# China's Pursuit of a New World Economic Order

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SHANGHAI – Economists are increasingly divided over China's economic future. Optimists emphasize its capacity for learning and rapid accumulation of human capital. Pessimists focus on the rapid decline of its demographic dividend, its high debt-to-GDP ratio, the contraction of its export markets, and its industrial overcapacity. But both groups neglect a more fundamental determinant of China's economic prospects: the world order.

The question is simple: Can China sustain rapid GDP growth within the confines of the current global order, including its trade rules, or must the current US-dominated order change drastically to accommodate China's continued economic rise? The answer, however, remains unclear.

One way that China is attempting to find out is by pushing to have the renminbi added to the basket of currencies that determine the value of the International Monetary Fund's reserve asset, the Special Drawing Right (SDR). As it stands, that basket comprises the euro, the Japanese yen, the British pound, and the US dollar.

The SDR issue was the audience's main concern when IMF Managing Director Christine Lagarde spoke in Shanghai in April. Her stance – that it is just a matter of time before the renminbi is added to the basket – garnered considerable media attention. (Regrettably, however, the media read too much into her statement.)

Former US Federal Reserve Chair Ben Bernanke faced the same question in Shanghai last month. He was purposely vague in his response: the renminbi's inclusion in the SDR would be a positive step, he said, but it could not be taken until China makes much more progress in reforming its financial sector and transforming its growth model.

The IMF is expected to vote on the renminbi's inclusion in the SDR this October, at its regular five-year review of the SDR basket's composition. But even if, unlike in 2010, a majority votes to add the renminbi to the basket, the United States may exercise its veto power. Such an outcome would not be surprising, given that US opposition (though in Congress, not within the Obama administration) blocked reforms, agreed in 2010, to increase China's voting power within the IMF.

Limited use of the SDR implies that adding the renminbi would be a largely symbolic move; but it would be a powerful symbol to the extent that it served as a kind of endorsement of the currency for global use. Such an outcome would not only advance the renminbi's internationalization; it would also provide insight into just how much room there is for China within the existing global economic order.

So far, it seems that there is not enough. In a 2011 book, the economist Arvind Subramanian projected that the renminbi would become a global reserve currency by the end of this decade, or early next decade, based on his observation that the lag between economic and currency dominance is shorter than traditionally believed. Today, China is the world's largest economy (based on purchasing power parity) and the largest participant in world trade, and its government has been actively promoting renminbi internationalization, such as through the relaxation of foreign-exchange regulations. And yet the renminbi is used internationally much less than Subramanian's model predicted.

As a result, China remains subject to US monetary policy. If the Federal Reserve raises interest rates, China must follow suit to keep capital from flowing out, despite the negative impact of higher interest rates on domestic growth. Given the US dollar's dominance in international transactions, Chinese companies investing abroad also face risks associated with exchange-rate fluctuations.

In fact, over the last decade, international trade rules have created significant friction between China and many other countries, including the US. Now, free-trade agreements are being negotiated – namely, the Trans-Pacific Partnership and the Trans-Atlantic Trade and Investment Partnership – that will undermine the continued expansion of Chinese exports to the extent that they raise entry barriers for Chinese firms.

Clearly, China has faced major challenges within the existing global system as it tries to carve out a role befitting its economic might. That may explain why, with its "one belt, one road" initiative and its establishment of the Asian Infrastructure Investment Bank (AIIB), China's government is increasingly attempting to recast the world order – in particular, the monetary and trading systems – on its own terms.

The “one belt, one road” initiative aims to re-create the ancient overland and maritime Silk Roads that carried goods and ideas from Asia to Europe. Given that the project will entail significant Chinese investment affecting some 50 countries, its appeal in the developing world is not difficult to fathom.

The AIIB, too, has proved appealing – and not just to developing countries. In fact, 57 countries – including major powers like France, Germany, and the United Kingdom – have signed up as founding members, which may reflect a growing awareness of the US-dominated order’s diminishing returns.

From China’s perspective, sustained domestic economic growth seems unlikely within the existing global system – a challenge that Japan and the other East Asian economies did not encounter during their economic rise. Indeed, the only country that has encountered it is the US, when it replaced the UK as the world’s dominant economic and financial power before World War II; fortunately, that precedent is one of accommodation and a peaceful transition.

To be sure, China still needs to undertake important domestic reforms, especially of the financial sector, in order to eliminate distortions in resource allocation and stem the economy’s slowdown. But the refusal by China’s leaders to pursue export-boosting currency depreciation, even in the face of decelerating growth, suggests that they are willing to make the needed sacrifices to secure the renminbi’s international role and, with it, long-term economic growth and prosperity.

Whether or not the renminbi is added to the SDR basket this October, a gradual transformation of the global system to accommodate China seems all but inevitable.

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