach intends to make use of the sub-regional FTAs more proactively, thereby utilizing TPP and RCEP as channels towards the final goal of FTAAP. China as a member economy of APEC has fully supported this regime change in APEC's regionalism approach. Though not documented by Chinese policymakers and/or scholars, this strategic position of China can be interpreted in two ways. The first interpretation is that China might have done so because it wanted to maintain the option of joining the TPP negotiations at a later stage. The second possible interpretation is that China, when approving the above APEC decision, did not expect that the TPP would assume the influential status it currently has.

As a result, China seems to have embarked aggressively on the RCEP, thereby challenging the expected increasing influence of the United States on the East Asian regional architecture. With the potential weakening of ASEAN centrality as a leadership instrument for promoting East Asian regionalism as a result of accelerated negotiation of the TPP initiative, which attracted 40 per cent of ASEAN's membership, the outcome of the competition between RCEP and TPP may have negative impacts on East Asia's endeavour to shape its own regionalism. To achieve its proclaimed policy goal of contributing to the East Asian regional architecture, China has to find constructive ways to play a more effective leadership role.

6. Conclusion: How Can China Play a Leadership Role?

The shaping of the East Asian regional architecture faces a number of challenges. The competition between the TPP and RCEP initiatives, which resulted in leadership rivalry between the United States and China, has posed another significant challenge to the East Asian regional architecture, in addition to the two notable challenges of overlapping membership and a leadership vacuum. As ASEAN centrality is endangered especially through the launch and acceleration of TPP negotiations, China's leadership role is more than welcome if there is to be a successful future for the East Asian regional architecture.

It is imperative that any country bear in mind that regional and global leadership require a certain amount of sacrifice. For instance, the United States secured the global leadership role in international trade and investment by maintaining a far more open trade and investment regime than other participants in the multilateral trading system since the launch of the GATT system. This has opened the US market to products from all over the world, and more specifically from the developing countries. Although the United States has now become more prone to regionalism than before, the country's advocacy of free trade under the multilateral trading system had long safeguarded the GATT/WTO system. China's quest for stronger leadership on the question of East Asian regional integration should refer to the experience of the United States.

China can attain the needed leadership role in the following ways. First, China's participation in the TPP negotiations in the near future appears to be the most effective. Though it may be extremely challenging for China at the moment, China's strong commitment to participating in the near future would send an extremely positive signal to East Asian participants in the TPP negotiations. It could also mobilize a number of countries in the region that belong to the second group (RCEP-only negotiators) to take a decision in favour of the TPP, as well. Especially for some East Asian countries that have already declared their readiness to participate in the TPP negotiations, such as Korea and Thailand, it would be a welcome signal to accelerate their participation, which then would weaken the relative dominance of TPP vis-à-vis RCEP. Second, China could attempt to facilitate the RCEP negotiations by providing more incentives to other participants. As China currently is the most important export destination for most East Asian countries, improving their access to China's ever-growing market is in everybody's interest, including Korea and Japan. By opening its market more affirmatively, China could encourage East Asian countries to pay more attention to RCEP rather than to TPP, thereby accelerating the RCEP negotiation process. An earlier conclusion of the RCEP negotiations enabled by such a generous Chinese trade policy would pose a real threat to the TPP negotiation process, and consequently to the US intention to contain China. Third, it appears to be the most desirable way of contributing to the East Asian regional architecture that a CJK FTA be concluded at an earlier stage, which could then be extended to Southeast Asia, in order to finalize the process of regional integration, as noted by Park (2011). If China is successful in mobilizing Korea and Japan to agree upon a common formula of market liberalization and confidence-building through it, with the final longer-term view of peace-building in the region, it would be an excellent way to play the leadership role. Though a number of political hindrances are to be overcome on this road, this third alternative would be an important milestone in the peaceful coexistence of countries in East Asia, especially by way of regional integration.

Notes

[1] For more detailed discussion of the underlying factors, see Park (2013).

[2] http://www.fta.go.kr/new2/ftakorea/ftakorea2010_d.asp (viewed on August 10, 2013).

[3] http://www.mofa.go.jp/policy/economy/fta/index.html (viewed on August 10, 2013).

[4] http://fta.mofcom.gov.cn/english/index.shtml (viewed on August 10, 2013).

[5] This debate is similar to the one that attracted much attention in the mid-1990s, especially on the relationship between regionalism and multilateralism. At that time, "building block" arguments were contrasted with "stumbling block" arguments. For the details, see Park (2006).

[6] Mattli(1999) suggested the following three preconditions for successful regional integration: (1) a common understanding of the potential economic benefits; (2) a common recognition of the necessity of regional integration in economic difficulties; (3) emergence of good-will leadership countries. Park (2011) argues that East Asia has already achieved the first two conditions, whereas the region still encounters enormous difficulties in achieving the third condition.

[7] Choi (2010) suggests that Korea's leadership role should be a soft-power leadership, which combines the country's intellectual and entrepreneurial leadership.

[8] Wang (2011) points also to the "temporary" nature of ASEAN's driver-seat role in East Asia's regional architecture, which was caused mainly by the leadership rivalry between

China and Japan.

[9] The East Asian FTA (EAFTA) was proposed by the East Asian Vision Group in its final report as part of the more comprehensive East Asian Community (see East Asia Vision Group Report 2001). The EAFTA initiative, however, recently gave way to other initiatives, such as TPP and RCEP that encompass wider regional coverage and an expanded membership.

[10] As will be analyzed in the following section, this stance of China on membership has changed as a result of the very recent emergence of TPP and RCEP as competing institutional regional architectures for the Asia-Pacific region.

[11] It is interesting to note that both Japan and China have deviated from their respective traditional stances. The membership of RCEP exactly matches that of CEPEA that had long been promoted by Japan, before the country participated in the TPP negotiations early 2013. China, instead, had to accept ASEAN's initiative to start the RCEP negotiations with countries that have already successfully negotiated an FTA with ASEAN, thereby balancing the strategic moves made by the United States and Japan.

[12] Hu (2013) lists Laos, Indonesia, Korea, Thailand, Taiwan, Colombia, Philippines and Costa Rica as countries and regions that have expressed interest in TPP.

[13] Some analysts point to the major divergence in the interests of negotiating countries on sensitive issues, such as intellectual property and state-owned enterprises, and predict either a failure of the whole negotiation process or a low level of liberalization in contrast to its ambitious agenda. See (Lee and Bang 2012).

[14] It should be noted in this context that in 2013 Korea expressed its interest in participating in the TPP negotiations and has since than started bilateral consultations, which are the first stage of TPP accession.

[15] For a more detailed discussion of the potential gains and losses of China's accession to TPP, see Hu (2013).

[16] The 2010 APEC Summit Meeting adopted a Declaration that contains the following sentence: "An FTAAP should be pursued as a comprehensive free trade agreement by developing and building on ongoing regional undertakings, such as ASEAN + 3, ASEAN+6, and the Trans-Pacific Partnership, among others." See APEC (2010). Even though RCEP was not explicitly mentioned in the Declaration, the membership of ASEAN+6 exactly matches that of RCEP, thus making the interpretation put forward in this paper acceptable.

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Chapter 9
A New Round of Transregionalism: Impact on the G20

He Ping[1]

A new round of regionalism, with transregional and interregional features that transcend traditional geographical boundaries, is taking shape in response to a wide range of new global governance issues, such as the stagnating Doha Round and flawed financial regulations. According to the World Trade Organization's "World Trade Report 2011", "one half of PTAs (preferential trade agreements) currently in force are not strictly 'regional'," and nearly all of the PTAs that have been signed but are not yet in force or are currently under negotiation are interregional (World Trade Organization 2011). This strong momentum has been attracting increasing attention from regional organizations, such as the Inter-American Development Bank and the Asia Development Bank (ADB 2013). Among current forms of transregional cooperation, the Trans-Pacific Partnership Agreement (TPP), the Transatlantic Trade and Investment Partnership (TTIP) and the Regional Comprehensive Economic Partnership (RCEP) are the most important in terms of their size and strategic significance. In this chapter we look at the common features of the different trade arrangements and their impact on the Doha Round trade talks and the G20 from the perspective of a "coalition of the willing".

1. Origins and Goals of Transregionalism

The new round of transregional cooperation has become an important component of economic and trade strategies of major countries across the world. A number of representative mega-foreign trade agreements, such as TPP, TTIP, RCEP and the EPA/foreign trade agreement between Japan and Europe are gradually taking shape (Figure 1). President Obama emphasized in his 2013 Trade Policy Agenda that the United States would join with "willing trading partners" to "constantly seek ambitious, comprehensive, and high standard trade and investment commitments" (The Office of the United States Trade Representative 2013). The United States is stepping up its pursuit of transregional cooperation initiatives, such as Trade and Investment Partnerships (TIPs) and Trade and Investment Framework Agreements (TIFAs) with countries in the Middle East and North Africa, and with regional organizations and blocs, such as the Gulf Cooperation Council (GCC), the East African Community (EAC) and the Association of Southeast Asian Nations (ASEAN). Besides the TTIP negotiations with the United States, the European Union started EPA/FTA talks with Japan in March 2013. In a number of official documents, the EU has emphasized that 90 per cent of world demand will be generated outside the EU in 2015. Emerging from the financial crisis and the sovereign debt crisis, the EU member states have recognized that trade growth is one of the few ways available to them for creating jobs and boosting economic growth without imposing additional heavy fiscal burdens. If the EU concludes its current free trade talks with Canada, the United States, Japan, ASEAN, Southern Mediterranean (Morocco, Tunisia, Egypt, Jordan), India, the South American Common Market (MERCOSUR), the GCC, and the African, Caribbean and Pacific Group of States (ACP), it will add 2.2 per cent to its GDP or EUR 275 billion. In employment terms, these agreements could generate 2.2 million new jobs, accounting for 1 per cent of the total EU workforce (The European Commission 2013d).

Figure 1 Population and Economic Scale of Mega Foreign Trade Agreements in the New Round of Transregionalism (中村志保 2013)

	Scale		Population affected	
	Dollars (trillion)	Global percentage	Population (million)	Global percentage
TPP	27.6	38.5	790	11.4
RCEP	21.2	29.6	3 400	49.0
Japan-EU EPA/FTA	22.5	31.4	630	9.1
TTIP	32.3	45.0	820	11.8

From the perspective of international political economy, the new round of transregionalism is burgeoning for two reasons.

First, this new round is the product of the further extension and deepening of global value chains and production networks. In the representative electronics, automotive and machinery sectors, complete production lines from design and raw materials, through parts and components, and semi-finished products to end products, now not only transcend national boundaries, but also go beyond subregional and even regional geographical constraints. With the increase in outsourcing and trade of intermediate products, the so-called "trade in tasks" identified by Gene M. Grossman has been gradually taking shape outside the traditional trade in end products and services (Grossman and Rossi-Hansberg 2008). Therefore, enterprises' productivity and prices of one nation are closely related to those of other nations. Lowering tariffs and non-tariff barriers for certain products or services not only serves relevant export enterprises, but also benefits other domestic enterprises that occupy the lower end of the value chain and production networks. Tariff and non-tariff barriers may no longer be a "protection" for national enterprises but a "curse". In this connection, the negotiating model of "exchange of concessions" established in the initial stages of the GATT and the WTO is no longer fully suitable in the new international economic and trade landscape. The "trade-investment-services-IP nexus" identified by Richard Baldwin has become the core of international business in the twenty-first century. Although the WTO agenda also involves intellectual rights, investment and trade in services, what concern the Doha Round most are still basically twentieth-century issues. Baldwin even believes that twenty-first-century regionalism threatens to undermine the WTO's role as the world's rule writer and rule keeper (Baldwin 2013).

Therefore, the National Board of Trade of Sweden has proposed to go beyond traditional "offensive and defensive" interests in negotiations and to engage in TTIP negotiations from a global value chain perspective to create a more open and reciprocal environment for export and import enterprises, achieving the integration of trade in goods and services (Kommerskollegium 2013).

The overlap between the networks covered by regional trade agreements signed by Europe, South America and North America, and their global production networks lagged far behind that in Asia and Oceania in 2008. That is to say, partners in foreign trade agreements signed by European and American countries were not their major trading partners (OECD 2013). This is why European and American countries are stepping up their efforts in TTIP negotiations and the EPA/FTA talks with Japan. This trend is reflected not only in the transregional cooperation between developed economies, but also in the nations covered by TPP and RCEP, which are at different stages of economic development. As demonstrated in a number of cases, such as the Japan-Thailand EPA, specialization-based vertical intra-industry trade promotes PTAs between developed countries and developing ones, and these PTAs are an institutional factor in the ability of developing countries to attract transnational corporations in developed countries (Manager 2012).

In addition, since 1959, bilateral investment treaties (BITs) aimed at protecting investors' rights and interests have been increasing exponentially. This requires that the relevant countries become more integrated and provide a set of policy approaches rather than a single one, including but not limited to investment acknowledgment, intellectual property rights protection, labor rights and interests, environmental protection and other things, in order to increase the resilience of global value chains, reduce costs in production, logistics and marketing, and guard against potential risks.

Second, forestalling potential major changes in the international economic and trade environment, while strategically planning for the future, developed countries are seeking rights to write, interpret and execute the new international economic trade rules through a new round of transregionalism.

To begin with, a hierarchy has been established through the PTAs signed between traditional high-income countries and middle-income ones in which the former serve as the hub surrounded by the latter as spokes, while the core is made up of the United States, Europe and Japan (Manager et al. 2012; Bilal et al.2011). However, the rapid rise of emerging countries, especially the so-called BRICS countries (Brazil, Russia, India, China and South Africa), has loosened up the hierarchy. The attempts by the United States and Europe to continue to dominate the making of global economic and trade rules can be regarded as a renewed effort to reshuffle and consolidate the existing hierarchy, thereby resurrecting the Quad in the WTO in a changing international economic and trade landscape. The Quad members—the United States, the European Union, Canada, and Japan—are all engaged in negotiations on TPP, TTIP or the EU-Japan EPA/FTA. In this sense, the new round of transregionalism can also be regarded as the developed economies' institutional response to the challenges created by the rise of the emerging economies. The global economic crisis has not led to increased frictions between American and European countries, but has rallied them under the "Western flag", as proven by the agenda of the Transatlantic Economic Council and their collective behaviour within the G20 (Lagadec 2012). Daniel S. Hamilton, for example, emphasizes that with their relatively declining power, the "normative posture" of the EU and the United States constitutes a comparative advantage. Active defense of and adherence to the liberal international economic order has become a key area of Europe-US cooperation. There may need to be greater push-back on rapidly developing economies through established trade and regulatory mechanisms so as to increase the incentives for them to become truly "responsible stakeholders" in the global economic system (Hamilton 2012).

Daniel W. Drezner has proposed a typology of regulatory coordination based on the divergence of interests between great powers and other international actors. As the two ends of the spectrum, "harmonized standards" and "sham standards" represent low conflict and high conflict, respectively. When great powers are unable to reach agreement among each other but can strike bargains with other countries, the outcome is the emergence of "rival standards". When the great powers face low adjustment costs but other countries have higher adjustment costs, the likely route to coordination is through "club standards", thus increasing the importance of "great power concert" (Drezner 2007). It is not difficult to discern that both the new round of transregionalism (TPP and TTIP) and the traditional G8 (strictly speaking the G7) are taking on the features of clubs.

Likewise, Miles Kahler and David A. Lake propose that besides supranationalism, there are two alternative or supplementary mechanisms. One is "hierarchies" in which a dominant state makes the authoritative decisions, such as dollarization. The other is "networks", based on enduring or repeated interactions among multiple actors typically characterized by reciprocity. However, "networks" lack supranational and legitimate third-party authority to arbitrate potential disputes, such as the Basel Accords (Kahle and Lake 2011). If "hierarchies" still remind us of the theory of hegemonic stability, "networks" reflect regional and transregional cooperation such as TPP and TTIP. The former aims at providing public goods, while the latter provides club goods to specific members.

The new round of transregionalism is not limited to tariff barriers, but also takes in domestic regulation, focusing on a regulatory "race to the top" rather than a "race to the bottom" (The European Commission 2013b). According to United Nations Conference on Trade and Development (UNCTAD) statistics, technical barriers to trade (TBT) are found to affect a large share (30 per cent) of international trade. Sanitary or phytosanitary (SPS) measures affect more than 60 per cent of agricultural products. Quantity control, price control, intellectual property rights, rules of origin, government procurement restrictions, subsidiaries and other non-technical tariffs are major barriers to trade (Nicita and Gourdon 2013). Traditional agreements between the countries of the North are more integrated than those between the countries of the South. Besides, there are claims that the new preferential agreements signed by the EU and the United States are going ever further in their coverage by including provisions in areas that are not currently covered by WTO agreements, such as investment protection, competition policy, labor standards and protection of the environment. This suggests that the EU and US agreements effectively serve as a means for the two hubs to export their own regulatory approaches to their PTA partners, as reflected in the TPP and TTIP talks (Horn et al. 2010).

Kenneth W. Abbott and Duncan Snidal articulate the five stages of so-called "ANIME": agenda-setting, standard negotiation, self-implementation, monitoring, and enforced implementation (Abbott and Snidal 2005). In terms of regulatory standard setting (RSS), governments, enterprises and NGOs are in a triangular interaction, and the role of the latter two partners in enhancing the government's core role in international regulatory setting is irreplaceable, especially in agenda-setting, standard negotiation and enforced implementation (Ibid). Big powers are still major writers of global regulations (Drezner 2007).

Traditionally, national regulation primarily concerns "hard rules", implemented and enforced by governments. By contrast, much of global regulation has traditionally been "soft law", that is, voluntary standards, best practices and the like (Mattli and Woods 2011). The US antitrust agencies, for example, function primarily through the judiciary, relying on state and federal courts to determine the outcomes of cases. By contrast, the European Union and its member states have administrative competition policy regimes, primarily utilizing bureaucratic agencies to render decisions and enforce antitrust laws. Competition policy is therefore regarded as a representative case of "non-regime" in major international agendas, as despite relentless efforts by the United States and the European Union to establish the relevant mechanisms, actual treaty regimes have never been put in place (Dimitrov et al. 2007). The TPP and TTIP initiatives and their progress have enabled major economies such as the United States and the European Union to merge in an unprecedented way based on mutual monitoring, regulatory reforms and policy adjustment, heralding a new era in which a small number of countries set high standards for others. The EU even regards the merger of the US and EU regulatory models as a new public good whose systemic spillover will be able to promote further progress in multilateral trade negotiations (The European Commission 2013a).

2. Impact of the New Round of Transregionalism on Multilateral Trade Liberalization

The impact of the new round of transregionalism is reflected, first and foremost, in its relationship with multilateralism, the continuation and new developments of the debate between traditional multilateralism and regionalism.

The potential benefits to be derived from the new round of transregionalism might diminish the already weak interest of important economies in promoting the multilateral process. Regional and transregional agreements, in fact, provide the best alternative to a negotiated agreement and also increase the likelihood of deadlocks under the WTO (Odell 2009). According to a 2009 estimate by Ecorys, EU GDP would rise by EUR 122 billion a year while US GDP would go up by EUR 41 billion a year, if 50 per cent of the non-tariff barriers between the two sides were removed(Ecorys 2009). A 2010 study by the European Centre for International Political Economy (ECIPE) estimates that, given increased productivity and trade facilitation, the dynamic welfare gains of zero-tariffs are estimated to be USD 58-86 billion for the EU and USD 59-82 billion for the United States (Erixon and Bauer 2009). According to an independent study by the Center for Economic Policy Research, TTIP is likely to bring EUR 119 billion (0.5 per cent of EU GDP) and EUR 950 billion(0.4 per cent of US GDP) in economic gains to the EU and the United States, respectively, and EUR 100 billion to the rest of the world (Centre for Economic Policy Research 2013). A Centre d'Etudes Prospectives et d'Informations Internationales (CEPII) study shows that TTIP could bring a growth rate of 0.3 per cent in GDP and USD 98 billion and USD 64 billion in income growth for the EU and the United States, respectively (Fontagné et al. 2013). A preliminary estimate by the European Commission shows that the growth of trade with the United States would create more than 7 million jobs for the EU (The European Commission 2013b). An estimate by the US Chamber of Commerce projects that removing all the tariffs within five years between the EU and the United States would generate GDP growth of USD 180 billion for each side, and further removing general non-tariff barriers would bring extra growth of 3 per cent for both sides (American Chamber of Commerce in France 2013). A disputed report released by the Bertelsmann Foundation earlier on showed that TTIP will increase the per capita incomes of the EU and the United States by 4.95 per cent and 13.4 per cent in real terms, respectively, and 3.27 per cent globally(Felbermayr et al. 2013). By 2025, the TPP track (including the 12 negotiating parties and South Korea) would yield global annual benefits of USD 295 billion (USD 77.5 billion for the United States), and the Asian track USD 500 billion (USD 1.3-USD 2.4 trillion for FTAAP) (Petri and Plummer 2012; Petri et al. 2012). However, as Gary Clyde Hufbauer and colleagues estimated, the benefits from a Doha Development Agenda agreement are in the USD 63 billion to USD 283 billion range (Petri and Plummer 2012), far below the abovementioned transregional agreements.[2]

What is more important, perhaps, is that constrained by the financial crisis, a sluggish domestic economy and other pressing issues, governments in the major economies lack the determination and popular support needed to advance the multilateral trade process. The "Zeitgeist" that helped to open up and conclude the Uruguay Round are now nowhere to be found (Grasstek and World Trade Organization 2013). The diminishing leadership of the major powers confines the influence of the Doha Round to paper. Scholars with more radical views such as Susan C. Schwab, former US trade representative, have made it clear that the Doha Round is doomed and it is time to give up trying to save it. In his opinion, the dichotomy between developed and developing countries was outdated and the negotiating structure, like the unilateral concessions, special and discriminatory treatment of developing countries and trade facilitation package deals were also obsolete. The best way out of the deadlock is to accomplish a number of smaller, more concentrated bilateral or multilateral negotiations and agreements and to allow like-minded countries to join (Schwab 2011).

Historically, the process of multilateral trade liberalization in the WTO has been driven by corporate interests, notably in the United States and Europe. The early rounds of trade liberalization in the GATT were driven primarily by US private sector interests. The impetus for the Uruguay Round came in large part from the service sector, and especially intellectual property interests, in the United States and Europe. In contrast, the Doha Round has always been plagued by a lack of private sector interest. This absence was the result of a number of factors, mainly bilateral and regional liberalization in goods and services, which has reduced the incentive of major negotiators to negotiate multilaterally. With all this happening outside the WTO framework, Northern countries do not have to expend negotiating capital within the WTO to secure outcomes that their firms are obtaining with lower costs at the bilateral or regional level (Mattoo and Subramanian 2011).

3. Is the G20 Another Effective Platform for Transregional Cooperation?

The magnitude of the collapse of trade in the aftermath of the financial crisis was closely related to protectionist measures, disruptions to the supply of trade credit and the development of global supply chains (Eichengreen 2011). These were also factors leading to the creation of the Group of 20 (G20). However, in the strict sense of a "coalition of the willing", the G20 is not an ideal forum for the new round of transregionalism and lacks the ability to substantially advance trade liberalization within the bloc or globally. Nevertheless, the G20 is still helpful in facilitating communications between major economies, especially in promoting exchanges, dialogue and even consensus between governments.[3]

As the world moves towards greater globalization, the boundaries and rivalry between nations with disparate social systems, ideologies, levels of democracy, degrees of economic development and religious beliefs have been receding. The emergence of the G20 is both a reflection and a product of this trend and is also serving as its engine. However, it cannot obscure major countries' different positions and divergent interests in relation to major issues. As Stewart Patrick points out (Patrick 2011), although the Group of 20, which includes emerging economies, has more "representation" than the Group of 8, with regard to global leadership it harbours more potential crises in terms of its "like-mindedness", and "effectiveness" (Alexandroff and Kirton 2010). Such crises did not manifest themselves at the outset of the global financial crisis when these countries cooperated to prevent financial, fiscal and banking meltdown. But as the financial crisis recedes, and with the G8 recovering from shocks and the G20 agenda expanding, this intrinsic structural deficiency will become increasingly acute.

In terms of trade liberalization, the G20 has not transformed itself from a "crisis committee" to a "global steering committee". G20 member states have proposed, at summit meetings, finance ministers' meetings and meetings of the chairs of central banks, to establish rule-oriented trade and investment mechanisms, resist pressure for protectionism, promote trade liberalization and step up efforts to conclude the Doha Round talks. Trade facilitation assistance has also incorporated in G20 trade policy. Despite all this, the G20's scorecard with regard to market opening is not satisfactory. Overall, the G20 members have refrained from using explicit protectionist instruments during the crisis eras. Instead, most of the new protectionism has come in the form of potentially WTO-consistent use of temporary trade barriers such as antidumping, countervailing duties and safeguards, applied mainly to trade between developing countries in the G20 (Bown and Kee 2011). According to the Global Trade Alert (GTA) report, the rising protectionism after the financial crisis largely came from the G20 members, whose protectionist measures accounted for 58 per cent of global protectionism in 2009, increasing to 70 per cent in 2012, and still as high as 60 per cent as of 19 August 2013 (Evenett 2013). From November 2008 to the end of August 2013, the G20 members had implemented a total of 1 527 beggar-thy-neighbor measures, and 89 per cent of these protectionist measures remain in place. Of the protectionist measures still in force worldwide, the G20 countries are thus responsible for two-thirds. In the five years since the first crisis-era G20 summit, the BRICS have imposed more than twice as many protectionist measures compared with the most developed industrial countries—the United States, Japan, Germany and Canada. From 2009 to 2013, between 60 and 70 per cent of incidents harming G20 commercial interests have had their origins in discriminatory measures taken by G20 members themselves (Ibid).

If the G7/8 embodies the geographical power of the old trilateral world, a key positive feature of the G20 is its cross-regional reach. Not only was the G7/8 deemed the club of the rich; it came to be viewed increasingly as a club of like-minded countries. The participation of rising powerhouses and Southern countries in the G20 is not because they share a common language with G8 members, but because of their economic size, which the G8 cannot afford to overlook (Cooper 2010). The G20 is not only an attempt to achieve a balance of payments, but also a means for emerging powers to check the abuse of power by major industrialized countries (Bayne 2011). Developing countries such as Brazil, India and China, as members of the G20, are enjoying greater presence in decision-making bodies concerned with international economic and trade agendas, making these bodies more diverse, but also increasing the likelihood of ineffective negotiations and deadlocks (Narlikar 2010). As manifested in the Doha Round talks, the core of the debate between developed countries and emerging economies is not technical details, but different perceptions of equality, democracy, justice, development and other basic values, which are unlikely to be moderated in the short term.

On the other hand, the G20 cannot represent all countries either. The 150-odd nations outside the G20 risk becoming "the marginal majority". Singapore and 27 other small or medium-sized countries have formed an informal coalition known as the "Global Governance Group" in an attempt to respond to or even counterbalance the G20 (Payne 2010). On one hand, the size of the G20 countries entails a decline in "informality" and government leaders' "comfort zone". On the other hand, the G20 has not been able to fend off criticisms that it is still an instrument of concerted power (Cooper and Thakur 2013). Many even believe that the conflict and rivalry between the "liberal order" advocated by Europe and the United States and the "emerging powers", represented by BRICS, is the inevitable result of the relative decline of the former and rise of the latter, and will persist and even escalate as their positions and views continue to differ. Therefore, the G20 cannot address the contradiction between efficiency and democracy with regard to WTO decision-making; it may even worsen it. The G20 cannot replace the WTO; it can only provide external support by adhering to its rules and regulations (Narlikar 2010).

4. Conclusion

On 7 December 2013, nearly 20 years after the WTO's inception, the Bali Package, the first multilateral agreement under the WTO, was concluded, marking an interim outcome of the difficult Doha Round talks. The new round of transregionalism has generated pressure for this breakthrough, and the interaction between the two has provided relevant countries with more policy options. On one hand, regional arrangements have a role to play as it may be desirable that some policy regimes are supra-national but sub-global. Regional arrangements may also be "testing grounds" for innovations in policy coordination and harmonization, and thus help in identifying well-designed global policies (Pomfret 2007; Crump 2006; Crump 2007). As European integration and the establishment of the North America Free Trade Area have promoted the multilateral trade process, the new round of regional and transregional integration represented in TPP, TTIP and RCEP should also move in this direction. At the same time, the WTO can learn from the Asia-Pacific Economic Cooperation (APEC) about setting spontaneous multilateral best practice guidelines and related consulting centres to improve the transparency of the Committee on Regional Trade Agreements (CRTA), thus responding more effectively to the challenges of the new round of transregional cooperation.

On the other hand, as the best option to achieve multilateral trade liberalization, the WTO should also attempt to discuss the so-called non-Doha issues that have emerged over the past decade, and try to make more interim breakthroughs by plurilateral agreements, while multilateral agreements seem difficult to reach, so as to maintain the favorable momentum for multilateral trade liberalization (IMF 2011). Both the Doha Round and the WTO provide a means of reducing protection and trade commitments, and institutions for rule-making and monitoring. The addition of new issues is very important to ensure that multilateral negotiations keep looking forward(Hoekman 2013). In fact, apart from multilateral package deals, the WTO does not lack plurilateral agreements based on reciprocity and sectoral agreements based on the "critical mass" principle, for example, the Agreement on Government Procurement, the Agreement on Trade in Civil Aircraft and the Information Technology Agreement. By 2012, only 34 of the 158 WTO members (around 21.5 per cent) had entered fully into all the three agreements, including the European Union and its 27 member states (Grasstek and World Trade Organization 2013). In this sense, a limited number of countries meeting the higher standards on specific issues is not something to be concerned about for the WTO and the multilateral process, but a favorable condition for making breakthroughs in the current deadlock.

Notes

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[2] Hufbauer's estimate is only one of the many other projections. An IMF study showed that, taking into consideration the role of trade liberalization in increasing company productivity and expanding exports, the Doha Round might increase global GDP by 0.2-1.4 per cent or USD 150-900 billion (see IMF, "The WTO Doha Trade Round-Unlocking the Negotiations and Beyond", 16 November 2011). For other estimates, see Antoine Bouët and David Laborde, "Eight Years of Doha Trade Talks: Where Do We Stand?", IFPRI Issue Brief 61, November 2009; Yvan Decreux and Lionel Fontagné, "Economic Impact of Potential Outcome of the DDA", CEPII, Working Paper, No.2011-23, 2011.

[3] John Kirton (2013) has carefully examined the views of various schools on the G20. He has a rather high opinion of the G20, even thingking that the group has become the systemic hub of global governance.

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Chapter 10
A Critique of the G20's Role in UN's Post-2015 Development Agenda

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As the project of the United Nations Millennium Development Goals (MDGs) will end in 2015, forging the Post-2015 Development Agenda has been under debate: should it remain focus on the MDGs or should the focus be expanded to include the Sustainable Development Goals (SDGs). Generally speaking, the developed countries are more concerned with guiding the direction of global development within the framework of norm-building, with the aim of embedding more political and social standards and values in the post-2015 development process by imposing conditions on development resources. This may deviate from the gist of poverty reduction and development under the MDGs. In contrast, the developing countries generally prefer to construct the Post-2015 Development Agenda on the basis of the MDGs and oppose the diminution or even the complete replacement of MDGs with SDGs. Such debates reflect countries' different stages of development, and thereby their different interests and demands. This has led to a mismatch of visions and strategic focus in drawing the blueprint of global common development. It remains uncertain that whether the Post-2015 Development Agenda sponsored by the UN could unify the various development views into a common goal of the international community and provide guidance on global coordination efforts to promote development. Compared with the United Nations, the G20 has a smaller membership, which might be conducive to better coordination and hence enable it to play a complementary and supportive role with regard to the Post-2015 Development Agenda. If the G20 can make substantive efforts in critical development areas, this will greatly benefit effective implementation and coordination actions on international development cooperation.

1. The G20 and the UN Post-2015 Development Agenda

The G20's concern with the UN Post-2015 Development Agenda arises mainly for two reasons.

First, the G20 seeks to reverse the marginalization of the G20 development agenda. The development agenda is not a new issue for the G20, but for a long time it was not a core concern. The G20 Ministerial Meetings that held before the global financial crisis hit in 2008 already reflected the concern in the development agenda. In June 2010, the G20 Toronto Summit Communiqué touched upon development issues and announced the establishment of Development Working Group (DWG). According to the Communiqué: "reducing the development gap and poverty has become an integral part of robust, sustainable and balanced growth and securing a stronger and more flexible world economy."[1] The concern was first made a core item of the G20 agenda at the Seoul summit held in November 2010: development, exchange rates, the global financial safety net and the reform of international financial institutions formed the four core issues. However, the development agenda had not been the focus of G20 Leaders' Meetings.

The fact that the development agenda was one of the key items on the agenda of the G20 Seoul Summit was due to the strategic interests of South Korea. As a new member of the OECD's Development Aid Committee (DAC),[2] South Korea wanted to boost its international clout from G20 as an important platform for multilateral cooperation. With the experience of rising from being an aid-receiving country to a member of the club comprised of major donor countries around the world, it was conducive to enhancing South Korea's soft power, to promoting exchanges of experience, and to advocating international development cooperation. The G20 summit was a showcase. The *Seoul Development Consensus on Shared Growth* stated the strategic concerns about taking development issues as the main agenda item. It mentioned that, as the premier forum for international economic cooperation, the G20 has a responsibility to complementing the efforts of aid donors, the UN system, multilateral development banks (MDBs) and other agencies, to help developing countries to achieve the MDGs.[3] In order to enhance the implementation capability of the G20 in development area, the Seoul Summit also set up the Multi-Year Action Plan (MYAP), which established nine pillars for the development agenda: infrastructure, human resources, trade, private investment and job creation, food security, flexible growth, financial inclusiveness, domestic resource mobilization, and knowledge sharing. In order to realize the relevant objectives, MYAP laid down six principles.[4] In 2011 at the G20's Cannes Summit, the development issue was among the main topics, albeit was ranked last but one. Considering the deteriorating situation in the euro zone, the Cannes Summit put the issue of restoring confidence in the euro zone at the top of the agenda, addressing the international monetary system, social issues, financial regulation, and development. The Cannes Summit continued with the nine pillars that laid down at the Seoul Summit, with a particular focus on food security, infrastructure, and development financing. In 2012 the Los Cabos Summit focused on infrastructure, inclusive green growth, and food security.[5] The 2013 St. Petersburg Summit emphasized four of the nine pillars of Seoul Action Plan: food security, financial inclusion and remittances, human resources, infrastructure, and mobilization of domestic resources.[6]

However, development issues seem to have gradually become marginalized at G20 summits. As a "leaders' summit", the G20 can hardly influence leaders from G20 member countries on agenda-setting, in particular the leaders of major powers. At the Seoul Summit, it had been hoped that development could become the G20's main issue. However, due to the change in the US Federal Reserve's monetary policy and the ending of so-called "QE2", the topic of "currency wars" unexpectedly became the focus of this summit. Countries with different levels of national income or from different continents all expressed great concern on this issue, including developed countries such as Germany, emerging economies such as Russia and Brazil, and South Africa from the continent of Africa. The immediate effect of quantitative easing in the United States was a major depreciation of the US dollar, triggering a rise in commodity prices and speculative capital flows into emerging markets. This severely endangered the stability of global financial markets and the steady economic development of emerging market economies. It also manifested that the G20 summit, then only three years old, was largely a contingency mechanism. The situation remains the same today. Although everyone recognizes the importance of development, it is impossible to make it the most important and urgent topic on the agenda. In 2011 at the G20's Cannes Summit, the euro zone crisis was the focus, at the expense of the development agenda. And at the St. Petersburg Summit in 2013, in turn, it was the Syrian crisis that dominated. Given the contingent basis of the G20, it is difficult to confer the same urgency on long-term development issues as on such hot topics as QE2. Although it is regarded as the premium forum for global economic affairs, it is still hard for the G20 to coordinate and balance between short-term contingency issues and long-term global economic governance. However, this situation may be changed because development is the most important and urgent topic in the long term, despite short-term reluctance to address it.

It would therefore be wise for the G20 to remain in alignment with the UN Post-2015 Development Agenda in order to find a solution to the dilemma of the marginalization of development issues.

Second, the focus on the UN Post-2015 Development Agenda is conducive to institutional transformation of the G20. With the impact of the global financial crisis gradually receding, the G20 needs to transform itself from a crisis response mechanism into a long-term governance mechanism. To achieve this, the selection of issue areas is crucial. Development is an appropriate long-term topic.

On one hand, it would help to enhance the effectiveness of the G20. As the main forum for global economic affairs, the G20's role depends greatly on the political willingness of major economies. In order to secure the G20's central role and vindicate the voices of developing countries in global economic governance, it's necessary for the G20 to discuss development. The involvement of the G20 in the UN Post-2015 Development Agenda raises its international profile and influence. It also provides a channel for its interaction with other relevant international organizations.

On the other hand, it would help to increase the G20's legitimacy and to expand its relations with the developing countries, global major donor countries and emerging donor countries. The development issue has great significance for the G20. First, development and poverty-reduction have long been a critical issue for developing countries. If the G20 becomes a global coordination center for development cooperation, it would be easier to address the problem of fragmentation with regard to development, which would definitely be good news for the global development agenda. Second, the development issue is intrinsically linked to other issues of global economic governance. There will never be strong, sustainable and balanced growth without real development in developing countries. Third, the current G20 development agenda encompasses four main topics: infrastructure, food security, human resource and green growth. The G20 deems economic growth to be the foundation for realizing these development goals, however. These goals also overlap with the goals laid down in both the MDGs and the SDGs. It is clear that the G20's involvement in the development agenda will be a mutually beneficial process.

2. Feasibility of the G20's Involvement in the UN Post-2015 Development Agenda

Although the development agenda has been a major topic of discussion at G20 summits, there has been more and more discussion on whether the G20 should focus on development exclusively and whether such a focus can really make a difference. The objections to the G20's focus on development are mainly based on two grounds: first, it is an inappropriate mechanism; second, there is a problem of overlapping mechanisms.

The issue of inappropriate mechanisms focuses on the G20's institution-building and inherent nature. In terms of institution-building, the G20 has a rotating presidency which is not appropriate for focusing on long-term topics such as development, which need continuous support, and may impair the organization's effectiveness. Furthermore, the G20 is more of a decision-making mechanism than an implementation mechanism. The lack of implementation capacity makes it hard to bring about substantive outcomes in the development field. In terms of its nature, the G20 is a political organization with strong political clout. A more efficient approach to development is thus to persuade other institutions to make more contribution to development and to provide more aid, rather than attempting to do all these things by itself. If the G20 had a much wider and more diverse agenda, it stifles it. In the view of Barry Carin, the G20's development agenda is a white elephant, with a decorative but not a substantive effect. A better option would be to keep global development on the G20 agenda but not to "mainstream" it. As Carin observes, the G20 should add an issue to its agenda if there is a vexing problem with major implications for all its members and which is unlikely to be resolved elsewhere. The G20's role should be clear, with prospects for strengthening other international institutions and for a probable positive outcome that would enhance the organization's credibility (Carin 2013a).

The problem of overlapping mechanisms can be described as follows. There are already so many international institutions in the development area, including the UN, the World Bank, and the OECD at global level, with various regional development banks such as the Asian Development Bank and the African Development Bank, as well as many bilateral development aid institutions. The G20 does not need to replicate their efforts. Apart from anything else, the G20 has no special advantages compared with these organizations, which makes it hard to make a prominent contribution to development. Professor Robin Davies of Australia's National University frankly criticizes the current development agenda of the G20 as lacking in substance, loose in structure and toothless (Davies 2013).

Those favourable viewpoints of including development in the G20's agenda talk mainly in terms of enhancing the legitimacy of the G20 and long-term development of G20 mechanisms. Since its establishment the G20 has been dogged by the problem of legitimacy. The G20 member countries account for 85 per cent of world GDP and almost two-thirds of the world's population, but the non-G20 countries are greatly dissatisfied with it. In their eyes, the G20 is too dominant in global economic governance. To solve this problem, the G20 has been making great efforts in the past five years to enhance its representativeness and legitimacy by accumulating opinions from such forums like Think 20, Civil Society 20 and Business 20. It was against this background that the development issue gradually became one of the core items on the G20 agenda, because it concerns with the interests of developing countries. In the view of Professor Mike Callaghan of Australia's Lowy Institute, "development is a priority for the G20. At the most basic level, G20 members must be concerned not only with their own economic prospects, but also with the implications of their policies for non-G20 members, particularly low-income countries. Moreover, the advancement of developing countries should be an important focal point in the quest for strong and sustainable global growth. And it is a two way process" (Callaghan 2013).

In the interest of the long-term development of G20 mechanisms, the inclusion of the development issue would help to transform the G20 from a contingency mechanism to the steering committee of global economic governance. There is no doubt that it was due to the global financial crisis that the G20 was upgraded from a ministerial meeting to a leaders' summit. In 2007 the subprime crisis broke out in the United States, which later turned into a global financial crisis. In November 2008, the first G20 summit was held in Washington. Then in April and September of 2009 the G20 leaders held their second and third summits in London and Pittsburgh. The three summits that held within one year provided an opportunity for the leaders of the major economies to meet and to advocate cooperation and consensus-building. It played an indispensable role in stabilizing global financial markets, taking joint measures to address the economic recession, and consulting on the future development of the world economy. However, with the gradual easing of the financial crisis, the issue of how to transform the G20 smoothly into a regular mechanism of global economic governance has come more and more to the fore. The legitimacy of the G20 stems mainly from its effectiveness in addressing the crisis. However, it has not been easy for the G20 to continue to play an effective role in global economic governance. Because of this, the development issue should be a core item in the post-crisis G20 agenda. Development and poverty reduction are of long-term significance for the large group of developing countries, but the outcome of development cooperation has been influenced by various factors, including the problem of fragmentation, particularly in relation to action and finance. If the G20 became the coordination center for global action on development, it would be a good news for the global development agenda. Furthermore, the G20 Pittsburgh Summit established its role as the premier forum in international economic affairs and the development issue should clearly be part of that. There would never be strong, sustainable and balanced growth without economic development in developing countries.

In brief, the debates on the G20 development agenda show that five years after the holding of the first G20 summit, there is still great uncertainty over the future development of G20 mechanisms and its competence and role. There is also a possibility that the United States may gradually reduce its involvement in the G20 in the post-crisis era and the G20 may be marginalized. Hence the G20 needs to include more long-term economic issues, such as development. The development issue is also inseparably related to other global economic issues. The problem is how to turn the G20 into a major forum for coordinating global development and the focus is the Post-2015 Development Agenda.

The Seoul Summit showed that the G20 clearly and objectively recognizes its role and focus in the development area. The G20 stressed its role as a complementary one with a view to improving the current international development aid system, rather than replacing or guiding it. International development aid has long been obsessed with the problem of fragmentation, with the donors, aid distribution and aid funds, which all manifest such a trend. The international community has never reached a conclusion on the debate over the necessity and the effectiveness of development aid. As for the G20, it is essential for it to play a different role in the international development aid system, which already has overlapping institutions. As the premier forum for international economic issues, the G20 has the capability to play an active role in promoting the international development consensus, in particular in terms of assisting the relevant United Nations agencies in realizing the MDGs and promoting the building of a development consensus on the Post-2015 Development Agenda.

The Seoul Development Consensus for Shared Growth designated the G20's focus in the development area as "development partnership" and "outcome-oriented", which means that the major concern of the G20 in this area should be to promote a more equal development partnership and outcome-oriented international development cooperation.

3. The Role of the G20 in the UN Post-2015 Development Agenda

What role can the G20 play in international development cooperation, as well as in relation to the Post-2015 Development Agenda? The 2013 G20 summit in St. Petersburg answered this question. The Russian government clearly mentioned this point in its summary of the outcome of this summit: "The UN is currently shaping its Post-2015 Development Agenda, and the G20 is committed to assisting the UN in this endeavor."[7] In the *St. Petersburg Development Outlook*, it said that: "The G20 seeks to complement international efforts towards further progress on internationally agreed development goals. The Agenda takes account of the outcomes of the UN High-Level Plenary Meeting on the MDGs, as the as the processes such as the Fourth UN LDC Summit, the 4th High-Level Forum on Aid Effectiveness and the United Nations Conference on Sustainable Development (Rio + 20). We seek to ensure that the future G20 development agenda is flexible enough to respond to the Post-2015 Development Agenda."[8]

However, there are also negative views on the G20's supportive role, mainly concerning the extent of the G20's implementation capacity. Professor Barry Carin believes that the G20 is only a secondary player in the development area (Carin 2013a). Although the G20's declarations and leaders' statements have widespread effect, there is still significant competition in shaping the global discussion. The president of the World Bank is pushing for the eradication of poverty by 2030. The United Nations will monopolize the debate for the next 18 months, discussing the Rio+20 sustainability goals and the post-2015 successor to the UN Millennium Development Goals. However, the G20 can influence the future research agenda, posing specific questions, and issuing remits to be reported on at future G20 meetings. However, constrained by its limited implementation capacity, it is difficult to attract the (limited) resources of international development organizations to be put under the G20's framework.

In fact, the G20 played a role in setting the Post-2015 Agenda. On one hand, at the Toronto Summit, it established the working group on development, accompanied later by the Seoul Development Consensus for Shared Growth at the Seoul Summit. The following Cannes, Los Cabos, and St. Petersburg Summits have shown a persistent focus on the development issue. The 2013 St. Petersburg Development Outlook clearly stated that the G20 will assist the UN in pushing forward the Post-2015 Agenda. On the other hand, since the outbreak of the global financial crisis, every G20 summit has stressed the importance of strong, sustainable and balanced growth. Discussing growth and development together has become a great contribution by the G20 as the premier forum for coordinating international economic affairs.

If the G20 is to play a greater role in the development field, especially with regard to the Post-2015 Agenda, it should not be limited to presenting advice and reporting to the UN. The G20 should create a new institution to fill a gap in the global governance development architecture, similar to the Financial Stability Board. A new Global Development Council could be established on the basis of the Working Group on Development. Currently, there are many global, regional and bilateral international development and aid institutions, as well as even more non-governmental development organizations, which have great difficulty in coordinating with each other. Hence the G20 could exploit its status as principal forum for international economic affairs to make a difference in international development cooperation. Based on fully harnessing its role as a leaders' summit, the G20 could improve its weak implementation capacity through national commitments and mutual assessment processes, enabling it to make a substantial contribution to the Post-2015 Development Agenda. The leaders attending G20 summits represent their own countries. Therefore, even if the commitments they made are not binding under international law, they are manifestations of national image and national action, which has an intangible but relatively strong soft constraint effect.

If the G20 could harness its coordinating power and try to make a substantive contribution in the development area, it may still play an influential role in the UN Post-2015 Development Agenda. To achieve this, the G20 can take the following measures.

First, it can coordinate various positions to achieve consensus on the UN Post-2015 Development Agenda. Many international institutions and agencies with wide-ranging opinions are involved in setting the development agenda. The UN Secretary-General set up a UN working group[9] mandated in particular to forge the Post-2015 Development Agenda. He also set up a High Level Panel of Eminent Persons and designated a Special Advisor on Post-2015 Development Agenda. In the meantime, work on the Sustainable Development Goals set by the Rio+20 Conference Outcome Documents is in process. There is also an open working group composed of 30 members with the mandate of presenting drafts on Sustainable Development Goals for the 68th UN General Assembly (2013—2014). The Rio+20 Summit Outcome Documents provided that the drafting of Sustainable Development Goals should be combined with the Post-2015 Development Agenda. There is also the Development Policy Committee under the ECOSOC, which provides inputs and advice on emerging inter-sectoral development issues. The members of this committee are also working on conceptual issues related to Post-2015 Development Agenda.[10] Besides UN agencies, some regional organizations, such as the EU and various NGOs, have given their views and advice on the UN Post-2015 Development Agenda. It has been a challenge to effectively coordinate and integrate advice on the development agenda from the world and to strike a balance among different interests to make efficient use of global resources.

The G20 can support the UN on the Post-2015 Development Agenda. Barry Carin has proposed that the G20 could try to simplify the agenda, because it may be easier to achieve consensus within the G20 than in the UN. It may be feasible to merge the visions and objectives of Post-2015 Agenda to form a limited number of guarantees with substantive contents and time-constraints (Carin 2013b). In terms of its membership, the G20 includes traditional donor countries, such as the United States and the EU, and emerging economies, such as the BRICS. It also includes certain medium-sized powers, such as Canada and South Korea. Therefore, it not only covers—with its strong representativeness-the major actors in international development cooperation, but also has the capacity to achieve consensus due to its limited membership. The G20 may become a mechanism for communication and cooperation between the traditional and emerging donor countries. In terms of representativeness, the G20 is superior to those existing multilateral development cooperation mechanisms, such as the OECD.

Second, it can establish a Global Development Council to integrate the fragmented global development governance. The G20 should not be reduced to just an advisor to the UN if it intends to have greater role in development and the Post-2015 Agenda. It may be possible for the G20 to set up a mechanism to mend the gaps in global development governance. Like the Financial Stability Board (FSB), it may set up a Global Development Council on the basis of the Working

Group on Development. As already mentioned, there are a great number of global, regional and bilateral international development and aid organizations, as well as many NGOs, therefore, coordination is becoming a major problem. The G20 may make a contribution by coordinating international development cooperation, based on its role as premium forum for international economic affairs. It can also make full use of the leaders' meeting to improve its implementation capabilities through national commitments and mutual assessment.

If the Global Development Council becomes a reality, it would be conducive to forging consensus and setting goals for the UN Post-2015 Development Agenda, as well as for better coordinating and cooperating among major international development organizations, such as the OECD, the World Bank and regional development banks.

Third, it can focus on certain essential development sectors, to make a substantial contribution to the UN Post-2015 Development Agenda. The G20's contribution to the Post-2015 Development Agenda will not be limited to setting objectives and principles. More importantly, it will involve guiding and implementing work on the realization of global development goals. Infrastructural deficiencies have long been a bottleneck restraining further development in developing countries, in particular transnational and transregional infrastructure. Due to concerns about the long investment cycles, the large scale of investments and investment risk due to political instability in some countries or regions, the private sector has a limited role to play in infrastructure-building. The governmental role has therefore received more attention. In recent years, research and investment on infrastructure has been increasing. The World Bank and some regional development banks, such as the Asian Development Bank and the African Development Bank—and even the BRICS Development Bank, which is still in its preparatory stages—all have a great interest in development financing for infrastructure-building. The G20 members include major global donors, which has made it possible to make a major contribution to infrastructure-building in support of the work of UN development-aid agencies, the World Bank, and other multilateral development banks. In 2014, Australia takes the presidency of the G20 summit in Brisbane. In his speech as in January 2014 at the Davos World Economic Forum, Australian Prime Minister Tony

Abbott delivered a speech that spoke highly of the achievements made in global poverty reduction and development during the past decade. He stressed that Australia would make strong growth the thematic issue of the 2014 summit as it is the key to all global problems. In the speech, Mr Abbott dubbed himself an "infrastructure prime minister" and expressed the hope that the Brisbane Summit would see decision-makers, financing institutions and contractors join together in forging a feasible infrastructure financing plan for a long period of time.[11] The Communique of the G20 Meeting of Finance Ministers and Central Bank Governors held in February 2014 made it clear, in Article 7, that it is committed to create a good investment climate for promoting investment in infrastructure and SMEs. It also stressed that this has been crucial to global economic growth in the medium and long term, therefore encouraging private investment in the infrastructure sector.[12]

The G20 can include the goals and plans of its member countries with regard to infrastructure-building in its support framework and make those part of its contribution to the Post-2015 Development Agenda. In 2013, Chinese President Xi Jinping presented plans for infrastructure-building in the Silk Road Economic Area and the Maritime Silk Road, as well as preparatory work on the establishment of the Asian Infrastructure Investment Bank. The G20 should show its support and encouragement for such initiatives, because such large-scale trans-regional infrastructure-building has great potential for stimulating economic growth. It will provide considerable support for the 2 per cent growth goals over the next five years to increase global aggregate GDP.

In the meantime, China can also use the G20 platform to obtain more international support. Chinese Foreign Minister Wang Yi made it clear that "the Silk Road Economic Area and Maritime Silk Road are characterised by economic cooperation, people-to-people communication and cultural exchange. The priority is to promote connectivity and trade and investment facilitation. This will be done through equal consultation and gradual promotion. The goal is clear, namely, mutual cooperation and win-win outcomes and forging a community of interest. It is an open-ended initiative, parallel with existing mechanisms in the region. We welcome all the countries in the region or with an interest in joining the initiative. We could obtain common benefits through common discussion and common work". Chinese Deputy Foreign Minister Li Baodong directly stressed the role of infrastructure-building as common concern for the APEC and G20 in terms of creating momentum for global economic growth:

> Infrastructure building is productive investment that can increase domestic demand, employment, and productivity, and also be conducive to foreign trade and investment facilitation, leading to more efficient and effective flows of people and commodities. The APEC has been in the vanguard in this respect. Its next step is to further deepen relevant work by designing the blueprint for Asia-Pacific connectivity so as to enhance overall infrastructure and connectivity building in the areas of software, hardware, and people-to-people interaction and cultural exchange. The involvement of the G20 should focus more on creating a favourable investment climate for infrastructure-building and demanding more investment from multilateral development banks.[13]

Generally speaking, it is feasible for the G20 to include infrastructure-building as an area of major concern. This has the support from both China and Australia, the incumbent G20 presidents.

Fourth, regional cooperation mechanisms should be mobilised in order to obtain more support at regional level for the UN Post-2015 Development Agenda. The G20's support and complementary contribution does not mean that it has a secondary role. As the premier forum for global economic affairs, the G20 not only needs to present a solution for specific economic governance issues, but also to work on network building for global economic governance. Regional economic governance is an important dimension of the global economic governance network. A global economic governance institution to coordinate various regional mechanisms has long been in lack. The G20 an use the post-2015 development to improve its communication and cooperation with regional economic governance mechanisms, for securing consensus building on and subsequent implementation of common development goals.

In the second half of 2014, the APEC Leaders' Meeting will be followed by the G20 summit. As respective chair countries of the G20 and APEC, Australia and China have consulted on how to enhance communication and mutual support on related issues between the two mechanisms. On 15 April 2014, the two countries each delegated a think tank to co-sponsor the G20-APEC regional coordination meeting in Shanghai. Both the Australian G20 Sherpa Ms Heather Smith and Chinese Deputy Foreign Minister Mr Li Baodong have expressed positive views on coordination and cooperation between the two organizations. The joint press report released after the meeting mentioned that "APEC and G20 could take joint actions in terms of such areas as structural reform, connectivity, investment and infrastructure building, and trade [...] APEC and G20 should enhance their cooperation to increase the positive effect on regional and global economy and take joint actions to promote reforms in trade and economic areas of APEC and G20 member economies"[14]. It seems that we can take this opportunity to establish a liaison mechanism between the G20 and APEC and provide an example for more institutional connections between the G20 and regional mechanisms. There will be three benefits from this: first, strengthening the connection between issues discussed by the G20 and APEC to pursue joint efforts to promote global economic growth; second, stabilizing the role of the G20 as the premier forum for global economic affairs and creating a new approach for the G20 in establishing connections with other regional cooperation mechanisms; third, promoting APEC's influence by using the G20 platform to draw more international attention to APEC issues and processes.

Fifth, the B20 within the G20 summit framework could provide micro-level support for the Post-2015 Development Agenda, as an indispensable channel for enterprises to join global development cooperation. The B20 is a business summit within the G20 framework and is comprised of entrepreneurs from G20 member countries. The B20 is also an important channel for the implementation of G20 decisions. The G20 will lack implementation capabilities for its efforts in economic growth, job creation, and improving the business environment without participation and support from the enterprise level. Australia Prime Minister Abbot correctly opined that: "if our national economic policies cannot bring profits for enterprises, these policies will have no effect at all." He stressed that all countries faced the challenge of promoting sustainable economic growth and that the business sector played a major role in increasing growth and employment.[15] This does not mean that the G20's agenda should be adjusted according to the preferences of entrepreneurs. Nevertheless, we must be aware of the insights and advice of enterprises on the operation of the micro-economy, which are critical to the realization of the economic goals of sustainable economic development and job creation.

In 2014 the B20 will focus on a package of clear and feasible recommendations on growth and employment promotion. There are several working groups comprised of about 300 people, holding periodic meetings, that has engaged in preparatory work for the B20 meeting to be held on 16-18 July. After that, the B20 has a dialogue with the G20 trade ministers on 19 July and with the G20 Finance Ministers on 20-21 July, preparatory to the B20 Enterprise Leaders' Summit to be held on 14-15 November. Their ultimate goal is to provide recommendations to the G20 Leaders' Summit to be held on 15-16 November. Besides, the B20 also has a liaison mechanism involving the Labor20, Think20, Youth20 and Civil Society20. Currently the B20 Working Groups work mainly on four issues: financial development, human resources, infrastructure building and investment, and trade. It is estimated that there will be about 57 trillion dollars of global capital demand for infrastructure and investment, with a capital gap of about 20 trillion dollars based on current capital sources.[16] It will be a crucial element in closing the capital gap to promote the participation of enterprises and the private sector. It would not be sufficient to rely solely on government resources in global development cooperation. The microfoundations for economic development lie in the development of private enterprises. For developing countries, it has become the foundation for finding a solution for employment and sustainable development to set up and support the development of more SMEs. As a platform comprising both multinational companies and SMEs, the B20 can provide objective and effective policy advice for creating a better business environment. It has played an important role in achieving and implementing consensus among G20 leaders. Therefore, the G20 can make better use of the B20 platform to provide an implementation mechanism for the UN Post-2015 Development Agenda and to build bridges between the UN-sponsored global development agenda and private enterprises around the world.

4. Conclusion

As Mr Wu Hongbo, United Nations Under-Secretary General for economic and social affairs put it, the UN Post-2015 Development Agenda should turn human development into real sustainable development. The MDGs are the cornerstones and basis of the SDGs. The MDGs could ensure that in our lifetimes we build a poverty-free and sustainable world for future generations (Wu 2013). As the premier forum for coordinating international economic affairs, the G20 has both responsibility and the capacity to build a sustainable world based on collective development.

Notes

[1] Toronto Declaration, 26-27 June 2010, http://www.g20.utoronto.ca/2010/g20seoul-consensus.html, Last accessed February 7, 2014.

[2] South Korea formally joined the OECD in 1996. In 2010, it became a member of the OECD's Development Aid Committee (DAC), making South Korea the first country to switch from being an aid-receiving country to a DAC member country.

[3] Seoul Development Consensus for Shared Growth, Seoul, November 12, 2010, G20 Information Centre, http://www.g20.utoronto.ca/2010/g20seoul-consensus.html.

[4] "Multi-Year Action Plan on Development", Seoul, 12 November 2010, online at: http://www.g20.utoronto.ca/2010/g20seoul-development.html, accessed on 11 March 2014. The six principles are as follows: (1) Focus on economic growth. Be economic-growth oriented and consistent with the G20 Framework for Strong, Sustainable and Balanced Growth, which requires a narrowing of the development gap. More robust and sustainable economic growth in LICs will also go hand-in-hand with their capacity to achieve the MDGs. (2) Global development partnership. Engage developing countries, particularly LICs, as equal partners, respecting their national ownership and recognizing that the most important determinant of successful development is a country's own development policy. (3) Global or regional systemic issues. Focus on systemic issues where there is a need for collective and coordinated action, including through South-South and triangular cooperation, to create synergies for maximum development impact. (4) Private sector participation. Promote private sector involvement and innovation, recognizing the unique role of the private sector as a rich source of development knowledge, technology and job creation. (5) Complementarity. Differentiate, yet complement existing development efforts, avoiding duplication, and strategically focus on areas where the G20 has a comparative advantage and can add value focusing on its core mandate as the premier forum for international economic cooperation. (6) Outcome orientation.

[5] 2012 Progress Report of the Development Working Group, 19 June 2012, http://www.g20.utoronto.ca/summits/2012loscabos.html, accessed on 8 June 2014.

[6] St. Petersburg Development Outlook, 5 September 2013, http://www.g20.utoronto.ca/summits/2013stpetersburg.html, accessed on 8 June 2014.

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[8] The St. Petersburg Development Outlook, http://en.g20russia.ru/news/20131129/784497471.html, last accessed 26 January 2014.

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Part II

Actors, Positions and Constellations

Chapter 11
China, the United States, and the G20: Instituting Cooperative Multilateral Governance

Adam S. Hersh

In the words of Nobel Prize-winning economist Elinor Ostrom (1990), a community is a group "with a common set of problems". The Group of 20 nations, or G20, is one such community.

Not least of the common problems the G20 shares are the challenges of strengthening and stabilizing economic growth and making it more sustainable for long-term welfare around the world. With G20 member countries together comprising some 86 percent of the global economy, leaders of G20 countries are the de facto governors of the global economy.

Increasingly, major bilateral relationships interplay with multilateral relationships such as the G20. Deepening relations between the United States and China—and between these two countries and other G20 members—are necessary but not sufficient conditions for establishing the G20 as a successful multilateral institution for global economic governance. As the world's two largest economies and primary contributors to key international economic imbalances, China and the United States share a special responsibility for marshaling member countries to strengthen the G20 community and the global economic cooperation.

As stewards of the world's economic commons, leaders of China and the United States have special responsibilities to ensure the global public goods of an effectively functioning system of trade and finance; a system that helps resolve the conflict over international economic imbalances and facilitates cooperative actions toward rebalancing. And these two countries—together and within the G20—have critical roles to play in strengthening how they govern these global economic commons.

To do so, it is imperative that U.S. and Chinese leaders muster the courage to take the long-term view, looking beyond the daily grievances to find a vision for meaningful action that builds on 35 years of a peaceful, and deepening Sino-American relations to create the world where we escape the historical premise that a rising power comes into conflict with an established one. For as surely as there are cooperative gains to be shared from deepened global cooperation and policy coordination, there is also a dimension of conflict in determining how those gains will be distributed within and across national economies.

The G20 has a central role to play in mediating the resolution of conflicts to achieve cooperation, and leaders of both countries would be wise to invest their energies in the institution's success. G20 leaders should strive to forge multilateral institutions capable of mediating conflict and keeping the world economy on a stable path to growth. Is the G20 up to this task?

This chapter takes stock of the G20 from the perspective of Ostrom's (1990) set of seven principles for successful cooperative governance of common pool resources. Though the G20 is making significant progress towards these seven principles, it has achieved only four out of the seven measures. The three it lacks—providing a credible system for monitoring, sanctioning, and facilitating effective dispute resolution. After taking stock of the G20, this chapter explains some of the conflictive dimensions of the US-China relationship, and concludes by suggesting a path forward for deepening the US-China relationship and embedding it.

Unfortunately, these missing institutional features are essential to enabling enforcement of the cooperative norm in global economic governance. Without these institutions, the research suggests difficulty avoiding the "tragedy of the commons" in multilateral economic relations that leads all parties back toward the imbalanced growth and financial fragilities that characterized the world economy before the crisis.

1. Governing the Global Economic Commons

The G20 was forged under the necessity of crisis in 2009 as an institution for global economic governance, with an immediate focus on first putting out the financial fires, then coordinating stimulus through macroeconomic policies, and some aspirational pledges to tackle the long-term problems to global economic coordination. The fire is now out and the central question remains: is the G20 capable of sustaining cooperation among member countries over the long term?

Though all parties to the G20 have skin in the game, coordination to achieve even well known potential economic gains can be elusive in a non-cooperative world. Leaders make policy choices independently and with strategic intent, taking account of the likeliness that others will similarly make strategic choices from their own policy menus. Skeptics of efforts at multilateral governance often implicitly see the prospects of cooperation as a "prisoner's dilemma"—a tool for modeling social interactions. In the prisoner's dilemma, two people will be best off if they cooperate, but the incentives from the structure of the social interaction makes it likely that both will defect from cooperation with one another. At times, the people may obtain cooperation and escape the worst, but in repeated interactions under such conditions people default to non-cooperative norms.

Though international economic relations may seem like a prisoner's dilemma, in fact it is more apt to view as a social interaction known as an assurance game, famously described by Jean-Jacques Rousseau (Skyrms 2004) in the parable of the stag hunt—where a community of hunters can choose to cooperate in hunting a deer, or defect to catch a rabbit for themselves, in which case the others get nothing. In the stag hunt, a better outcome for all is possible through cooperation, even though individuals can get ahead by working alone, although everyone else will be worse off. In these situations, the institutions for the community can be effective for sustaining cooperative norms that produce higher general social welfare.

In other words, how can the G20 help keep members on track to hunt stags? Economics, in particular thanks to Ostrom (1990), has much to say not just about the trade and current account imbalances in China and the United States, but about what kinds of institutions are needed to sustain such cooperative governance of common use resources—from public wells to a well-functioning, rules-based global economy. By interacting, informally or through formalized structures such as the G20, members can "try to work out a contract with the other[s], or find the ones most likely to cooperate, or agree on rules for punishing cheaters, or artificially change the incentive ratios", and by doing so, can create an institution for collective action that benefits all of the group members.

Ostrom identifies seven "design principles" for community institutions successful at sustaining cooperative governance, though is quick to point out that such principles are not all necessary conditions for success, nor do they share an equal weighting of importance.[1] But these design principles are regularly observed in some combination in institutions of communities that succeed at cooperative governance.

(1) Defining clear group boundaries.

(2) Matching rules governing use of common goods to local needs and conditions.

(3) Ensuring that those affected by the rules can participate in modifying the rules.

(4) Making sure the rule-making rights of community members are respected by outside authorities.

(5) Developing a system, carried out by community members, for monitoring members' behavior.

(6) Imposing graduated sanctions against rule violators.

(7) Providing accessible, low-cost means for dispute resolution.

The G20 succeeds on a number of these key principles: a clearly defined group of members (Ostrom's 1st principle); consensus decision-making processes (3rd), and a mechanism for self-determination of the community (4th). In particular, the G20 took a step toward community building by expanding from the original G7 countries in recognition of the need to integrate the large populations and fast-growing regions of the world that have been converging economically on the advanced economy countries. The advanced countries also agreed to a rebalancing of capital stakes and voting shares in the international financial institutions, the case for which developing countries in general have been pressing since before the launch of the 2001 Doha Round of trade talks.

Table 1 shows the change in the voting shares of IMF in particular. The

United States diluted its voting share by half a percentage point, while the 27 countries of the European Union conceded 3.1 percent of their voting share. Japan's voting share remained essentially unchanged.[2] Overall, developing countries as a group gained a 5.5 percent share, of which China's and Korea's shares more than doubled, and India's share increased by more than one-third. In total, Japan, China, Korea, and India together now control 16.5 percent voting shares of the IMF—equal to the United States. This should by no means suggest that these four countries form some kind of governance alliance but is indicative of how much governing authority has shifted toward Asia as a result of these reforms. And developing countries have posted similar capital and voting-share increases at the multilateral development banks as well.

Table 1 Distribution of IMF Voting Shares(%)

	Current share	Pre-reform share	Change
United States	16.5	17.0	−0.5
European Union	29.4	32.5	−3.1
China	6.1	2.9	3.2
Japan	6.1	6.1	0
Korea	1.7	0.8	0.9
India	2.6	1.9	0.7
Developing countries	37.2	31.7	5.5

Source: IMF, 2011.

The rebalancing of voting shares in the international institutions makes good sense for a number of reasons. The developing world is much larger in population and is continuously delivering a larger relative share of global economic growth. Greater representation democratizes and enhances the credibility of these institutions. In Ostrom's words, it helps "ensure that those affected by the rules can participate in modifying the rules". This underwrites the institution's legitimacy, and thus the social capital that members are willing to invest in it.

A greater representative stake in multilateral-governance institutions also calls upon co-equal partners to shoulder commensurate responsibility to contribute to the group's public goods. Viable international-governance institutions reflecting the rise of "pivotal powers" don't "(require) the United States to step back, but others to step up"(Hachigian and Shorr 2012). But stepping up is costly—requiring G20 leaders to spend political capital to build consensus for cooperation and embed this in a set of multilateral governance institutions. Here, the continued failure of the Republican-led U.S. House of Representatives to approve reallocation of IMF capital reinforces skepticism for cooperation, and undermines the credibility of the United States in brokering a broadly inclusive institution for which other leaders would be willing to face domestic political risks (Truman 2014).

The willingness of members to monitor and sanction one another in order to uphold community standards, even when doing so imposes a cost, is an essential principle to an effective institution for multilateral governance over macroeconomic policy. In fact, unlike community mechanisms that can impose order from the outside, such as the WTO, only community-based mechanisms are feasible to enforce agreements among members in the community of sovereign member states.

When states have the authority and discretion in choosing an independent, albeit interdependent policy course, only what economists call *endogenous enforcement* mechanisms can successfully uphold the rules of the community. To succeed, the community must set and enforce a system of self-policing. Absent effective endogenous enforcement, the community lacks a mechanism for dispute resolution (Ostrom's 6th and 7th principles).

Like with Rousseau's stag hunt, without enforcement mechanisms, countries find it enticing to hunt rabbits and default to individually advantageous policies, even though defecting means the rest of the world will lose the stag. The lack of credible enforcement mechanisms makes it difficult to resolve the political costs for leaders to cooperate on economic governance with responding to local conditions (Ostrom's 2nd principle).

Community relies on multilateral enforcement—socially sanctioning members who stray from the community standards and shirk common responsibility for the overall health of the global economic system. The process calls on the community of G20 member countries to hold each other accountable for the consequences that each member's national economic policies have an affect on others' economies, and calls for the greater economic good—as one calls to a principle as motivation—that can be found through coordination and cooperation. This typically presents leaders with policy choices carrying potential political costs from harming particular sets of domestic interest groups.

The more equal partnership in the international financial institutions between advanced and developing economy countries is a foundation for international cooperation, but the true measure of a shift toward cooperative norms will be whether G20 leaders build successful institutions for monitoring and enforcing community members' adherence to community rules (Ostrom's 5th and 6th principles). Building the social capital among leaders to commit to a regime sustain peer monitoring of multilateral economic governance will only come over time, especially without the pushing of a simmering global crisis as in 2009. Such social capital can only be built through the long march of ongoing investment in diplomatic engagement to build trust and social capital among leaders and their official representatives to the G20.

While the G20 checks out on four of Ostrom's seven measures, it lacks three critical principles to ensuring effective dispute resolution among community members—providing a credible system for monitoring, sanctioning, and facilitating effective dispute settlement. The willingness to cooperate depends on perception of a mutual stake in the outcomes and a mutual sense of fairness in the terms of an agreement. Theory and experience suggest that sustaining such a system of cooperative multilateral economic governance which meets these criteria is a rare occurrence in international economic history.

2. Sticking Points on the Path to Rebalancing

Within the G20 there is a fundamental tension over how to distribute the costs of adjustment for rebalancing. Should the deficit country adjust through austerity, constraining its living standards in order to pay off the financial assets sold abroad? Or should the surplus country, growing through exports in part at the expense of other economies, adjust to refocus its growth more intensively on domestic demand?

Unsurprisingly, one's answer depends a lot on where one stands in the world and how one views the history of these international economic institutions. Aside from differing historical perceptions, leaders also face a complex web of competing domestic and transnational interest groups. For these groups, any policy adjustments can result in profound changes in how economic costs and benefits are distributed between and within countries. These dimensions of distributional conflict present G20 leaders with difficult political tasks.

In the words of Caixin Managing Editor Wang Shuo, "better mutual understanding solves problems caused by misunderstandings, but not problems that have nothing to do with misunderstandings" (Hachigian 2014). Conflict over distribution of the economic costs and benefits of rebalancing will remain a prominent point of international economic relations. But the goal remains the same: effective elimination of trade and current account surpluses and deficits between countries.

It is up to G20 leaders to forge institutions capable of writing, monitoring, and upholding standards of conduct in the global community—be it for global commerce and finance, or more generally in relations between nation-states. This is easier said than done as it requires both international cooperation and domestic change that is the sensitive domain of sovereign choice. But by embedding mechanisms for effective dispute resolution into strong multilateral institutions, the United States, China, and other G20 nations can diffuse the conflicts that stand in the way of cooperation and rebalancing, and reduce the tensions that allow leaders more political space to tackle the domestic structural origins of international imbalances.

3. Steps Forward for the U.S. and China in a Multilateral World

Where should G20 leaders aim and how should we measure the milestones in building a credible institution for multilateral economic governance?

Behavioral research suggests simple alterations that can result in more cooperative outcomes. And political scientists tend to see leaders and nation-states behaving in much the same way as in scenarios of individual-level interactions. For example, Alexander Wendt (1994) posits that states, through repeated interactions with "other" state entities, form their own collective identities and interests.

From the U.S. perspective, economist Barry Naughton (2013) observes, China seems "perpetually dissatisfied with the global system, and determined to extract as many benefits as it can from the system, without making any constructive proposals to change the system". But it is understandable how political leaders in China and other developing countries may interpret the situation differently.

Efforts to build institutions for international economic governance, such as the G20, are a recent development in the history of international trade and finance. The fruit of these efforts were formalized only in the post-World War II Bretton Woods System of fixed exchange rates and adjustments balanced between surplus and deficit countries. But as the international financial system began evolving and liberalizing after 1973—when power shifted more toward financial creditors—the onus of adjustment shifted in favor of austerity policies (Hersh 2013). Skepticism about these institutions has led many countries in effect to opt out of the present system.

Trust is built in baby steps, but accumulation of repeatedly successful interactions where people tend to reward cooperation with past cooperators (Axlerod 2006). Therefore, a first step for G20 leaders is to build the momentum for cooperation by first grasping for low-hanging fruit, and using this momentum to strive for deeper reform than can complete the G20's goal to sustain cooperation by mediating economic conflict between members and enforcing the rules of the community. These steps illuminate the path ahead:

3.1 Recommit community members to the Mutual Assessment Process

G20 leaders delegated to the IMF a set of economic analyses called the Mutual Assessment Process, or MAP, to assist in a country-to-country peer-review process. The MAP established economic criteria for evaluating the extent and causes of international imbalances and to simulate the effects of economic rebalancing versus continuing on with business as usual. The IMF in turn delivered a stream of valuable and informative economic research on the G20 nations. In fact, in many instances IMF economists proffered fresh rethinking of principles and policies of international integration and liberalization of financial trading. But the MAP does not solve the G20's institutional shortcomings; the technical analyses alone do nothing to spur action to change the non-cooperative norm. Part of mutual assessment must be a follow-up process, where leaders discuss the analyses and possible reforms of the international economic architecture. G20 members should hold each other to the expectation of full cooperation in the MAP, including supplying requisite forecasts and information on national economic policies needed for the analyses, as a step toward broadening the G20 leaders' dialogue.

3.2 Housekeeping on outstanding commitments

To preserve credibility, the G20 still has work to do on prior commitments. The United States should work to ensure that the G20 makes good on these, including implementation of the 2010 International Financial Institution, or IFI, reforms, which shifted ownership and voting shares of the IMF and World Bank toward developing countries, including China. Sadly, conservatives in the U.S. Congress have blocked the United States' requisite approval to reallocate IMF capital, also delaying quota reforms at other multilateral financial institutions (Lachman 2014).

3.3 Define the community

To strengthen the effectiveness of the community, G20 members should revisit and clearly establish membership criteria. Current membership of the G20 is not ideal in terms of it comprising the world's actual largest economies or in equitable geographic distribution of representation in the multilateral process. Since under current rules, the annual G20 host country has the authority to invite guest-country representatives, the United States should express support for the informal convention of a "permanent" guest status for representatives of the African Union, the Association of Southeast Asian Nations, and other international bodies as appropriate.

3.4 China's emergent voice and responsibility

The strength of institutions depends on their credibility for being open and equitably participatory, as well as their ability to dole out responsibilities. In the G20's case, both would be aided if China were to serve as host country to the G20 at the earliest opportunity. At present, the agreed-upon schedule of rotating G20 leadership will transition from Russia in 2013 to Australia in 2014, and to Turkey in 2015. The next opening for China to serve as host would be in 2016, and the United States should encourage such an assignment.

3.5 Finish the work on financial regulation reform

From the get-go, G20 members established a core mandate for national implementation of internationally coordinated financial reforms. These are needed to secure volatile, speculative capital markets around the world. As literally thousands of rules prescribed by the 2010 Dodd-Frank Act—the United States' most significant financial regulatory reform in more than a decade—are yet to be written, let alone implemented, by U.S. supervisory authorities. The United States first should lead by example and finish the work of getting its own financial house in order. Meanwhile, major financial regulatory reforms are underway in China, and financial regulation across the G20 will be impacted by ongoing negotiations in the mega-regional Trans-Pacific Partnership and Trans-Atlantic Trade and Investment Partnership. The G20 and other multilateral financial institutions will need to play central roles in ensuring members adhere to effective prudential financial regulation.

3.6 Missing institutions

As a further step, G20 leaders should examine the benefits of creating other missing international institutions that can help facilitate stable, sustained growth and rebalancing. The steps for these entities to take should include a sovereign bankruptcy mechanism that provides rules for the orderly restructuring of debts that preserve the public investments in equitable growth, and an international clearing union such as that proposed by John Maynard Keynes (Skidelsky 2001). This would provide a central clearing mechanism, much like on a stock or commodity exchange, by automatically adjusting respective international trade and financial surpluses and deficits among imbalanced countries. Such a mechanism would allow for orderly adjustment of accumulated reserve surpluses in order to maintain appropriate exchange rates.

3.7 Revisit governance issues

The United States and China have particular interests in marshaling G20 community members to revisit governance issues in the World Trade Organization, or WTO, and other international economic institutions. In particular, the United States should encourage members to revisit the effectiveness of the WTO dispute-settlement mechanism for adjudicating the rules of the trading system. A transparent, balanced, and efficient dispute-settlement process would benefit all member nations, smoothing frictions in international economic relations.

4. Prospects for Change

The problems arising from non-cooperative norms in international economic governance will not go away organically—the only way to ease the economic tensions and unlock the potential economic gains is for leaders to rise above day-to-day squabbles and domestic political obstacles to deeper coordination. Unfortunately, history suggests this is a difficult feat to achieve: the last major effort at global institution building took two world wars and a world economic depression to motivate erection of the post-war economic architecture of the Bretton Woods system.

U.S. leaders now need to recognize—for better or worse—that they no longer enjoy unilateral authority. Chinese leaders have expressed a desire to seek a new model of major power relationships (Center for American Progress 2014). Though there is not yet a consensus on what this new model might entail, it is clear that to avoid the historical premise that conflict will arise between a rising power and an established power, both powers—and all parties to the global community—must endeavor to embed these relationships in strong multilateral institutions like the G20.

Common ground for global cooperation begins with national politics that put a people-centered focus to economic development policies. Not only does rising inequality within countries fueled by global economic integration poison domestic politics in nation-states, but it entrenches the creeping plutocracies that defend our current non-cooperative norms in multilateral economic relations.

Notes

[1] An eighth design principle, for governance in nested tiers, is not as relevant in interstate relations.

[2] Technically, Japan's voting shares increase and exceed that of China, but the increase and the excess over China are little more than a rounding error.

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Chapter 12
A New Model of Major-Country Economic Relations between China and the United States and Its Effects on the G20

Song Guoyou

Sino-US economic relations represent a new model of economic relations between major countries. As the world's largest developing country and the world's largest developed country, respectively, China and the United States have specific advantages in terms of resources, market, capital and technology, which are strongly complementary. This chapter focuses on the important differences between this new model of major-country economic relations, shared by China and the United States, and the old one, looking at its main features and future development, as well as its interactions with the G20.

1. Sino-US Economic Relations: Old and New

Compared with previous Sino-American economic relations, the new model of major-country economic relations between China-U.S. is characterized by the following:

1.1 Bilateral Trade Relations

The United States is China's largest single export market, as well as its biggest trade partner, while China's importance for America is not so obvious, which is reflected in China's small share of US exports. However, within the framework of a new model of major-country economic relations, Sino-US trade relations will change enormously.

First, as a long-term tendency, Sino-US bilateral trade is becoming increasingly significant to the latter. According to US statistics, US trade with China accounts for 14.6 per cent of its total foreign trade,[1] which is the highest proportion since the establishment of Sino-US diplomatic relations and only 1.8 per cent behind US trade with Canada. China will surpass Canada and become America's largest trade partner in the coming few years if the current rate of increase is maintained.

Second, the magnitude of US exports to China will exceed the growth magnitude of China's exports to the US and its exports to China will be a source of momentum for US exports overall. For example, the rate of increase of China's exports to the US was 3.5 per cent in 2013, in comparison with 10.4 per cent in the other direction. The rate of increase of US exports to China is 7 per cent higher than that of China's exports to the US. The Chinese market is becoming a key region in terms of US exports.

Last but not the least, the growth margin of the Sino-US trade deficit is decreasing and the bilateral trade imbalance is being improved. In the past, the enormous US trade deficit with China was a significant feature of Sino-US economic relations, and an important obstacle not just economically but also politically. A new model of major-country economic relations between China and the United States reflects a tremendous decrease in the US trade deficit with China. The main factors in this include: (i) long-term appreciation of the RMB exchange rate; (ii) a US push towards re-industrialization and a transformation of industrial structure, expanding US exports to China; (iii) China's exports are diversifying, which will reduce US imports; and (iv) China is undergoing transformation in terms of its economic development model, which will promote China's imports from the US. For these reasons, Sino-US bilateral trade will increasingly develop towards balance in the long run.

1.2 Sino-US Investment Relations

A new model of major-country economic relations between the China and the United States will also characterise bilateral investment.

First, in terms of the levels of investment, China's direct investment in the United States will surpass US investment in China enormously, a pattern of contrarian investment. After the establishment of Sino-US relations, the United States played the role of one-way investor; in the 1980s, 1990s and even early 2000s, China attracted a large amount of direct investment from American enterprises. However, the financial crisis has severely hurt US investment in China, while Chinese investment in the United States has risen significantly. For example, China's direct US investment has surpassed US investment in China since 2011. More significantly, this is not temporary. Chinese investment in the United States will surpass US investment in China for a long time, due to the huge foreign exchange reserves held by China and the accelerated speed of Chinese enterprises' internationalization. Contrarian investment between China and the United States will become a significant feature of Sino-US economic relations.

Second, in terms of the ownership of corporations that invested in the United States, although state-owned companies now have the lion's share, private companies will become the mainstream in future.

Third, in terms of national security sensitivity, enterprises that invested directly in the United States will shift from industries of low sensitivity to those of high sensitivity. In the past, Chinese investment in the US was located mainly in the sectors such as food, real estate, and new energy resources; with the deepening of Sino-US economic relations and the future Bilateral Investment Treaty (BIT), Chinese investment in American sectors concerning national security, such as telecommunication, power facilities, and high-end machine manufacturing, will increase.

1.3 Sino-US Debt Relations

China's purchasing of the US's national debt makes up a significant part of Sino-US economic relations. China is the largest foreign holder of US Treasury bonds, comprising 8 per cent of the US national debt.[2] In general, China's purchasing of American treasury bonds brings mutual benefits and deepens Sino-US economic cooperation. This not only means relatively secure and reliable investment products, but also the stability of the US financial system and the relief of the federal government's budget deficit.

The new model of major-country economic relations between China and the

United States will be characterized by the following in terms of US treasury-bond purchasing. First of all, in the period ahead, China will maintain the level of 1.25 trillion USD, and will not sell off within a short time, although there will be no increase as in former times. A stable large sum will become an important cornerstone of the new model of Sino-US economic relations. Second, although US Treasury bonds held by China are relatively stable, they will experience higher volatility than in the past, and the monthly turnover of treasury bonds will be in billions of dollars. Third, in terms of specific activities, China will more intensively purchase or sell off US bonds so as to increase flexibility. However, at the same time, China will also maintain stability by holding US long-term bonds in order to achieve a stable return on investment, and will not trigger short-term volatility in the US financial market.

2. The Main Features of the New Model of Sino-US Economic Relations

2.1 Solid Political Incentive in Launching a New Model of Sino-US Major-country Economic Relations

The presidents of China and the United States met in California in June 2013. In this meeting, they confirmed that China and the United States are now enjoying economic relations that are highly complementary in structure and deeply beneficial, and that the two countries should seize the opportunity for economic transformation and growth to take further advantage of complementarities and cultivate new growth areas in cooperation.[3]

The presidents had a frank discussion on issues of mutual interest and reached a consensus on economy and trade. They agreed to give full play to such mechanisms as the Strategic and Economic Dialogue, the Joint Commission of Commerce and Trade, and the Governors Forum, to strengthen strategic coordination and push forward practical cooperation. They also agreed to boost Sino-US cooperation within the framework of multi-lateral and regional economic relations, sustain trade and investment freedom, oppose protectionism, improve global economic affairs and propel strong, sustainable and balanced growth of the regional and global economy. They also agreed to properly handle economic and trade issues by dialogue and to advance negotiations on the Sino-US bilateral investment accord, as well as to provide a fair, transparent and stable framework for mutual investment. Without doubt, all these will become key issues of a new model of major-country economic relations between China and the United States for some time to come.

In fact, the Annenberg Estate meeting between the Chinese and US presidents can be seen as a historic beginning with regard to economic relations. It provides a powerful political incentive with regard to the new features of Sino-US economic relations and will become the fundamental axis of future Sino-US economic relations.

2.2 China's Further Reform and Opening-up Provides New Strategic Opportunities for a New Model of Major-Country Economic Relations between China and the United States

China's new government and leaders, who took office in early 2013, confirmed the significant political decision on further reform and opening-up. The Third Plenary Session of the Eighteenth Central Committee of the Chinese Communist Party made the market's decisive status clear, and issued more than 300 suggestions on reform. All these suggestions target internal reform and external opening-up. According to a signed article by Chinese Vice Premier Wang Yang, which was published in *The Wall Street Journal*, in the coming five years, China will have imports worth 10 trillion USD, 400 million visits by travellers overseas and foreign investment worth 500 billion dollars (Wang 2013). China's increasing reform and opening-up will create more commercial opportunities for the United States and bring about a new strategic chance to develop a new model of Sino-US major-country economic relations.

2.3 Sino-US BIT Will Become the Most Significant Bilateral Mechanism Breakthrough in a New Model of Economic Relations between China and the United States

Negotiations on the Sino-US BIT were officially launched within the framework of the fourth Sino-US strategy and economy dialogue in 2008. Before the fifth Sino-US Strategy and Economy Dialogue in 2013, China and the United States held nine rounds of negotiations, and complemented the initial discussions and technical consultation on core issues and the concerns of each side. Sino-US

BIT negotiations aim to improve the protection of investors, proactively promote bilateral investment and are of great importance in developing the new model of major-country economic relations.

2.4 Sino-US Local Economic Cooperation Lays a Social Foundation for the New Model

Local cooperation is a new area of Sino-US relations. Both countries attach increasing importance to regional roles. Sino-US provincial and inter-city cooperation is an active force in Sino-US relations and significant in the structuring of new-type major-country relations. Exports to China have already become an important part of the exports of all states in the United States. China has become the largest export destination for some US states, and the number of such states is rising. According to statistics released in 2013, exports to China take up more than 10 per cent of overall exports in over ten states.

2.5 Global Multilateral Trade Negotiations Are Becoming new Common Interests in the New Model of Sino-US Major-Country Economic Relations

China and the United States are involved in new interactions in global multilateral trade negotiations. For instance, both are leading members of the WTO Doha round talks and negotiations on the Trade in Services Agreement (TISA). If these two negotiations are successful, more products and areas will be introduced into the global trade system, which will be important in promoting global multilateral trade freedom. In this sense, China and the United States have common strategic interests and will cooperate more closely in the future.

2.6 Sino-US Energy Cooperation Will Push the New Model of Economic Relations to New Heights

Cooperation on energy, especially clean energy, is a priority of both governments, and will become one of the main highlights of Sino-US economic and trade cooperation. China and the United States are the two largest energy consumers in the world, and, at the same time, two of the most important energy production countries. Deep Sino-US cooperation on energy will not only become a crucial support for a new model of major-country economic relations, thereby benefitting the Sino-US bilateral relationship, but also guarantee global energy security and common interests and responsibilities in handling common challenges.

Future energy cooperation between the two countries will include the following: it will be easier for enterprises from one country to enter the markets of the other; both countries can cooperate well in such spheres as smart power grids, carbon capture, and shale gas; both can make a common effort to better maintain the international energy market and ensure diversity of energy supply; the two countries can also construct more bilateral, multilateral, and global energy cooperation mechanisms. Furthermore, the United States can export liquid natural gas (LNG) to China.

3. Potential Contradictions in the Building of a New Model of Major-Country Economic Relations between China and the United States

There will be more than cooperation in the new Sino-US economic relationship. Contradictions will remain, but new features are emerging. These contradictions may exist in a new way or just as a continuation of old problems. The development of new-type Sino-US relations will be restricted if these problems cannot be dealt with properly.

3.1 Trade Protectionism will Continue for a Long Time

China considers that the United States conducts unreasonable investigations into imports from China, followed by taxation, with the excuse that its actions are "anti-subsidy" and "anti-dumping". Moreover, the United States has sued Chinese products for alleged abuse of WTO rules. Likewise, the United States thinks that China's investigations into American products are discriminatory, thus affecting US exports. It is hard to eliminate trade protectionism because it is not only about employment, but also a reflection of national emotions with regard to the domestic economy. It will inevitably appear from time to time and influence the development of the new-type Sino-US economic relations.

3.2 Investment Protectionism will Increase

Sino-US BIT negotiations have reached the substantial stage of text negotiations and will eventually reach an agreement. Nevertheless, China and the

United States will continue to have disputes over specific investment policies in the future, and will criticize one another at times. In China's opinion, the procedures and standards of decisions made by the Committee on Foreign Investment in the United States (CFIUS) are not transparent enough and the factor of national security is overestimated when overseas investment is reviewed (Zhong 2013). On the other hand, the United States will probably accuse China of hindering investment, saying that the Chinese government is not as friendly as it was, the general investment environment is deteriorating, and various invisible barriers have been set up by the Chinese government on overseas investment, including those from the United States (ACCS 2004).

3.3 Mutual Dissatisfaction about Significant Economic Decisions

The most important feature of the new model of Sino-US relations is that the two economies rely on each other heavily and are increasingly equal. This way, certain macroeconomic decisions will affect the other strongly. Whenever there is a more negative influence, contradictions between two countries will show up. China and the United States need to closely coordinate strategically so as to curb negative spillovers. In the future, China's dissatisfaction with the United States in terms of macroeconomic policies will focus on monetary policy based on quantitative easing (QE), exchange rate policies focused on the value of the US dollar, financial policies aimed at reducing government debts, as well as industrial policies focused on reindustrialization (Song 2011). In conclusion, China expects that the United States will not exert its current economic hegemony and can negotiate with China on these issues that affect China's economic interests. Likewise, US dissatisfaction with China's economic strategies will concentrate on RMB exchange rate reform, the economic status of state-owned enterprises, government procurement policies, compliance with trade regulations and protection of intellectual property rights.

3.4 Competition between China and the United States in Terms of Bilateral and Regional Trade Negotiations

China and the United States are cooperating in terms of multilateral free trade negotiations, which will probably become the spotlight of a new model of major-country economic relations, while fierce competition will continue between the two countries as far as bilateral and regional free trade negotiations are concerned. This competition is reflected in the Trans-Pacific Partnership (TPP) and the Regional Comprehensive Economic Partnership (RCEP). TPP is a free trade agreement including 12 Asian-Pacific countries led by the United States. Compared with traditional free trade agreements, TPP asks for higher standards on government procurement, intellectual property and trade in services. RCEP consists of 16 member countries, including China, and is scheduled to finish negotiations by 2015. The United States considers itself excluded from RECP because it comprises countries and regions on the western rim of the Pacific Ocean. The United States and China are the de facto leaders of TPP and RECP respectively and exclude each other's participation, reflecting Sino-US competition in free trade negotiations. The United States expects to acquire benefits in the global new round of free trade negotiations through TPP, forcing China to accept the new rules on global trade proposed by it. China, on one hand, has an open mind on the TPP negotiations, but on the other hand is pushing RCEP to make real progress for the sake of comparative advantage (Song 2013).

4. Future Development of the New Model of Sino-US Major-Country Economic Relationship

The general feature of the new model of major-country economic relations between China and the United States is the co-existence of friction and cooperation, with more cooperation than friction, in general. Specifically, future Sino-US major-country economic relations will be characterized by five, increasingly obvious, aspects.

4.1 Equivalence of Economic Interdependence

In the past, China has had less influence in Sino-US economic relations because it needs the US market and capital more than the other way round. However, with the growth of China's economy, especially when China's GDP comes to exceed that of the United States, asymmetric interdependence will undergo great changes. Generally speaking, Sino-US economic interdependence will tend to equivalence, and China can more strongly mould Sino-US economic relations than at present, so as to safeguard its own economic interests more effectively.

4.2 Domestication of Economic Policymaking

Future economic relations between China and the United States will be more subject to domestic economic policies than macroeconomic policies. A few years ago, the influence on one another's economy was probably taken into consideration first when some significant macroeconomic policies were being made, especially by China. In future, however, both countries will consider domestic economic development as top priority when making national macroeconomic policy. This change in policymaking is more obvious in relation to China.

4.3 Localization of Major Players in the Economy and Trade

Current Sino-US economic relations are managed mainly by the central government and various ministries. In future, however, China's provinces and cities, as well as US states will play a more significant roles. This is not only because local governments are great beneficiaries of Sino-US economic relations thereby more motivated to maintain stability, but also because the platforms at local level for economic cooperation between China and the United States have matured and are now able to regulate Sino-US economic relations.

4.4 Economization of Political Relations

In the past, one major factor affecting Sino-US relations was the political aspect of economic relations. However, with the continuous development of Sino-US economic relations, a contrary tendency has appeared, the economization of political relations. The two governments will try to relate political relations to economic relations, which means presenting some issues concerning politics and security in terms of economic relations, simplifying political issues in an economic way with a view to resolving sensitive security issues on the basis of comparatively stable and controllable economic relations. For instance, the current cyber security issues between China and the United States are actually security issues, but both countries are inclined to define them partly as economic issues.

4.5 Globalization of Economic Relations

Whether or when China's GDP will surpass that of the United States remains to be seen. But in any event, they are the two largest economies in the world, and this will increasingly take them beyond bilateral relations and present issues of increasing global influence. Against this background, both countries will pay more consideration to the development of new Sino-US economic relations and play a leading role in the global economic system.

5. Effects on the G20 of the New Model of Major-Country Economic Relations between China and the United States

Given their status in the global economic system and their importance in relation to how the rules are shaped, new economic relations between China and the United States will also have a great effect on the G20, which itself is a relatively a new multilateral mechanism of global economic governance.

Generally, a new model of major-country economic relations between China and the United States will be highly complementary with the G20. China and the US have promised to strengthen coordination and cooperation, seek mutual interests in more sectors, and promote the G20 to become the main forum for international economic cooperation under the framework of the G20.[4] The healthy development of the new model will represent a good supplement and support for the G20, strengthening rather than undermining it.

5.1 Alignment of New-model Sino-US Major-country Economic Relations and the G20

Integrated Concepts

The concepts underlying the new model of major-country economic relations between China and the United States are avoiding conflict and confrontation in economic disputes, mutual respect and win/win cooperation (Yang 2013). These concepts are linked with the G20, whose aim is constructive and open dialogue among major economies on crucial international economic issues, laying the foundation for discussion and negotiation. At the same time, the G20 stresses mutual respect among member countries and win/win economic coordination.

Close Positioning

The new model of major-country economic relations between China and the United States shows their willingness to push for the healthy development of both sides. The G20 is the world's most significant multilateral economic coordination mechanism aimed at cooperation and promoting stable and sustainable economic development, [5] and also provides a coordination and dialogue platform for major economies at different stages of development.

Interlinked Interests

In essence, the new economic relations between China and the United States are closely related to the G20 in terms of interests. As the world's biggest economies, China and the United States cannot be independent from other economies, and meanwhile, other economies need China and the United States to provide them with strong opportunities for development. If China and the United States can develop their economic relations and help to resolve economic disputes through a new model, this will also enable the members of the G20 to better reach consensus to achieve global development.

Cooperative Policies

The new economic relations between China and the United States and the G20 are characterised by cooperative policies, besides a high degree of consensus on concepts, positioning, and interests. Generally speaking, the key areas are monetary, financial, trade, and industrial policies. Although these policy areas are especially significant and highly sensitive to the two economies, in this era of globalization they have to be addressed at a global level. China and the United States cannot make crucial economic decisions without considering the global economy. They need the help of the G20 to obtain international support. Likewise, significant G20 policies have to be endorsed by China and the United States.

A new model of major-country economic relations between China and the United States is highly congruent with the G20, and represents the docking of the two largest economies and global multilateral cooperation. Benign interactions and mutual learning are beneficial to the stability and prosperity of the global economy. In this sense, the new economic relations between China and the United States can help the G20 to better coordinate the global economy.

5.2 The World Economy Needs a New Sino-US Economic Relationship

The world economy will remain sluggish for some time to come. China and the United States, as the biggest economies in the world, are endowed with a special mission to become the stable growth engines of the global economy. To achieve this, both countries need to change the current economic growth pattern, mobilize potential productivity, restrain factors that curb economic growth and achieve long-term and stable growth. Efforts from one side alone are not enough to promote robust growth in the world economy. With regard to Sino-US bilateral economic relations, it is imperative that they cooperate in the following crucial sectors.

More Inclusive Trade Relations between China and the United States

Such relations are characterized mainly by three aspects: bilaterally, China and the United States should be committed to resolving economic disputes through dialogue, implement trade measures with caution, and create a good trade environment for both sides. China and the United States should solve disputes on bilateral trade in good time and properly with the help of current negotiation mechanisms. The United States should relax restrictions on, and indeed promote the exports of high-tech products and high technologies to China, thereby liberating mutual potential. Regionally, China and the United States should prevent regional free trade negotiations, which are led by each side separately, from becoming exclusive trade camps. They should also respect each other's core trade interests and need to upgrade RCEP and TPP into a unified Asian-Pacific free trade agreement. Globally, China and the United States should make joint efforts to guard against trade protectionism and proactively push forward the WTO Doha Round on the basis of the current Doha Bali Agreement.

Fairer Investment Relations between China and the United States

Reliable, free and large-scale investment is needed if the world's economy is to achieve stable growth. The United States has become the world's largest outward direct investment country, and China will become more and more important in this regard in the future. China and the United States can do more to expand global free investment. In terms of the internal investment environments in China and the United States, the two governments need to end unfair treatment towards overseas investment, provide good conditions for inward FDI and should not erect visible or invisible barriers to curb foreign investment. At the bilateral level, China and the United States should sign a high-standard and balanced Sino-US BIT, dealing with market access and investment protection. Bilateral investment, especially direct investment from

China to the United States, needs to be expanded. At the global level, China and the United States need to create a fair and open investment environment for global capital, and reach a global multilateral investment agreement among major economic players to advance global investment to a higher level.

More Coordination on Global Economic Governance

Efficient governance is needed for the stable growth of the global economy. With the emergence of the G20, global economic governance has undergone some reform. As guardians of current global economic system, China and the United States need more coordinative cooperation: what is valuable within the present governance system should be retained, but reforms should be deepened. Especially with regard to the reform of the international monetary and financial system, the US government should respect the interests of emerging economies, including China, and support reform, achieving the goals laid down in 2010 by the International Monetary Fund.[6] In addition, China and the United States have safeguarded the primary role of the G20 in governing the global economy, and should continue to support its role as main international economic forum, guaranteeing the robust, sustainable and balanced growth of the world economy.

6. Conclusion

China and the United States are proactively constructing a new model of major-country economic relations with an eye to the future. This is crucial if the two economies are to achieve mutually beneficial development and win/win cooperation. China and the United States should meet their commitments on cooperation, expand potential interests, avoid potential risks, restrict bilateral disputes on the economy and trade and strengthen dialogue and exchange under strategic leadership to push Sino-US economic relations into a new landscape.

Without doubt, the two countries' efforts for growth and a new balance in economic relations, as well as to foster global multilateral free trade and fair investment are beneficial to the recovery and strong growth of the global economy. It is important to note that a new model of major-country economic relations between China and the United States is not intend to replace current international economic governance mechanisms, especially the G20. China does not want to make the new model of major-country economic relations between China and the United States into a "G2", nor does it intend to undermine the important role of the G20 in global economic governance. A new model of major-country economic relations between China and the United States will prove a beneficial supplement for the G20 and will bring about closer multilateral coordination among G20 members.

Notes

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Chapter 13
China and the EU: From Strategic Partners to a New Relationship between Major Powers?

Jörn-Carsten Gottwald

1. Introduction

China and the European Union have–in their own words–established a comprehensive strategic partnership. Even before the new Chinese leadership under Xi Jinping took office in November 2012 and March 2013, respectively, both sides had agreed to further develop bilateral relations into a model for the twenty-first century. The two sides announced the EU-China 2020 Strategic Agenda for Cooperation in 2013. This agenda constitutes an ambitious programme of comprehensive policy coordination and joint initiatives beyond the negotiations of a new investment agreement (EEAS 2013). This serves to indicate that both sides wish to revise the current strategic partnership and provide new impetus for bilateral cooperation. In his programmatic speech at the College of Europe in 2014, President Xi concluded that the "relationship between China and the EU has become one of the most important bilateral relationships in the world ...(but) we should not forget that there is still greater room for the growth of China-EU relations and the potential is yet to be fully tapped" (Xi 2014:1).

The agreement of a new agenda coincides with a new approach to China's role in international politics developed by the new Chinese Communist Party, or CCP, leadership. On his first visit as Secretary-General of the CCP and President of the People's Republic of China to the United States Xi Jinping reiterated and reinforced the idea of a "New Major Power Relationship" for Sino-US ties. The term was readily adopted by the Chinese media and officials alike, as well as by their American counterparts. In Europe, however, this slogan was interpreted predominantly as applying to the established and the rising superpower, without major implications for the EU. In the Chinese debate, however, the jury is still out on whether this concept should also apply to the European Union and other states. This raises important questions: can this new idea stimulate the debate on moving EU-China relations to a new level? Does the fact of a significant level of bilateral relations—making EU-China ties a fairly "old" relationship—affect further development? And is the question of old or new major power relationships relevant to the daily functioning and long-term success of the G20? Finally, does it allow China to make a positive contribution to global economic governance and the global economy?

2. EU-China Strategic Partnership and the Global Financial Crisis

Relations between the EU and the People's Republic of China are comparatively well advanced. Diplomatic relations were officially established in 1975. In the words of the EU External Action Service, the "partnership, which is based on the 1985 EU China trade and cooperation agreement, has grown to include foreign affairs, security matters and international challenges such as climate change and global economy governance" (EEAS 2014). Economic ties started to flourish in the context of China's socio-economic modernization. Political interest in developing relations strategically found explicit expression from 1993 onwards. A multi-layered multi-dimensional web of political, economic and social ties emerged subsequently. In 2003, the two partners agreed to turn the "secondary relationship" (Yehuda 1993) of "distant partners" (Kapur 1990) into a comprehensive and mature strategic partnership. While politicians from both sides continue to praise the importance and intensity of the relationship, academic and public observers are often critical of the substance and nature of the strategic partnership (Holslag 2012). Continuing differences between the member states (Fox and Godement 2009) and changes in the mutual normative view (Mattlin 2012) highlight the institutional and normative vagueness of this relationship. More recently, Chinese observers have started to consider the EU "a power in relative decline" whose difficulties offer "new opportunities to advance the relationship" (Chen Zhimin 2012; Qin Yaqing 2012), potentially in the context of establishing new major-power relationships.

The 2008 global financial crisis and ongoing efforts to revise global economic governance in its wake point towards a decisive moment of truth for the strategic partnership. Both sides are key actors in the most important forum dealing with the crisis, the G20 (Chin 2010; Bersick and Gottwald 2013a). Established as a forum to facilitate cooperation between central banks and finance ministers, it was elevated to head of states and government level in November 2008 and grew into a multi-layered set of working groups and committees cooperating closely with international organizations such as the IMF, the World Bank and the Financial Stability Board. Addressing the global financial crisis has been the key objective since the first summit but has always been linked with attempts at reforming global economic governance (Chan 2013; Tiberghien and Duggan 2013). While its theoretical and practical significance is still under debate (Kirton 2013; Cooper and Thakur 2013; Schirm 2013) the G20 clearly signals a decisive change in global governance, with an enlarged steering committee that includes established as well as emerging countries.

In 2008 and 2009 many observers interpreted the global financial crisis as a symbol of the decline of Western capitalism and called for alternatives. East Asia and the People's Republic of China were expected to provide missing leadership (Achaya 2011). The EU soon found itself in serious economic and political straits but insisted on remaining true to its normative foundations, including its commitment to global cooperation. Thus, the strategic partners found themselves at a critical juncture, "In institutional analysis, critical junctures are characterized by a situation in which the structural (that is, economic, cultural, ideological, organizational) influences on political action are significantly relaxed for a relatively short period, with two main consequences: the range of plausible choices open to powerful political actors expands substantially and the consequences of their decisions for the outcome of interest are potentially much more momentous" (Capoccia and Kelemen 2007: 343). The global financial crisis provided a catalyst for China's emergence as a potential superpower. This challenges the normative basis on which Sino-EU relations have been built

(Bersick and Gottwald 2013b). Thus, from a theoretical as well as a practical perspective the China-EU strategic partnership merits new impetus, particularly at a time when the Chinese leadership is attempting to redefine its role in relation to the dominant political power, the United States. Suffice to say that the role of the United States in EU-China relations resembles the famous "elephant in the room" who is ostensibly ignored by everyone else even though reduces the room for manoeuvre for all present.

3. China's New Major Power Approach

If the global financial crisis provided a critical juncture for change and the sovereign and private debt crisis in Europe increased calls for substantial joint action, the earlier failure to conclude a new cooperation agreement had already highlighted the need for new concepts such as "the New Major Power Relationship", which is usually attributed to the Chinese president and secretary-general of the CCP, Xi Jinping. A few months before Xi was selected as new party leader, he introduced the idea of a new framework for relations between the United States and China during a visit to the US in February 2012. The concept was picked up by then State President Hu Jintao at the Sino-US Strategic High Level Dialogue in Beijing in March 2012, and further elaborated during Xi's state visit to the US in June 2013 (Renmin Ribao 2013). The basic idea behind this concept involves avoiding conflict between an established super-power and an emerging rival through mutual trust and respect for different domestic developments. It thus ties in with the earlier foreign policy dogma of peaceful development and Hu Jintao's emphasis of interpreting international politics and China's growing importance as a win-win situation for everyone, not a zero-sum conflict.

The concept of the New Major Power Relationship sought to address one fundamental issue in Sino-US ties with great significance for EU-China relations: the lack of mutual trust (Lieberthal and Wang 2012). Trust has been identified as a key cause of tension in Sino-EU ties as well. While some voices in China have proposed including all major powers, including the European Union and even the system of major powers, others have expressed their scepticism (Pang Zhongying 2014: 3-4). Xi Jinping had extended his analysis in his Report to the 18th Party Congress to all advanced economies(Yu Sui 2013). Key elements of the New Major Power Relationship concept found their way into China's new EU policy white paper, albeit without explicit use of the term (State Council 2014). Within Europe, interest in the concept as a source for new impetus for the Strategic Partnership has been miniscule: there seems to be virtually no official document or source applying this idea to EU-China relations.

4. The Structure of the Partnership

The issues of trust and the normative foundations of the strategic partnership have been a constant factor in EU-China summits. These discussions contrast sharply with the institutionalization of bilateral relations over the years. While issues of economic exchange and cooperation are considered the core of the bilateral relationship, they form only one out of three pillars of the official structure with political dialogue and people-to-people dialogue complementing the economic and sectoral dialogue (see Table 1).

Sophisticated as the structure may appear, it is built on substantial normative and policy disagreement. The key objective of the EU's China policy is to integrate and socialise the PRC into the global economy. As China has joined the WTO and plays an important role in the G20 and all sorts of economic coordination forums, this objective has lost some of its significance. These positive developments notwithstanding, ongoing issues of market access and fair treatment continue to encourage the strategic partners to seek further economic cooperation. In this respect, further EU aims in dealing with China remain to be achieved: contributing to a improvement in the social system, contributing to the development of a sustainable socio-economic model. On the Chinese side, the key interest is to benefit from European technology, know-how and investment, and to support the EU in taking an active stance in global politics. These interests could be summed up in the dual objective of promoting domestic reforms and balancing US hegemony (Cottey and Gottwald 2008).

While economic integration between the two economies has advanced at a remarkable rate, the growth in bilateral trade and investment has been accompanied by an increase in related bilateral tensions. Trade relations have increased more than tenfold, from 4 billion euros in 1978 to 428 billion euros in 2011. In 2011, 17% of EU imports came from China. China is the EU's biggest

Table 1: The Organizational Structure of EU-Chinese Cooperation

EU-China Dialogue Architecture-main elements*

SUMMIT
ANNUAL
Presidents of the European Council and Commission

I Pillar-Political Dialogue			
High Level Strategic Dialogue (Annual) High Representative for Foreign Affairs and Security Policy			
Regular contacts between HRVP and Chinese Foreign Affairs/ Defence Minister		Political Directors Dialogue (annual)	Meetings between Chinese Foreign Affairs Minister and EU HoMs Chinese Foreign Affairs Minister and EU HoMs
Meetings of EUSRs and Special Envoys	Political Dialogue on Africa (COAFR Dialogue)	Political Dialogue on Latin America	Political Dialogue on Asia
Security and Defence Dialogue	Dialogue on Non Proliferation and Disarmament	Taskforce on Cyber Issues	Human Rights Dialogue
European Parliament All 3 Pillars			
Delegation for Relations with the People's Republic of China			

II Pillar-Economic and Sectoral Dialogue				
High Level Economic and Trade Dialogue Annual EC Vice-Presidents responsible for Competition, for Economic Affairs, Trade Commissioner				
Joint Committee Ministerial/ Senior Officials Meeting(Annual)				
Joint Customs Cooperation Committee(JCCC)	Macroeconomic Dialogue	Trade and Investment Policy Dialogue(TIPD)	Consultation mechanism on Industrial products and WTO/TBT	Dialogue and Consultation Mechanism on Industrial Sectors
Economic and Trade Working Group(ETWG)	Dialogue/WG on Intellectual Property Rights	Economic and Financial Dialogue	Competition Policy Dialogue	Working Group on Best Practices in Trade Defence Instruments
Working Group on Market Economy Status	EU-China Joint Customs Cooperation Committee Steering Group	Joint Follow-Up Group on Drug Precursors	High-level Transport Dialogue *Subdialogues include:* —*EU-China Maritime Transport Agreement Implementation Meeting*; —*Dialogue(not formalised) on Aviation Relations*; —*Urban Mobility Dialogue*	EU-China Space Technology Cooperation
Innovation Cooperation Dialogue	Science and Technology Steering Committee	Nuclear Energy cooperation Steering Committee		Information and Communications Technologies Research Dialogue
Dialogue on Information Technology, Telecommunications and Informatisation	Dialogue on Energy (including HLME)	EU-China Declaration on Energy Security/ Working group		Dialogue on Electricity Markets
EU-China Climate Change Partnership and BCM on Climate Change	Environment Policy Dialogue	China-Europe Water Platform Dialogue/WG	Bilateral Cooperation Mechanism on Forests	Dialogue on Sustainable Tourism
EU-China Urbanisation Partnership	Dialogue on Agriculture	High Level Dialogue on an Integrated Approach to Ocean Management	Dialogue on Fisheries	Regional Policy Dialogue
High Level Dialogue on Migration and Mobility	Dialogue on Labour, Employment and Social Affairs	Policy Dialogue and Cooperation in Health and Safety at Work	Dialogue on Health	Dialogue on Employment and Social Policies
Dialogue on Product Safety	Consultation and Cooperation Mechanism on Health and Safety of Consumers	Memorandum of Understanding concerning Animal Health Cooperation	EU-China Working Group on Pharmaceuticals	
Other exchanges(not a regular dialogue)	Disaster Risk Management Project			

III Pillar-People-to-People Dialogue		
High Level People-to-People Dialogue (biannual) Commissioner for Education, Culture, Multilingualism and Youth		
Policy Dialogue on Higher Education and Vocational Training Affairs, incl. Dialogue on Multilingualism	Policy Dialogue on Cultural Affairs	Policy Dialogue on Youth Affairs
Euro Area Troika(Chair of Eurogroup, ECB and Commissioner for Economic and Monetary Affairs)—China Dialogue Pillar 2		
With Ministry of Finance, NDRC, People's Bank of China (Minister, Governor)		
European Economic and Social Committee Pillars 2 & 3		
EESC-China Economic and Social Council Roundtable		

Source: European External Action Service, http://eeas.europa.eu/china/docs/eu_china_dialogues_en.pdf.
* This diagram is not exhaustive. The scope, nature and number of dialogues changes regularly.

provider of manufactured goods. Nearly 9% of EU exported goods in 2011 went to China. In 2011 Europe was among the top five sources of foreign direct investment to China (17 billion euros), while China's investments in Europe have been increasing rapidly since the 2008 global financial crisis (3.1 billion euros in 2011)(Council of the European Union 2012b).

Furthermore, referring to negotiations on a EU-China investment agreement are expected to start, both actors are considering talks on a China-EU free trade agreement, according to the Chinese Ambassador to the EU(Ding Qingfen 2014). In the trade of goods, which reached 433.6 billion euros in 2012, China has a trade surplus with the EU. In the trade in services the reverse is the case, with the EU having a trade surplus; however, the trade in services is ten times lower at 42.6 billion euros. Despite the strong trade relationship between China and the EU, there are still a number of problems concerning the terms of trade. Brussels has 31 ongoing trade investigations, 18 involving China. The largest one involves imports of Chinese solar panels, cells and wafers valued at 21 billion euros. Most of these cases involve dumping cheap Chinese products on the European market(EEAS 2013b). A fundamental dispute regarding solar panels showcased the split among EU member states and nearly led to a major trade war between the two partners in 2013.

5. Strategic Partners in the G20?

Conflicts notwithstanding, the strategic partnership between the two sides offers a remarkable basis for global cooperation as major powers. Global economic cooperation and governance in particular constitute a "core issue" (Luzenberger 2013: 37). Addressing the need to overhaul global economic governance offers ample opportunities to add substance to the claim that Sino-EU ties can provide a model for bilateral cooperation in the twenty-first century (Barroso 2012). These efforts should be directed at the G20 summits, which have shifted focus from crisis response to reforming global economic governance (Kirton 2013; Cooper and Thakur 2013). In its membership and procedures, the G20 represents a global power-shift. It brings together established and emerging powers. If the EU and China are seeking to redefine their relationship, the challenge of coming to terms with the global financial crisis and their respective roles in the G20 are good places to start.

A key issue for the G20 has been financial market regulation. In this area, the EU and China have been intensifying and broadening cooperation since the early 2000s. A sectoral dialogue and several projects were implemented in 2005. In its early stages, this dialogue was dominated by the European desire to socialise China into global economic governance. The dialogue led to profound working relations between leading experts and decision-makers. Interviews in Brussels and Beijing indicate that these networks played an important informal role in ensuring mutual awareness and understanding of policies and interests. Therefore, when the turmoil on financial markets was rightly acknowledged as a lethal threat to global stability, the EU and China could rely on an expert community and multiple channels to coordinate their policies. In various speeches, leaders on both sides expressed their readiness to "redouble their joint efforts to tackle global challenges such as the international financial and economic crisis" (Council of the European Union 2012). However, it took the strategic partners until 2013 to put the G20 prominently on the bilateral agenda.

The EU's ambition to play a central role in global financial governance was repeatedly stated and found clear expression in the European Council declaration (2009) that "the European Union will take a leading role at the global level in promoting a swift return to sustainable economic growth ...bringing forward the reform of financial markets" (European Council 2009: 8). China's leaders, by contrast, emphasise their role as a representative of developing and emerging nations. China's leaders still seek above all a stable and positive environment for domestic policies (Yu Sui 2013).

Europe played an important part in setting up the first G20 summit at the leader level, while China remained on the sidelines and was "caught unprepared by the call for a summit" (Kirton 2013: 237). No evidence suggests a concerted EU-China approach in spite of the thematic and political proximity to key contents of the EU-China partnership. The Chinese position was exemplified in then President Hu Jintao's programmatic speech at the Washington summit 2008. He called for close cooperation and a fundamental review of global rules but did not push individual items on the agenda. China started to exert "focused leadership" (Bersick and Gottwald 2013a) only on core issues such as IMF reform and development. By contrast, the Chinese leaders emphasised the special responsibility of the more advanced economies and warned against premature moves.

On the first two G20 summits held at Washington in November 2008 and in London in April 2009, both the EU—including its member states—and China managed to influence the agenda(Hodson 2011:97-101). The institutionalization of the G20 Leaders' Summits agreed at the Pittsburgh G20 Summit in September 2009 (Group of Twenty 2009b) "owes much to the diplomatic efforts of the EU" (Hodson 2011:101). After substantial internal debates, the Chinese government announced a massive stimulus package a few days before the Washington Summit to boost domestic growth and provide the Chinese leadership with a substantial policy to be presented to the Leaders' Summit: the idea that China's economic growth would be the main contribution to global efforts. China's main economic interest at the first summits referred to the global economic recovery. Politically, it attempted to minimise binding commitments for its own domestic policies. As a consequence, Hu Jintao called for better international regulation of financial services, close macroeconomic cooperation and similar points without pushing individual elements of the agenda, with two remarkable exceptions: the old interest in substantial governance and voting-rights reform at the international financial institutions; the call for the promotion of development, including special protection particularly for the poorest and least developed countries (Hu Jintao 2008; Chin 2010).

While both sides managed to get key topics into the G20 summits in London, Pittsburgh, Seoul and Cannes, there is no evidence of joint policies. Rather, on some occasions EU interests matched those of the Chinese, allowing for joint support for individual items such as Bretton Woods reform or adding the issue of commodity prices volatility and food security to the ever-expanding list of G20 topics. In this regard, the French position—which had been discussed beforehand at a state visit by President Sarkozy to China and at a G20 Finance Ministers Meeting in Nanjing 2011—met the Chinese strategy in 2010 to include more areas such as food and energy security to the agenda (Xinhua 2010; Xie 2011). For China organizing resistance to far-reaching attempts by the United States to change China's currency policies gained prominence once macroeconomic coordination turned into governance reform. In this respect, China initially acted as "blocker of demands by other countries" (Cooper and Thakur 2013: 76), occasionally linking up with some European governments but not managing a united position with the EU.

The issue of how to address the euro zone crisis and what role to play for the G20 in this regard put the spotlight on the EU-China strategic partnership in the context of global economic governance. What could have been a substantial leadership resource turned out to be a fragile construction when called upon in times of crisis (see below). PRC leaders sought to minimise the effect of the eurozone crisis on the G20 agenda, and criticise the fact that the crisis would 'hijack' the Los Cabos Summit in 2012. In the end, the PRC had to accept that most discussions dealt with the situation in Europe. Similarly, the St Petersburg Summit in 2013 was overshadowed by the crisis in Syria and again left little trace of Sino-EU joint action.

6. Strategic Partnership and the Euro Sovereign Debt Crisis

The dissonance and normative shift in the strategic partnership became fairly obvious when Europe failed to address its sovereign and private debt problems. Before the global financial crisis, China had been attacked by leading European politicians and media as a major rival threatening Europe's social and economic well-being through its successful strategy of investment in and increased exports to Europe (and the world in general) (Gottwald 2010). When EU member states found it increasingly difficult to refinance their banks and national budgets, China suddenly emerged as something like a "white knight", riding to the rescue. While there is limited yet substantial Chinese investment in European debt (Casarini 2013; Anderlini and Spiegel 2010), the overall policy of the PRC follows a clear line: increased cooperation with Europe, rhetorical reassurance of partnership, but little additional investment in EU debt. Instead, the EU received outspoken advice to first deal with its problems itself before expecting major new foreign support. As a developing country facing substantial challenges at home, the Chinese leadership refuses to commit itself to major bail-outs for a wealthy region such as Europe. From 2011 onwards, Chinese leaders linked the issue of support to the solution of long-standing conflicts of interest in the partnership and made political concessions by the EU a precondition of further support (Wen 2011; Anderlini and Zhang 2011). "The lasting image and fitting metaphor will be that of Europeans going cap-in-hand to China to bail out their governments and financial institutions, and being told to find their own solutions."(Cooper and Thakur 2013:110)

7. Outlook: Strategic Partners in a New Major Power Relationship?

The ambitious new agenda Horizon 2020 underlines the need to revise the idea of a strategic partnership between China and the European Union. In this context, it is surprising that Xi Jinping's concept of a "new major power relationship" has had little effect on the partnership. In China, there are indications that the concept covers a number of important powers, potentially including the EU. In Europe, by contrast, these ideas are interpreted as a new approach by the PRC to come to terms with the United States. It is interpreted as a new attempt to strengthen previous claims that China's emergence will not necessarily lead to increased tension with the hegemon and does not constitute a threat to anyone. Europe's lack of enthusiasm might therefore be readily explained as a clear understanding of the true significance of the concept. Besides, the EU is facing an uphill task in preserving its own position as a major global power. The fall-out of the global financial crisis has cost the EU heavily in terms of global recognition. It has also contributed to the renationalisation of China policies. The German government has done little to diffuse the Chinese claim that EU China policies are predominantly decided in Berlin and occasionally in London or Paris.

In this respect, the concept of new major power relationships signals a further decrease in significance of the EU-China strategic partnership despite the continuing growth of bilateral exchanges at the expert and societal level. China has clearly stepped up its cooperation with the governments of the member states. Much will depend on whether or not the EU and China-EU relations will develop in the direction expected by the new Chinese leadership. The Chinese news magazine *Global Times* thus called Xi Jinping's visit to Brussels in April 2014 "Operation Seduction" welcoming that the partner apparently had found a way to put frictions aside and concentrate pragmatically on the development of bilateral relations (Lui 2014). Few days after the conclusion of Xi Jinping's visit, the Chinese government published a new China EU policy white paper with substantial proposals regarding the development of political ties (State Council 2014) on the basis of full recognition of normative differences and including clear requests regarding EU policy changes in the field of arms sales, or technology transfer. From an EU perspective, the new concept highlights China's turn towards emerging powers and the United States. It increases the pressure to redefine its own role in global politics. Europe's normative power is vanishing. The decreased significance of norms and a more realistic view on economic benefits and political tensions might foster an overdue normalization of Sino-EU ties which have often been overburdened with exaggerated ambitions.

The decision to officially incorporate society-to-society relations as the third pillar into the official structure of the EU-China strategic partnership might turn out to be the most decisive improvement in bilateral ties in recent times: it acknowledges the changing nature of the relationship and highlights the growing independence of transnational politics from ups and downs at summit level. While these developments send out a signal or reassurances regarding the substance of bilateral relations, they have yet to prove their significance beyond the partnership framework and at global level.

In the case of the global financial crisis and the G20, joint action by the strategic partners is barely detectable. China's new role in global governance has been more affected by its occasional alignment with other emerging powers among the BRICS countries and its complex relationship with the US than by its strategic partner the EU. Obviously, if the idea of new major power relationships helps to diffuse tensions with established and emerging economies, it will have a positive effect on the operation of the G20. At the same time, it constitutes an obstacle to the further institutionalization of the G20. So far, the G20 has been marked by a complex structure of ad-hoc coalitions and less by a stable alliance or axis of major powers. China's emphasis on new major power relations will further strengthen this feature, particularly at a time when the overall benefit of cooperating in the G20 has lost some of its appeal.

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Chapter 14
China-EU Cooperation in the G20

Jiang Shixue

1. Introduction

The so-called "Group of 20"(G20) has become one of the major forces in global governance. Although it is only five years since it came into being, it has substantial achievements in many areas, including stabilizing the world economy: as its fifth Anniversary Vision Statement (6 September 2013, Saint Petersburg) said, "Because of our actions, the global economy is more resilient"[1].

Both China and the EU are active in the G20. According to the China-EU 2020 Strategic Agenda for Cooperation, released at the 16th China-EU Summit on 21 November 2013, in Beijing, the two sides will "reinforce cooperation in multilateral fora, including coordination before major meetings, to establish a rules-based, more efficient, transparent, just and equitable system of global governance, emphasize multilateralism and the central role of the UN in international affairs and value the role of multilateral organizations and platforms such as the G20. The EU looks forward to China hosting a forthcoming G20 summit"[2]. Therefore, it can be predicted that China-EU cooperation in the G20 will become an important component of their bilateral relations in the future.

2. Attitudes and Positions of China and the EU towards the G20

Both China and the EU have adopted positive, active and supportive attitudes to the G20. This enthusiastic position has contributed to the success of the G20 and also reflects the attractiveness of the multilateral platform. It also exhibits the intention of China and the EU to participate in global governance, which in turn constitutes the political conditions of their cooperation in international affairs.

2.1 China's Attitudes and Position Towards the G20

China supports the important role the G20 has been playing in promoting global governance and participates in all kinds of activities of the G20 in an active and constructive way. Chinese leaders have attended all the G20 summits and have praised its work and achievements. At the London Summit in 2009, for instance, Chinese President Hu Jintao said that the G20, which is broadly representative, is an important and effective platform for the international community to deal with the international financial crisis.[3] At the Pittsburgh Summit in 2009, he urged the G20 to keep on strengthening coordination of macroeconomic policies and make the policy orientation more consistent, effective and forward-looking.[4] At the St. Petersburg Summit in 2013, Chinese President Xi Jinping reiterated that the G20 is an important platform where the developed and developing countries can work on policy coordination on international economic affairs and that China would like to see the G20 become an important force in stabilizing the world economy, establishing a safety net for global finance and improving global economic governance.[5]

The report presented by Hu Jintao, General-Secretary of the Central Committee of the Communist Party of China (CPC), to the 18th CPC National Congress on 8 November 2012, also asserted that "[China] will actively participate in multilateral affairs, support the United Nations, G20, the Shanghai Cooperation Organization, BRICS and other multilateral organizations in playing an active role in international affairs, and work to make the international order and system more just and equitable"[6]. This means that the G20 and other multilateral institutions will occupy a more important position in China's foreign diplomacy.

Other G20 members, particularly those taking the presidency, have also attached importance to China. On the evening of 21 October 2008, President Hu

Jintao was asked to have a phone conversation with President Bush of the United States to discuss issues at the coming G20 summit in Washington DC.[7] During the French presidency in 2011, a high-level seminar on reforming the international financial architecture was held on 31 March in Nanjing, capital city of China's Jiangsu Province, at the request of France. French President Sarkozy and then Chinese vice premier Wang Qishan addressed the opening ceremony. Also present at the meeting were finance ministers and central bank governors from China, France, the United Kingdom and Russia, as well as IMF Managing Director Dominique Strauss-Kahn and European Central Bank President Trichet.

On 25 August 2011, Sarkozy stopped in Beijing for a brief five-hour visit en route to the French territory of New Caledonia. He discussed the world economic situation and the coming G20 summit to be held in Cannes with his Chinese counterpart. He expressed his concern about the world economy and hoped that France and China would cooperate closely to find ways of promoting world economic recovery at the summit. President Hu Jintao told his guest that, as the world economy faces many challenges, the international community must become more united to consolidate confidence to deal with the difficult situation. He believed that the Cannes Summit would be an important event that would meet everyone's expectations. The Chinese leader acknowledged the agenda of the summit and praised France for its successful preparations of the gathering. He also promised that China would continue to support France's endeavours and work along with other partners to make the summit a great success.[8]

China has not yet hosted a G20 summit, but successfully organized the seventh G20 Meeting of Finance Ministers and Central Bank Governors in October 2005. President Hu Jintao addressed the opening ceremony, declaring that, given the current world situation, G20 members must have dialogue on a mutually beneficial and pragmatic basis to seek common ground and resolve differences.[9]

2.2 The EU's Attitudes and Position towards the G20

The EU also attaches importance to the G20. The EU External Action Service believes that, since 1999, the G20 has contributed to strengthening the international financial architecture and fostering sustainable economic growth and development. The G20 now has a crucial role in driving forward cooperation between advanced and emerging economies to tackle the international financial and economic crisis, to restore worldwide financial stability, and to lead the international economic recovery and secure a sustainable future for all countries.[10] Herman Van Rompuy, President of the European Council, said ahead of the G20 summit in St Petersburg, that "coordinated, collective action is paramount. And the G20 has become the most systematic and far reaching global economic policy coordination exercise"[11]. According to José Manuel Durão Barroso, President of the European Commission, "the G20 is the central global setting where older and rising powers share leadership and find solutions to manage global issues, particularly in the area of the international economy"[12]. He believes that the G20 must take a holistic and ambitious approach and that is the only way the world can get out of this crisis without risking a worse crisis in future.[13] Before the Seoul Summit in November 2011, President Barroso told the European Parliament in Strasbourg that there was concern about once the pressure of the crisis which had brought G20 countries together receded, the G20 would find it impossible to fulfill its role as the primary forum for global economic coordination. "After this month's Seoul Summit, I can reassure you that that negative scenario was not confirmed", he said.[14]

President Barroso even suggested that the G20 summit at the level of Heads of State and Government was the result of an European initiative in 2008. "I would recall that both President Sarkozy and I went to Camp David to argue with President Bush for a global response. The G20 summit in Washington in November last year was the result of these joint efforts. Europe has therefore a particular responsibility in the current G20 process", he said.[15]

Apart from Germany, the United Kingdom, Italy, and the EU also has a seat in the G20. It is often said that the EU is over-represented in this world body, but it also indicates that the EU's position in the G20 is prominent.

The United Kingdom and France hosted the London Summit on 1 and 2 April 2009 and the Cannes Summit on 3 and 4 November 2011. As hosts, the two countries made great efforts to make the two gatherings a success. At each summit, G20 leaders publicized joint declarations and other important documents after they had discussed the world economic situations intensively. From then on they knew what was needed to deal with the international financial crisis. It can be noted that, without these two meetings, the world economic recovery would not have happened.

3. China's and the EU's Attitudes towards the G20

In order to explore ways of cooperation in the G20, it is necessary to identify the wish-lists of China and the EU. There are both similarities and differences.

3.1 China's Attitudes

Based on the speeches delivered by the Chinese leaders at G20 summits, we can summarize China's attitudes towards the G20 as follows:

(1) Restoring Market Confidence

In order to curtail the contagious effects of the international financial crisis, the major developed countries must take responsibility to implement responsible macroeconomic policies and to stabilize their own and international financial markets in the interests of investors. The G20 must strengthen coordination of national macroeconomic policies, expedite exchanges of information, and upgrade financial regulation at the international level.

(2) Reinforcing International Cooperation

The international financial crisis has happened at a time when economic globalization is forging ahead and interdependence between nations is deepening rapidly. As a result, no nation could escape its spillover effects. Cooperation is the only option available to face the crisis. As the effective platform of the international community, the G20 must cooperate to speed up structural reforms, calm the markets, promote growth, increase employment, improve people's living standards, and reduce the negative effects of the crisis on the real economy.

(3) Establishing a New International Financial Architecture

An equitable, inclusive and orderly international financial architecture is needed for the healthy growth of the world economy. The G20 must make great efforts towards this end. In this process, attention must be given to the following issues: how to enhance the transparency and validity of the process of choosing the leaders of the international financial bodies; how to increase the representativeness and rights of the developing countries; how to strengthen international financial regulation and make it better serve the development of the real economy; how to widen the use of the IMF's special drawing rights; how to improve the composition of the currency basket and build a global reserve system with stability, orderly supply and adjustable total volume; how to create internationally recognized standards and norms of financial regulation, improve supervision of the rating agencies and set up an effective warning system covering the whole world and the major international financial centers in particular; and how to reinforce monitoring of the macroeconomic policies of the major economies capable of issuing reserve currencies.

(4) Fighting Trade Protectionism

World trade based on an international division of labor and the comparative advantages of different nations is compatible with globalization. No one should practice protectionism in the name of stimulating economic growth. The G20 must be in a position to oppose protectionism in any guise. Particularly, the developed countries need to lower restrictions on exports from the developing countries so that a free and justy world trade regime can be established. At the same time, efforts must be made by the developed countries to lift bans on high-tech exports to the developing countries. Moreover, the G20 should push ahead with the negotiations of the Doha Round.

(5) Promoting Balanced Development of the World Economy

The imbalance of the world economy is reflected in the disparity between not only savings and consumption in some countries, but also in trade. Even in terms of the distribution of wealth, possession and utilization of resources, and the international monetary system, imbalance is evident. The causes of these imbalances are concerned with many factors, such as globalization, the pattern of the international division of labor, movements of international capital, the international economic system, the macroeconomic policies of the major economies, different consumption of culture, and ways of living and so on. However, the fundamental cause is the gap between the developed and the developing countries. Therefore, the G20 must prioritise narrowing this gap by fully implementing the Monterrey Consensus and the UN Millennium Development Goals, as well as by respecting the differences between development models.

(6) Helping the Developing Countries to Speed Up Their Development

Because of the developing countries' low level of development, lack of a diversified economic structure and weak capability to resist external shocks, the G20 must help them to reduce the damage of the international financial crisis by offering more financial assistance, writing off debts, cutting trade barriers for their exports, transferring more technology and strengthening their ability to grow.

(7) Promoting Sustainable Development

The G20 must play an active role in encouraging the development of "green" industries by encouraging countries to invest more and improve institution-building. Because not all countries are at the same level of development, a principle of common and differentiated responsibility must be followed. Furthermore, the G20 also needs to facilitate the spread of "green" technology and strengthen cooperation between nations to avoid "green" barriers.

3.2 The EU's Attitudes

The EU's attitudes towards the G20, which are also constructive and creative, can be summed up as follows: [16]

(1) Achieving a Swift Recovery of the World Economy

The G20 should coordinate the macroeconomic policies of the major economies so as to reduce the spillover effects of the international financial crisis, promote world economic recovery and create more jobs. In the process, it also needs to streamline their fiscal exit strategies by cooperating closely with the IMF.

Attention must be paid to the economic recovery of the least developed countries. The developed members of the G20 must implement the "Everything But Arms Initiative" and help them to achieve the Millennium Development Goals. [17]

(2) Implementing Financial Market Reforms

In order to avoid a future crisis, the G20 can cooperate with the Financial Stability Board to reform the financial markets thoroughly. All the G20 members must following BASEL II and III so as to strengthen regulation and supervision of the banking sector. [18] Meanwhile, the G20 should address the "too-big-to-fail" issue by setting up an effective resolution mechanism for financial institutions of systematic importance. It must pursue work on further regulatory reforms, including on effective cross-border crisis management, commodity derivatives, market integrity and shadow banking, and develop a financial transaction tax at the global level.

(3) Opposing Trade Protectionism

Trade can stimulate world economic recovery and create jobs. Failure to construct a free trade framework like the Doha Round would result in a loss of the momentum pushing forward world economic growth. As a result, the G20 must send out a strong signal opposing trade protectionism.[19]

(4) Eliminating Global Economic Imbalances

The G20 should implement policies to balance the world economy. Countries with a large trade surplus need to stimulate domestic demand, whereas those with a large trade deficit must boost their competitiveness. The emerging economies, China in particular, have made efforts towards this end. But they also need to make the exchange of their currencies more flexible.[20]

(5) Prioritizing Employment Creation

The world economic recovery is still weak and unemployment is high in many countries, leading to a fall in living standards and threatening social stability. Therefore, the G20 must work hard to create more jobs.

(6) Reforming the International Financial System

It is important to fully implement the IMF reform package which was agreed in 2010 so that its legitimacy, credibility and efficiency can be maintained. The EU members have all ratified the plan. The G20 must urge other members of the IMF to follow suit. Moreover, the G20 must push for closer cooperation between the IMF and regional financial arrangements, fight against tax fraud, money laundering and cross-border financial crimes, and explore the possibility of levying a financial transaction tax.

(7) Sharing the Effort on Climate Finance

As the risks posed by climate change are real and can already be seen, the G20 should call on all parties to significantly step up the pace of negotiations in order to keep the increase in global mean temperature to below 2℃ compared with pre-industrial levels. Developed countries should reduce their emissions by 80 per cent or more by 2050, as agreed at the G8 Summit in l'Aquila. Countries that have not yet done so should urgently make ambitious commitments to mid-term reductions and quantifiable actions. Financial resources will need to be scaled up urgently and substantially to reduce global greenhouse gas emissions and to adapt to the unavoidable effects of global warming. All countries, except the least developed, should contribute to financing the fight against climate change in developing countries with finance allocated according to need so that developing countries receive more than they are contributing.

(8) Promoting Energy Security

The G20 should commit itself to improving energy security by increasing oil and gas market transparency and containing speculation. Developing new energy-efficient technology is also important to ensure energy efficiency.

By comparing the wish-lists of China and the EU for the G20, we can reach the following conclusions:

(1) The expectations of both China and the EU for the G20 are quite high, and it seems that the G20 is believed to be able to do anything it wishes.

(2) Both argue that they have made great contributions to world economic stability and recovery.

(3) After the critical moment of the international financial crisis, the interests of both sides have shifted from calling for a rapid world economic recovery to dealing with other global issues.

(4) Both wish to see that all the action plans and other policies favorable to the world economic recovery are fully implemented.

(5) The EU worries more about unemployment whereas China, expresses more concerns about economic problems facing developing countries, and calls for more assistance from developed countries.

(6) Besides economic problems, the EU also wishes to see other issues, such as corruption and cross-border crime, can be tackled by the G20, and it also stood alongside with the United States at the St Petersburg Summit while discussing the Syrian crisis, whereas China wants the G20 to focus solely on economic issues.

Furthermore, the EU sometimes puts forward specific requirements for some countries. Before the Los Cabos Summit, for instance, the EU asked the United States and Japan to implement credible fiscal reforms and called on China to strengthen its social safety net and to carry out structural reforms so as to achieve marketization of the RMB exchange rate.[21]

4. Ways and Means of China-EU Cooperation within the G20

On one hand, the G20's position on the world stage is reinforced; on the other hand, as the second largest economy in the world, China's role in the G20 is also becoming more and more important. Moreover, China has close relations with the EU, and the two sides have established the so-called Comprehensive Strategic Partnership. As the wish-lists of the two sides with regard to the G20 are similar, it is natural for them to deepen cooperation on this international platform in the following areas:

(1) Joining Hands to Help the Developing Countries

As a developing country, China assumes international responsibilities by offering aid to other developing countries. China's foreign aid benefits the development of South-South relations and contributes to the common development of mankind.

The EU also wishes to help the developing world. President Barroso once said, "our developing country partners are the least responsible for this crisis but among the worst affected. So we have to face this. As I have said on numerous occasions, our growth and stability are completely linked to theirs and vice versa. Offering our assistance is not only the right thing to do—it makes good economic sense, too. Our promise to help developing countries integrate into the global economy so they can enjoy greater prosperity is a cornerstone of our founding values and will prove a foundation for global recovery"[22].

Therefore, both China and the EU can make good use of the G20 to coordinate their positions and policies to offer more aid to the developing countries in a more effective and constructive way. Particularly in the fields of medical care and education, both have gained valuable experiences. Undoubtedly, China-EU cooperation in this regard will result in a win-win situation.

(2) Exerting More Influence on the G20 Presidency

The G20's rotating presidency has a greater say in deciding the agenda and topics to be discussed at its summit and other meetings. Evidently, the agenda and the topics can have an important impact upon the direction of the world economy, as well as the economic policies of G20 members. Several G20 summits have raised the issue of world economic imbalances. But China has argued that this imbalance does not only reflect in large trade surpluses; rather, it involves disparities and disproportion in economic structure and economic governance, inequality of international economic rule-making, and the North-South gap in development levels. Therefore, if China and the EU can discuss issues of common interest and coordinate their positions, they can influence the G20 presidency in a certain way.

It is encouraging to see that the China-EU 2020 Strategic Agenda for Cooperation calls for both sides to strengthen cooperation on multilateral platforms by coordinating their positions before important gatherings. Consequently, China and the EU might set up an ad hoc working group to coordinating their positions and attitudes towards the important issues to be dealt with at G20 summits. In this process, China needs to keep close contact with not only the European Commission, but also the member states that have a seat in the G20 (Germany, France, the United Kingdom and Italy) and Spain, which attends the G20 summits as a permanent guest.

(3) Strengthening Cooperation in Reforming the International Financial System

The G20 played an important role in taking the first step towards restructuring the international financial architecture. In December 2012, the IMF Board of Governors approved major quota and governance reforms, which would benefit both China and the EU.[23]

However, this reform faces obstacles. For instance, the United States and other countries have not ratified the plan. Therefore, China and the EU need to call on them to respect the international consensus so that the IMF can upgrade its capacity to safeguard stability of international financial markets.

(4) Working Together to Transform the Functioning of the G20

The G20 was born at a critical point to save world economy from the international financial crisis. With the recovery of world economy, its importance seems to be in decline. Even its legitimacy is in doubt. Before the Seoul Summit in November 2010, for instance, Robert Wade and Jakob Vestergaard (2010) said, "gone is the 'fellowship of the lifeboat' we saw during the acute phase of the financial crisis; instead, emerging and developed countries find themselves increasingly at odds, both in their diagnoses of the global recession and in their prescriptions for recovery". The editorial page of the *Financial Times* (2 September 2013) also pointed out that the spirit of unity of the G20 had been broken and policy coordination had been proceeding haltingly, if at all. Therefore, as the newspaper suggested, the world needs the G20 leaders to rekindle their willingness, and to work together at the G20 summit in St. Petersburg.[24]

In fact, as early as the G20's Toronto Summit in June 2010, Chinese President Hu Jintao pointed out the need to transform the G20 from an effective mechanism to a platform for promoting long-term international economic cooperation, from coordinating fiscal stimulus to encouraging sustainable growth of the world economy, and from reacting passively to planning active for the future. He also proposed that proper relations should be established between the G20 and other international organizations.[25]

The EU and its member states have several seats in the G20. Therefore, China and the EU have many opportunities for cooperation in improving the functioning of the Troika and other mechanisms of the G20, as well as making the topics to be discussed at the Meeting of the Finance Ministers and Central Bank Governors, Business Summit, Civil Society Summit, Labor Summit, Think-tank Summit, and Youth Summit more compatible with the wishes of most countries in the world. Moreover, China and the EU also need to think about the need to institutionalize the G20 so that it does not become merely a talking-shop.

(5) Helping Each Other During the Rotating Presidencies

Within the present framework, the importance of G20 presidency is conspicuous. As the major actor in the Troika, the country taking the G20 presidency can have a decisive role in designing topics to be discussed at the summit.

5. Conclusions

According to the China-EU 2020 Strategic Agenda for Cooperation, the two sides would work together to establish a more effective, transparent, just, and reasonable system of international governance. Both would attach greater importance to the G20 and other multilateral institutions. The EU wishes to see

China soon chair the G20 summit.

The G20's position on the world stage is reinforcing. Moreover, China and the EU have established the Comprehensive Strategic Partnership. Therefore, the two sides have plenty of opportunities to cooperate in the G20 through the following ways: joining hands to help the developing countries overcome their economic difficulties; exerting more influence on the G20 presidency; strengthening cooperation in reforming the international financial system; working together to transform the function of the G20; and helping each other during the rotating presidency in the future.

Notes

[1] The G20 5th Anniversary Vision Statement listed the following achievements: "In Washington, London and Pittsburgh, we took decisive steps to stimulate the world economy, restore growth, recapitalise financial institutions, launch an ambitious program to reform the financial sector, maintain open markets and clamp-down on tax havens. Significantly, we established the Financial Stability Board (FSB), tripled the resources available to the IMF, and put in place our Framework for Strong, Sustainable, and Balanced Growth. This coordinated response helped to alleviate severe market distress and avert a global depression. In Toronto, Seoul, Cannes and Los Cabos the G20 demonstrated its leadership in returning to fiscal sustainability and promoting growth and job creation, structural, financial and tax reforms, anti-corruption, development, energy, agriculture, and fostering inclusive green growth. We also started working in partnership with developing countries outside the G20 to narrow the development gap and reduce poverty. In St. Petersburg we have emphasised restoring strong and inclusive growth and employment while ensuring fiscal sustainability, promoted financing for investment, including in infrastructure; made further progress on financial reforms; and we have made strong commitments on trade, development, addressing tax evasion, and on changing the rules that allow international tax avoidance related to the erosion of tax bases and shifting of profits." (http://www.g20.utoronto.ca/2013/2013-0906-vision.html)

[2] http://www.fmprc.gov.cn/eng/zxxx/t1101804.shtml.

[3] http://politics.people.com.cn/GB/1024/9073737.html.

[4] http://news.xinhuanet.com/politics/2009-09/26/content_12112502.htm.

[5] http://www.gov.cn/ldhd/2013-09/06/content_2482284.htm.

[6] http://news.xinhuanet.com/english/special/18cpcnc/2012-11/17/c_131981259_12.htm.

[7] http://news.xinhuanet.com/world/2008-10/21/content_10230015.htm.

[8] http://politics.people.com.cn/GB/1024/15511943.html.

[9] http://www.mof.gov.cn/zhuantihuigu/czhzhy7/mtbd/200805/t20080519_22038.html.

[10] http://eeas.europa.eu/g20/index_en.htm.

[11] http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/138659.pdf.

[12] http://europa.eu/rapid/press-release_SPEECH-10-322_en.htm?locale=en.

[13] http://europa.eu/rapid/press-release_SPEECH-09-126_en.htm?locale=en.

[14] http://europa.eu/rapid/press-release_SPEECH-10-682_en.htm?locale=en.

[15] http://europa.eu/rapid/press-release_SPEECH-09-140_en.htm.

[16] Council of the European Union, Informal Meeting of Heads of State or Government on 7 November 2008: Agreed Language, Brussels, 7 November 2008; Annex 1: Agreed Language with a View to the G20 Summit in London, in Council of the European Union, Brussels European Council 19/20 March 2009—Presidency Conclusions, Brussels, 29 April 2009; Council of the European Union, Agreed Language for the Pittsburgh G20 Summit—Achieving a Sustainable Recovery, Brussels, 17 September 2009; President Herman Van Rompuy, Joint Letter with European Commission President José Manuel Barroso on EU Priorities for the G20 Summit, June 23, 2010; G20 Summit: Joint Letter of Presidents Barroso and Van Rompuy to G20 Leaders, Brussels, 5 November 2010; Joint Statement by European Commission President Barroso and European Council President Van Rompuy on the 1st day of the G20 summit in Cannes, Brussels, 3 November 2011; Council of the European Union, Joint letter of President Van Rompuy and President Barroso to the EU Heads of State or Government on the G20 Summit in Los Cabos, Mexico, Brussels, 25 May 2012; G20 Summit: Improving Global Confidence and Support the Global Recovery-Joint Letter of the Presidents of the European Council and the European Commission, Brussels, 23 July 2013.

[17] Tailor-made to the specific needs of least developed countries, the EU's "Everything But Arms" arrangement was born in 2001 to give all less developed countries full duty free and quota-free access to the EU for all their exports with the exception of arms and armaments. http://trade.ec.europa.eu/doclib/docs/2013/april/tradoc_150983.pdf.

[18] The Financial Stability Board was established in April 2009 as the successor to the Financial Stability Forum. https://www.financialstabilityboard.org/about/history.htm.

[19] Before the Pittsburg Summit in September 2009, the EU was ambitious enough to propose that the Doha Round negotiations would be completed by 2010 (See: Council of the European Union, Agreed Language for the Pittsburgh G20 Summit—Achieving a Sustainable Recovery, Brussels, 17 September 2009, http://www.consilium.europa.

eu/uedocs/cms_data/docs/pressdata/en/ec/110166.pdf).

[20] The EU believes that it has not contributed to world economic imbalances because its trade deficit is not large, its inflation rate is low and its exchange rate policy is determined by market forces.

[21] Council of the European Union, Joint letter of President Van Rompuy and President Barroso to the EU Heads of State or Government on the G20 summit in Los Cabos, Mexico, Brussels, 25 May 2012.

[22] http://europa.eu/rapid/press-release_SPEECH-09-177_en.htm? locale=en.

[23] http://www.imf.org/external/np/sec/pr/2010/pr10477.htm.

[24] http://www.ft.com/intl/cms/s/0/fdf47b26-13d7-11e3-9289-00144feabdc0.html#axzz2tg7Ws7tK.

[25] http://www.gov.cn/ldhd/2010-06/27/content_1639029.htm.

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Chapter 15
China, the BRICS and the G20: New Configurations of Power in the International System

Rosana Pinheiro-Machado

1. Introduction

The emergence of new players in the world system guides the geopolitics of the twenty-first century, which has broken with the bipolar or even unipolar rationale that prevailed during a significant part of the twentieth century. In this new multipolar context, the "emerging countries", known as the BRICS (Brazil, Russia, India, China, and South Africa) undoubtedly play a key role in counterbalancing power relations across the wealthiest nations in the world, especially through their actions in the G20. Nevertheless, even though this new bloc concentrates a fifth of the world's GDP (USD 14.7 trillion) and nearly 50 per cent of the world's population,[1] its future as a defining agent of international relations remains uncertain. The breadth of its bargaining power in international negotiations is still an open-ended question whose answer depends on several variables, one of which is the group's internal cohesion, particularly with regard to China's alignment.

China occupies an ambivalent position in the world system: now a "developing" country and now an "empire". On one side, the country faces huge social and economic challenges and submits part of its agenda to the demands of the hegemons; on the other, it has the second largest economy in the world, the largest foreign currency reserves and the largest slice of total exports, thus affording it some autonomy and authority in the international arena. In taking this intermediate path, China is trying both to defend its own interests and to negotiate with the BRICS, while also "flirting" with the United States. This ambiguous and somewhat uncertain position is directly reflected in the quality of its relationship with the BRICS, given China's central role in the group. China alone has more than half the GDP of all five countries together[2] and, therefore, one could argue that "briCs" would be a better abbreviation than "BRICS". The inequality in the bloc translates into relations of neodependency, thus prompting dissatisfaction and restlessness regarding the Chinese phenomenon at present.

In this context, this article analyzes the role of China in the BRICS and, by extension, of the BRICS in the G20. We contend that the BRICS, by gaining representativeness in the G20, have constituted a significant bloc in the reconfiguration of the global power structure, although it is equally true that the scope of this action is limited by a number of constraints, including the bloc's internal inequality and instability. A radical change in relations between the so-called Global North and Global South depends on the group's cohesion and consolidation, which, in turn, depend on the quality of relations with China.

This chapter is divided into three parts, in addition to this introduction and the conclusion. In the first part, I provide a brief definition of the BRICS. In the second, I analyze the role of China in the BRICS as a whole, pointing to the country's uncertain alignment with the bloc. Finally, I note how the BRICS are presenting a more consistent and decisive agenda in the G20 and, in consequence, are coming to constitute a bloc capable of prompting change in today's international power structure.

2. Alphabet Soup: BRICs, BRICS, briCs...

The acronym "BRIC" was coined by Jim O'Neill in a 2001 publication by Goldman Sachs to designate the largest emerging economies of the world, Brazil, Russia, India, and China, whose growth then was much higher than that of the G7. Since then, the BRIC bloc has grabbed the world's attention as a symbol of the multi-polarity that has come to characterize the early years of the twenty-first century. In 2009 the bloc met for the first time, in Yekaterinburg, Russia. At the following year's meeting, in Brasília, South Africa was incorporated in the group, thus marking its passage from "BRIC" to "BRICS". Today, consideration is being given to the entrance of newly emerging countries, such as Indonesia, although nothing concrete has arisen from the negotiations.

Based on 2012 data, at the top of the group is China with a GDP of USD 8.2 trillion. In an intermediate position, Brazil, Russia, and India have GDPs of, respectively, USD 2.2, USD 2.0, and USD 1.8 trillion. At the base and distant from the others appears South Africa, with a GDP of USD 384 billion. Their wealth added up, the bloc accounts for some 20 per cent of the world's GDP. With regard to economic growth, the BRICS have had their ups and downs. The bloc as a whole recovered quickly after the 2008 world economic crisis, with a growth rate that was higher than the world average in 2010, with the exception of South Africa. However, in 2012, only Brazil was below the world average, precisely the country that had exhibited the most significant recovery after the global crisis (from 7.4 per cent in 2010 to 0.9 per cent in 2012).

Due to Brazil's lacklustre performance, rumors in the international press raised the question of whether Brazil should leave the group,[3] with only the "RICS" remaining.[4] But the same has been said about Russia. Paul Krugman, for example, stated that the group should be made up of the BICS, since the Russian economy was dependent on oil for its international trade.[5] Though India was little criticized, surely China is the country that continues to be seen as the major building block of the BRICS. More than one decade on, the very creator of the acronym BRICS stated that only China deserves to be in the group, "If I were to change it, I would just leave the 'C'"[6]. Furthermore, the existence of the group as a whole has been questioned. Emblematic in this regard is a 2013 text in *Foreign Affairs* with the title "Broken BRICS", referring to the growth slowdown of the bloc's countries (Sharma 2013), among other major publications.

However, it is not only pessimism that characterizes the rhetoric of the international media. Overall, the group's emergence has been viewed from extreme positions that have ranged from disdain to euphoria, and including fear. Books and special issues have also heralded a new global order, marked by "the rise of the rest", as defined by the 2012 special edition of *Foreign Affairs*; and the now classic study "Dreaming with BRICS" (Wilson and Purushothaman 2003). Both emphasize the emergence of superpowers potentially capable of ruling the world. In this context, there is clearly a tension in the narrative contest regarding the present and the future of the BRICS. And scholars have not shied away from this unsteadiness as it seeks to understand, predict and, ultimately, control the phenomenon, as power can be vested in every discourse (Foucault 2012).

In addition to economic issues, social and political problems have become a great challenge for the BRICS. With the exception of Brazil, the abyss separating the rich from the poor keeps growing, even with the rapid economic growth exhibited by the other four countries (Silvério 2012). Politically, domestic issues, among others the Chinese political system and the Russian invasion of Crimea, stir the debate on the future of the BRICS, a debate hyped by the media, which, as a key international actor in international relations, has the ability to create, reconfigure, or solidify hegemonic global discourses.

Given this context, one could ask about the capacity of the BRICS countries to come together as an alternative power bloc, one capable of imposing its agenda in the G20 and in the international system as a whole. However, regardless of the unstable conditions faced by each country individually, what we notice is the steady strengthening of these countries' negotiations with each new summit, year after year, reaffirming the importance of a cohesive group for the establishment of a global force that may act as an alternative to the hegemony of the wealthiest and most developed nations. Today, few would dispute that the BRICS represent a reconfiguration of the power structure, signaling more balanced relations in global governance, whose leadership is being reconfigured (Carmo and Pecequilo 2012). Notably, the ineptitude of the G7 countries, the IMF, and the World Bank in tackling the 2008 crisis paved the way for a new phase in the world system, when the countries of the BRICS were decisive in the restructuring of the global economy.

3. China's Alignment with the BRICS

If there is little doubt that the world is witnessing the emergence of a new "empire", the question is, to what extent will China act on its own or as part of a bloc? In order for the BRICS to represent an effective force in global governance, it is imperative that their internal differences and instabilities give way to greater cohesion and formality. This, however, depends directly on the role China plays in the bloc. Even though Beijing keeps reaffirming the importance of development in cooperation with the emerging economies, it is widely known that China has the capacity and the strength to act alone, without the help of the other developing countries (Carmo and Pecequilo 2012), just as the country has agreed to cooperate with several powers in the world system, including the United States (Glosny 2010; Ikenberry 2008). Surely, China needs the bloc far less than the other countries that make it up (Glosny 2010).

The Chinese government's official line, especially that of the previous administration (Hu-Wen), hinges on peaceful and harmonious development, in which cooperation with the BRICS and the other developing countries is critical for the reconfiguration of international geopolitics in a world in which power is more balanced. As stated by President Hu in paternalistic terms during a visit to New Delhi in 2012, "China is the defender of the developing countries". He added,

> These countries form an important part of common development of the world, which is conducive to a more balanced world economy, more reasonable international relations, more effective global governance and more durable world peace. [...] In their co-operation, BRICS countries have committed to promoting South-South co-operation and North-South dialogue, endeavouring to implement the United Nations Millennium Development Goals, working for early realisation of the goals set out in the mandate for the Doha development round negotiations, striving to secure a greater say for developing countries in global economic governance and fighting all forms of protectionism.[7]

Reality is more complex and multidimensional, however; China is one of the few countries in the world in a position to flirt with several forces at once. Moreover, though it is still early to analyze the politics of the new Xi-Li administration (2012), which has replaced the slogan "harmonious society" with "Chinese dream", there is clearly an intention to consolidate China as an exporting and militarized power, exhibiting a slight tendency to align with—rather than confront—the United States (Pinheiro-Machado 2013).

For a long time the nature of the Sino-American relationship was confrontational (Fairbank 1983). Today, however, although consideration is given to potential direct conflict, many researchers observe a slight accommodation that may signal the development of a peaceful agenda (Friedberg 2005; Glosny 2010; Ikenberry 2008). To Ikenberry (2008), unlike what many have predicted, the outcome of the emergence of China is not bound to translate into tension, battle, and conflict—which are characteristic of moments of power transition. It should also be added that there is no mechanical and simplistic passage whereby the rise of China/East represents the decline of the United States/West. The international system is not based on a single power; instead, it is tied to a complex power structure of institutions and countries, such as the G7. Hence, negotiating and aligning with the United States and the other developing countries might be the trend in China—and may directly affect the strength of the BRICS as an alternative power bloc in global governance.

China's tendency to align with the hegemon in the world system can be seen, for example, in the field of intellectual property, a key area in contemporary international relations, governed by the protectionist policies of the developed countries (Flynn 2013). For a long time China advocated the need for a flexible global intellectual property policy for the developing countries. For more than three decades, the country resisted, maintaining its development model based on the production of manufactured goods, as copycat products and/or cheap merchandise, driven by the understanding that this was its way of growing in the post-Mao era. Brazil, for instance, never had the muscle to defend the need for a special agenda for developing countries and, once the country was put on the Priority Watch List (PWL) of the United States Trade Representative, invested heavily to get off it in order to avoid foreign trade sanctions. China, which was always among the PWL countries, did little to change the situation. This situation changed only when the country announced a new development model, no longer based on the production of cheap manufactured goods, but aspiring to become a recognized power in high technology innovation and exports. Accordingly, there is a new trend of endorsing the global enforcement controlled by the nations of the Euro-American zone, one requiring alignment with Washington, the World Trade Organization

(WTO), and its protectionist treaties on intellectual property. However, this is done on its own terms (Pinheiro-Machado 2012).

China's possibility of negotiating in the international trade arena on its own terms is related to its broad export portfolio. Today, China is already Brazil's main trade partner, displacing US hegemony, which lasted for decades. China's situation differs from that of countries such as Brazil and Russia, which depend on exports of commodities and/or natural resources, thus resulting in the emergence of a relationship of neodependency among the BRICS. China's massive presence in Latin America and Africa, for example, provides short-term economic stimulus, but in the longer term tends to inhibit these countries' national industries, making them dependent on their primary resources (Gallagher 2008, 2011; Rocha 2002; Bull and Boas 2012). Nonetheless, bilateral trade relations between the emerging nations were fundamental not only in minimizing the impacts of the 2008 crisis, but also in the recovery of the global financial system (Carmo and Pecequilo 2012). Undoubtedly, China is, at the same time, an ally of and a threat to the other BRICS countries.

All the aforementioned aspects could lead to the conclusion that the nature of the relationship between China and the other BRICS countries is fragile and that, therefore, "dreaming with BRICs" (Wilson and Purushothaman, 2003) may become a veritable nightmare. After all, (1) China is fully capable of acting all by itself; (2) flirts with the United States; and (3) pursues unequal economic relations characterized by dependence with countries such as Brazil, Russia, and South Africa. In this chapter, however, we argue that the BRICS have actually advanced steadily toward cohesion and, consequently, toward the formation of a new bloc in the world system capable of imposing its own agenda—and China's presence in this process has been resolute and decisive. The group's weaknesses—stemming from domestic instabilities or even from the alignment with China—have not kept the bloc from moving forward and gaining ground, but surely limit its scope and potential for action.

4. The Role of the BRICS in the G20: Enlarging or Replacing the Global Order?

For Brazil, Russia, India, China, and South Africa, being a member of the

BRICS group mutually reinforces their developing-country identity. The creation of this bloc reflects the unilateralism that characterized the late twentieth century, just as unilateralism is waning in the new millennium. If there is no doubt that a reconfiguration of the powers of the world system is now proceeding, the question that still needs to be answered concerns the extent of the change. Some researchers note that the bloc's recent cooperation has been important in altering global governance, but also that it is constrained by, for example, the group's inequality:

> There is little evidence that China and the BRICs are trying to overthrow the existing international order. Instead, China has accepted and joined the existing order, and has been working together with other powers to reform its shortcomings. Although this negotiation is in its early stages and will likely be difficult, the willingness of China and the BRICs to work within the system and the openness of western countries to meet some of their demands makes it much less likely that China and other rising powers will try to overthrow the order (Glosny 2010: 100; also see Ikenberry 2008).

As already noted, many researchers have reaffirmed that the BRICS, and China in particular, are not threatening to "overthrow the order", but rather are cooperating with it and enlarging it. Thus, the US hegemony, directly or indirectly, would be maintained, more or less. However, even though there are in fact significant constraints on strengthening the bloc, we take the view that the group's ambition and scope of action are still open, especially if we take into consideration events in the aftermath of the 2008 world crisis. In the twenty-first century, the dynamic sphere in which the emerging countries have found their voice, set their agenda, and thus obtain representation in the international system is the G20 (Baumann 2012; Ikenberry 2008; Carmo and Pecequilo 2012).

The G20 summit of 2008, in the middle of the world crisis, provides clues about the coordinated efforts of the BRICS which resulted in greater influence in the group. As noted by Glosny (2010), the drafts of the report barely mentioned the emerging countries. However, after considerable pressure, the situation changed and the emerging countries joined and expanded the Financial Stability Forum. Thus, "China and the BRICs have learned that exchanging ideas also allows them to coordinate positions and maximize their bargaining leverage in meetings with Western powers"(Ibid.:113).

As noted by Carmo and Pecequilo (2012), the 2008 crisis caused a turnabout in established positions, redistributing power, especially because of the gradual decline of US hegemony. The G20 was the sphere chosen for discussing and presenting solutions to the crisis; it was argued that the G8 and the Bretton Woods institutions lack the means to present an alternative to the crisis. At this point, it is worth mentioning China's weight in the group, as it, with its reserves and foreign trade reach, was decisive for the establishment of a global agenda focused on the recovery of world growth.

The emerging nations chose to strengthen both their domestic markets and foreign trade, reducing economic, social, and political vulnerabilities. Russia was the most vulnerable country during the 2008 crisis, while Brazil, India, and China kept posting impressive growth rates over the following years (China and Brazil had an exceptional recovery, with growth rates of, respectively, 10 per cent and 7.5 per cent in 2010). After the crisis, the BRICS were still faring well when compared with the United States, Europe, and Japan. From 2002 to 2012, intra-BRICS trade rose tenfold, from USD 26.7 billion to USD 276.1 billion. In 2009-2012, as the economic and financial shock deepened, transactions within the bloc nearly doubled, from USD 143.6 billion to USD 276.1 billion (Drummond 2014).

Thus, the developing countries were the ones that showed the capacity to minimize the impact of the crisis. This led to coordination and coalition among the BRIC countries (not yet including South Africa), strengthening the emerging countries in the G20, while at the same time boosting the G20 as it consolidated as an internationally recognized and relevant sphere in international negotiations (Carmo and Pecequilo 2012).

The report on the first BRICs summit in 2009, underscores,

> (1) *We stress the central role played by the G20 summits in dealing with the financial crisis.* They have fostered cooperation, policy coordination and political dialogue regarding international economic and financial matters. (2) We call upon all states and relevant international bodies to act vigorously to implement the decisions adopted at the G20

> summit in London on April 2, 2009. *We shall cooperate closely among ourselves and with other partners to ensure further progress of collective action at the next G20 summit* to be held in Pittsburgh in September 2009. We look forward to a successful outcome of the United Nations Conference on the World Financial and Economic Crisis and its Impact on Development to be held in New York on June 24-26, 2009. (3) *We are committed to advance the reform of international financial institutions*, so as to reflect changes in the global economy. *The emerging and developing economies must have greater voice and representation in international financial institutions*, whose heads and executives should be appointed through an open, transparent, and merit-based selection process. We also believe that there is a strong need for a stable, predictable and *more diversified international monetary system*. (4) We are convinced that a reformed financial and economic architecture should be based, inter alia, on the following principles: democratic and transparent decision-making and implementation process at the international financial organizations; solid legal basis; compatibility of activities of effective national regulatory institutions and international standard-setting bodies; strengthening of risk management and supervisory practices. (BRIC 2009; *apud* Carmo and Pecequilo 2012:319)

The text conveys the idea that the crisis strengthened the group's identity and self-esteem, just as it acknowledges the fact that the G20 provides the bloc with greater space for action. Since 2009, the bloc's meetings have further strengthened the idea mentioned in item (3) regarding the need for a more diversified monetary system. The text corroborates Baumann in his analysis of the BRICS actions in the G20, as he contends that, "Notwithstanding these internal difficulties, the group has been able to deal, in a reasonably homogeneous manner, with some of the issues addressed in international debates, especially those related to the development dimension and those associated with proposals to mitigate imbalances of a conjunctural type" (Banmann 2012: 209).

Despite rumors concerning the bloc's present weakness, especially given the Brazilian economy's sluggish growth and the slowdown of the emerging economies as a whole, the 2012 (New Delhi) and 2013 (Durban) summits fully developed some high-impact projects from the perspective of global order. The BRICS has announced the creation of a monetary fund (in local currencies) and their own development bank to cushion internal and external crises, besides calling the US dollar into question as preferential and reserve currency. China may contribute USD 41 billion to the fund; Brazil, India, and Russia USD 18 billion; and South Africa USD 5 billion, giving a total of around USD 100 billion (Drummond, 2014).

The creation of a fund and a development bank is potentially capable of dramatically influencing the global order because, since the 1944 Bretton Woods agreement, the developed nations, and the United States in particular, control the International Monetary Fund (IMF) and the World Bank, which, in turn, organize the international system. To authors such as Arturo Escobar (2012), Bretton Woods and its institutions have engendered new dependencies in the post-colonial era, marked by financial subordination and control over what used to be called the "third world". An own development bank represents, (1) the possibility of autonomy in relation to the decisions of the developed countries; (2) broadening the scope of the G20 in international negotiations; (3) reordering the world balance of power; and, perhaps, (4) the establishment of new empires and hegemonic blocs, whose intentions are still to be defined.

5. Final Reflections

The BRICS countries are facing social, political, and economic challenges at home, while also being affected by intra-group competition and inequality. However, after the 2008 crisis we notice a trend towards stronger group coordination, thus assigning greater cohesion and formality to the vague and informal concept coined by O'Neill in 2001. The space in which the emerging countries can consolidate their representation in the international system is afforded by the G20, which, in strengthening itself, ultimately undermines—however slightly—the G8 as the prime sphere for international negotiation. This, of course, rather than an automatic or linear process, has been a gradual one. At every summit, new goals are set, partnership between emerging countries is reaffirmed, and both processes provide further input to the G20.

The G20, boosted by the BRICS, has helped to balance and diversify the global financial system. This directly implies the emergence of a new economic bloc that, as we have argued, is dependent on China. Just as we are witnessing a redistribution of power and multipolarity in international relations, China is rising as a "new power" and/or "new empire". All in all, we can discern the coexistence of a Chinese multivector diplomatic policy that, while seeking reconciliation with the United States (while also fiercely competing with it for market share), simultaneously acts as a bloc—via both the BRICS and the G20—in pursuit of greater protection and legitimacy in the international system.

Finally, in the intellectual sphere there is a narrative tug-of-war that seeks to define whether China and the BRICS are "threatening" and will "overthrow the established order". Answers vary from a *reconfiguration* of power in the twenty-first century, coupled with an *enlargement* of the established order, to a *replacement* of the power bloc. We have argued that this debate raises a false question. The ideas of a "threat" or an "overthrow of the established order" are imbued with an ethnocentric rationale and, therefore, make sense only from the point of view of the developed countries. From the perspective of the emerging countries, there is a rising coordinated attempt—albeit one constrained by domestic circumstances—to gain representativeness in international negotiations, which implies complex, non-linear movements simultaneously driven towards the enlargement and replacement of the established order, hinging on the assumption that enlargement, in itself, entails change and, to some extent, replacement of the current order. Forecasts departing significantly from this are speculative. Only the future will reveal the intensity and extent of the multipolar world; but there is no doubt that China is a key and defining actor in this process.

Notes

[1] Based on World Bank 2012 data.

[2] 2012 GDP, based on World Bank data.

[3] Actually, this would only show the weak and fleeting nature of a group incapable of effectively cooperating toward joint action, at the mercy of fluctuating short-term economic indicators.

[4] For example, "The B in BRICS, The Brazil backlash," *The Economist* (17 May 2012),

or "Does Brazil deserve its 'B' for BRIC?" *CNN* (11 June 2013).

[5] See "Krugman Says BRIC Really BIC". *The Moscow Times* (11 September 2011).

[6] See O'Neill, "China Only BRIC Country Currently Worthy of the Title," *The Wall Street Journal* (23 August 2013).

[7] "BRICS is the defender of the developing world," Interview with President Hu, *The Hindu* (28 March 2012).

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Chapter 16
The Transformation of the BRICS

Zhu Jiejin

1. Introduction

The BRICS is transforming from a dialogue forum focusing on global economic governance and policy coordination, into a full-fledged mechanism engaging in global economic, security governance, and also practical cooperation among the emerging powers. The establishments of BRICS New Development Bank(NDB) and BRICS Contingent Reserve Arrangement(CRA) have greatly pushed its institution-building process. At the same time, there is more and more criticism of the effects of BRICS cooperation on global governance, which can be summarized as two categories: one is that, the BRICS is not important, because these countries are facing big and different economic challenges without any glue among them[1]. Currently, as most BRICS countries' economic growth is slowing down, this opinion is getting more popular. The other view regards the BRICS as a threat to global governance. The purpose of BRICS institution-building is to counteract the influence of developed countries, to overthrow the liberalism as the basis of current global governance, and to revive the norms of mercantilism and sovereignty (Zaki Laidi 2012). All of this will lead to the so many deadlocks in global multilateral negotiations (Narlika 2010). The most direct evidence is that the G20 has been divided into the G7 and the BRICS, which finally going to the G0 (Bremmer 2012).

Towards the first opinion, Chinese foreign minister Wang Yi said that the

BRICS has made historical progress in Durban Summit, and no one would say the BRICS is not important[2], if we can successfully implement the Durban Action Plan. This paper focuses on the second opinion, arguing that the BRICS is not a threat to the global governance system, but a constructive force for inclusive change and reform of current international institutions.

The following is organized as follows, part one introduces what kind of transformation the BRICS is experiencing, especially after the Durban Summit; part two explores the role of the BRICS in the G20 and the whole global governance system; part three analyze the BRICS in the reform of international financial architecture; the final part is conclusion.

2. Durban Summit and Transformation of the BRICS

The Durban Summit is the last summit of the first cycle of BRICS summits. Being a young and promising informal international institution, the BRICS is facing both challenges and opportunities. Different members hold different opinions towards the BRICS, especially on how the second cycle of BRICS summits should be operated. Russia insists that the BRICS should pay more attention to political and security issues, while China and India should emphasize the economic cooperation among the members, including both practical cooperation and policy coordination.

Finally, the five members have built a consensus on the future direction, which is "we aim at progressively developing BRICS into a full-fledged mechanism of current and long-term coordination on a wide range of key issues of the world economy and politics"[3]. Here, "current and long-term coordination" means that the BRICS will not only coordinate their policies in multilateral international institutions like the G20, IMF, but also carry out the cooperation among themselves, like establishing their own development bank and contingent reserve arrangement. "Key issues of the world economy and politics" means that the BRICS will not only talk about global economic governance but also global security governance. In this sense, the BRICS is transforming from a dialogue forum or a tool to coordinate positions on a limited range of issues, into a full-fledged mechanism of strategic and ongoing cooperation on key international political and economic issues.

In order to push the transformation process, the BRICS is working hard on its institutionalization. Now it has built a multi-layered, wide-range covered cooperation architecture: leaders' summit playing the leading role, ministerial meeting including finance ministers and central bank governors meeting, foreign ministers meeting, trade ministers meeting, and agriculture ministers meeting pushing the practical cooperation which, sherpas meeting playing the coordination role, expert meeting and working group meeting including anti-corruption experts meeting, contact group on economic, and trade issues meeting playing the supplementing role.

Specifically, Chinese President Xi Jinping proposed a framework of "BRICS Closer Economic Partnership" (BCEP) in Durban, which lay down steps to promote intra-BRICS economic, trade and investment cooperation, and to facilitate a comprehensive market inter-linkages, financial integration, and infrastructure connectivity as well as people-to-people contacts.

After the Durban Summit, BRICS cooperation is on the fast track. More and more people realize that the BRICS really matters. But on the other hand, what kind of role the BRICS is playing within the current global governance system? What are the real attitude of these five emerging powers toward the existing international system?

3. The Role of BRICS in the G20 and the Global Governance

There is a huge debate on whether the BRICS is a positive force within the G20 and global governance system. Actually, on both the cooperation institutional framework and issue-areas, the BRICS is a crucial locomotive of G20 development. After the 2008 financial crisis, both the G20 and BRICS are playing a more important role in global economic governance. The former one is comprised of established powers and emerging powers, while the latter one is comprised of emerging powers only. The two institutions are interacting in mutual beneficial approach.

In terms of institutional framework, the BRICS emphasize the complementarities of South-South cooperation, not the substitute of North-South cooperation. The purpose of BRICS cooperation is to rebalance the world economy, to democratize the international relations, and to improve the global governance. The Sanya

Declaration said that the overarching objective and strong shared desire for peace, security, development, and cooperation brought BRICS countries together, which have a total population of nearly 3 billion from different continents. The BRICS aims at contributing to the development of humanity significantly and establishing a more equitable and fair world. The BRICS stresses the central role of the G20 as the premier forum for international economic cooperation, in combating the financial crisis through unprecedented coordination. Compared with other international institutions, the G20 is broader, more inclusive, diverse, representative, and effective. On political and security governance, the BRICS reaffirms the UN's central role in dealing with the global challenges and threats, and reiterates that the cooperation is inclusive and non-confrontational.

In terms of macro-economic policy coordination, the BRICS actively participates in G20 policy coordination to combat the global financial crisis, and to take active fiscal policy, easy monetary policy, and a huge stimulus package. In the post-crisis era, the BRICS is playing constructive role in formulating a "strong, sustainable and balanced" world economy framework. But European countries emphasize green growth and sustainable development, while the US stresses balanced growth, especially reducing US-China trade deficit. At the same time, the BRICS argues that world economic recovery is very fragile, and strong economic growth is still the basis of world economy. Consequently, the G20 has built the consensus to pursue "strong, sustainable and balanced" economic growth. It is a compromise and win-win negotiation process. In terms of implementing the framework, while US and Europe propose to establish a binding mutual assessment process (MAP), the BRICS emphasize that developing countries are in different development stage compared to developed countries, which need more flexibility in economic policy making, so the MAP should be in a non-binding approach. We can see that the BRICS is not directly against the proposal of the US and Europe, but complement some developing countries' perspective into the macro-economic policy coordination.

In terms of international financial regulation, the BRICS supports efforts to improve the institutions and rules of international financial regulation, to shatter the belief about the self-regulating nature of financial markets. In terms of institutions, with the access of BRICS and other emerging markets, Financial Stability Forum (FSF) was elevated to Financial Stability Board (FSB). In terms of rules, with support from the BRICS, Basel Accord II was updated into Basel Accord III. Shadow banking, hedge fund, OTC, and credit rating agency are historically being included in the sphere of international financial regulation at the first time.

In terms of trade, the BRICS take the WTO as the center of multilateral trading system and refrain from raising new barriers to trade in goods and services, imposing new export restrictions, or implementing WTO inconsistent measures to stimulate exports. In 2008, BRICS committed not to take protectionist measures in times of financial uncertainty until 2013. In 2013, BRICS again committed not to take protectionist measures until 2016. In terms of the deadlock of WTO Doha negotiation, BRICS strived to reach agreement on modalities that leads to a successful conclusion to the Doha Development Agenda with an ambitious and balanced outcome. On Regional Trade Agreements (RTAs) like TPP and TTIP, BRICS recognize the importance of their contribution to trade liberalization. Meanwhile, they emphasize RTAs should enhance the transparency and support the multilateral trading system.

In terms of development, the BRICS is active to push the development agenda into G20 summit. In G20 Seoul Summit, they made great effort to reach the Seoul Development Consensus and Multi-Year Action Plan. In G20 St. Petersburg Summit, they push the G20 to pass St. Petersburg Development Outlook. The BRICS emphasize that the biggest imbalance in the world economy is the widening development gap between the North and the South. Referring to how to narrow the development gap, the BRICS underscore the importance of economic growth, global development partnership, outcome oriented, infrastructure building, human resource development, food security, growth with resilience, financial inclusion, and knowledge sharing. Compared to developed countries groups, the BRICS pursue orientation of developing country, and respect the dynamic development needs of countries.

In terms of international financial architecture reform, the BRICS is active to push the reform of IMF and World Bank. At the same time, they play a constructive role to build new international financial institutions, which complementing the Bretton Woods institutions. In 2010, with the help of the BRICS, the G20 made the historical commitments on the reform of IMF and World Bank. Firstly, in the Toronto summit, advanced countries agreed to transfer 3.13% votes to emerging countries, making the latter the 47.19% votes of World Bank. Then in Seoul Summit, advanced countries committed to transfer 6% quotas to developing countries. In 2012 G20 Los Cabos Summit, the BRICS contributed $75 billion new resources to IMF, of which China 43 billion, South Africa 2 billion, and Russia, India, Brazil 10 billion respectively. Although the compliance of IMF reform commitment has been delayed again and again by the US congress, the BRICS still take high expectations on the changing of Bretton Woods institutions.

Meanwhile, the BRICS has taken some constructive measures to complement the existing global institutions, including establishing the new development bank and contingent reserve arrangement. In 2012 BRICS summit, BRICS leaders considered a proposal to establish a new development bank for "mobilizing resources for infrastructure and sustainable development projects in BRICS and other emerging economies and developing countries", to "supplement" the existing efforts of multilateral and regional financial institutions for international development[4]. In 2013 Durban Summit, BRICS announced that the establishment of a new development bank is feasible and viable. In 2014 Fortaleza Summit, BRICS said that, "we are pleased to announce the signing of the agreement establishing the new development bank, which will strengthen the cooperation among our countries and contribute to our collective commitments for achieving the global goal of strong, sustainable and balanced growth"[5].

During the 2012 G20 summit, BRICS leaders considered a proposal to set up a financial safety net amongst BRICS countries. In 2013 BRICS summit, they concluded that the establishment of a self-managed contingent reserve arrangement would have a positive precautionary effect, help BRICS countries forestall short-term liquidity pressures, provide mutual support and further strengthen financial stability. It would also contribute to strengthening the global financial safety net and complementing existing international arrangements as an additional line of defense. In 2014 Fortaleza Summit, BRICS leaders said, "we are pleased to announce the signing of the treaty for the establishment of BRICS Contingent

Reserve Arrangement with an initial size of USD 100 billion. The arrangement is a framework for the provision of liquidity through currency swaps in response to actual or potential short-term balance of payments pressures"[6].

Generally speaking, the BRICS is a positive force in the current international system, which always pushing the global governance reform in an inclusive and incremental approach. It reflects the views and preferences of developing countries, making global governance more diversified. Of course, BRICS cooperation, especially the establishments of BRICS Development Bank and Contingent Reserve Arrangement, give some pressure on G7 countries. However, if the G7 can take more inclusive rather than exclusive attitude towards the role of emerging powers in global governance, it will be a new beginning of the global governance era.

4. Conclusion

For the BRICS, the transformation from a dialogue forum focusing on global economic governance and policy coordination, into a full-fledged mechanism engaging in both global economic, security governance, and also practical cooperation among the emerging powers, marks the big progress on its institutionalization and also poses new challenges in the future.

On one side, global security governance is a new area for BRICS cooperation. The difference in political system, history, culture etc among the five new powers means the difficulties to build the political consensus on the future international political order. The coexistence of IBSA, China-Russia-India Trilateral cooperation mechanism, and the BRICS is one case of point. On the other side, practical cooperation among the five powers is also challenging. It is easy for the new powers to coordinate policies in global negotiations, because almost all of them are underrepresented in the current global governance decision-making system. But it is difficult to promote intra-BRICS economic, trade, and investment cooperation.

However, all the BRICS members share the perception that the world is undergoing major and swift changes which highlight the need for corresponding transformations in global governance in all relevant areas. The prevailing global governance architecture is regulated by institutions which were conceived in circumstances when the international landscape in all aspects be characterized by challenges and opportunities. "We are committed to exploring new models and approaches towards more equitable development and inclusive global growth by emphasizing complementarities and building on our respective economic strengths."[7]

Notes

[1] Joseph Nye, "BRICS without Mortar," http://www.project-syndicate.org/commentary/why-brics-will-not-work-by-joseph-nye; Ruchir Sharma, "Broken BRICS: Why the Rest Stopped Rising," *Foreign Affairs*, November/December 2012, pp.2—7.

[2] http://www.fmprc.gov.cn/mfa_chn/zyxw_602251/t1081860.shtml.

[3] Durban Summit Declaration, para.2.

[4] Fourth BRICS Summit: Deli Declaration, http://www.brics.utoronto.ca/docs/120329-delhi-declaration.html.

[5] Sixth BRICS Summit: Fortaleza Declaration, http://brics6.itamaraty.gov.br/category-english/21-documents/223-sixth-summit-declaration-and-action-plan.

[6] Sixth BRICS Summit: Fortaleza Declaration, http://brics6.itamaraty.gov.br/category-english/21-documents/223-sixth-summit-declaration-and-action-plan.

[7] Fifth BRICS Summit: Durban Declaration, http://brics6.itamaraty.gov.br/category-english/21-documents/69-fifth-summit.

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