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CHINA ANALYSIS: 25

CHINA SHAPES ITS POST-CRISIS AGENDA

CONTENT

Strategic culture, power balances and the analysis of geopolitical shifts are a long-standing Chinese obsession. Academic institutions, think-tanks, journals and web-based debate are growing in number and quality. They work to give China's foreign policies breadth and depth.

China Analysis introduces European audiences to the debates inside China's expert and think-tank world, and helps the European policy community understand how China's leadership thinks about domestic and foreign policy issues. While freedom of expression and information remain restricted in China's media, these published sources and debates are the only available access we have to understand emerging trends within China.

China Analysis mainly draws on Chinese mainland sources, but also monitors content in Chinese-language publications from Hong Kong and Taiwan. Reports from Hong Kong and Taiwan reflect the diversity of Chinese thinking, with occasional news and analysis unpublished in the mainland.

Each issue of China Analysis in English is focused on a specific theme, and presents policy debates which are relevant to Europeans,. It is available at www.ecfr.eu. A French version of China Analysis exists since 2005 and can be accessed at www.centreasia.org.

Introduction
by Francois Godement

How far is China willing to go in order to strengthen international economic governance? How central to China's own interests is global economic governance? The Chinese experts whom we consider in this issue of China Analysis seem to take a fairly short view. The thinking going on in China illustrates why, at the conclusion of the recent EU-China summit in Nanjing, premier Wen Jiabao remained publicly unyielding on the issue of monetary re-evaluation, choosing instead to lambast the "protectionism of some states" in Europe.

In the first of the four analyses (pp. 2-4), we look at the issue of decoupling of China's domestic economy from international demand, a perennial demand from China's partners and a feature of China's stimulus package and proactive lending policies. While the outside world is generally sold on China's resurgent growth and on booming consumption, the analysts from *Caijing*, China's best known financial magazine, are less sanguine. They see over loaning, growth without new employment, bubbles, and a central bank that has lost control of its key interest rate. They argue that if China wants the renminbi to stick with the dollar, it must have an interest rate that remains as low as its US counterpart. But *Caijing*'s liberal writers do not add the obvious conclusion: exports remain essential, not only as a component of GDP growth besides investment, but also as the only way to bolster employment based on labour intensive industries.

In the next analysis (pp. 4-5) we look at the shot in the arm that the stimulus package has given to state-owned firms in China. Drowning in cash, these companies are being pushed to look abroad for acquisitions and expansion. They don't share their profits – a key reason why China's savings rate is so high. But although they might benefit from a re-evaluation of the renminbi, they would face tougher competition abroad for their products. China's renationalized economy provides a domestic rationale for mercantilism, and economically liberal forces, which have been weakened by the global economic crisis anyway, are likely to retrench.

In the third analysis (pp. 6-8) we look at China's peculiar approach to a new theme – the internationalisation of the renmimbi. We can't take everything the Chinese press or even experts say at face value, but it appears that these analysts' views of the future run parallel to the international monetary system rather converge with it. They talk about a gradual, geographically based approach based on terms of trade. Convertibility of the currency is hardly mentioned – or, on the contrary, it is taken for granted, which it clearly should not be.

They also talk about a regional duopoly with the Japanese yen, which seems outlandish. The two countries certainly have a common interest in some monetary safeguards in North-east Asia. But how can Japan, the world's biggest contributor to the international financial system, form a kind of monetary union with a currency whose management remains largely opaque? Evidently, what we are seeing is a debate about the de facto use of the renminbi in international trade and credit transactions. This is in itself an important development, but it is based on China's immediate interests, not on global sharing of responsibility.

Finally (pp. 8-11), we look at the G20, which has often been hyped in the West as the ultimate answer to the problem of global governance but is regarded very soberly in China. Most of the analysts we look at praise the political symbolism of the grouping and the way it focuses attention on emerging economies, but they also see clearly the lack of enforcement of the G20's declarations and its marginal role. They also recognize that the two most important issues for China – monetary values and potential protectionism – are beyond the purview of the G20. What's more, they like it that way.

China wants to avoid confronting a large group of its partners on the issues which matter most to its immediate goals of high growth; monetary revaluation and issues of fair trade. This is why Premier Wen Jiabao has rebuked Europeans so strongly on these issues. Indeed, the two discussions China most wants to avoid at a multilateral level are about the level of its currency and trade caps. China must inevitably talk about these issues to some extent with the United States, its main customer and its main borrower. But it wants to avoid a wider discussion that might put more pressure on its own economic policies.

1. A Chinese dilemma too: maintaining employment beyond the stimulus

by François Schichan

Sources:
"Prepare to withdraw the stimulation measures from the economy", *Caijing*, July 17, 2009.
"Employment is an urgent and unavoidable priority", *Caijing*, August 31, 2009.
"It is probably too early to suspend the economic stimulus policy", *Caijing*, October 12, 2009.

Nearly a year after the establishment of the 4,000 billion yuan stimulus package and an expansionist monetary policy, the financial press in China is now raising the question of when to withdraw the exceptional measures that were agreed in November 2008. This has been prompted by the publication of the first figures showing the favourable macroeconomic results of these measures: in 2009, China's economic growth will surpass its 8% GDP growth target. But despite these results for 2009, many uncertainties hang over the recovery. The Chinese press is worried by the situation in the labour market and also emphasises that any decision to end the measures for stimulating the economy, particularly the money supply, must take into account the economic decisions taken by the country's main international partners.[1]

These analyses show that China faces a dilemma. From a purely economic point of view, the goal of a sustainable rate of growth calls for a rapid withdrawal of the economic stimulus package and in particular of the monetary measures. However, from a political point of view, the need to maintain employment levels in the short term puts pressure on the Chinese government to maintain the stimulus measures.

Caijing points out that the government has taken two kinds of measures to deal with the crisis. Firstly, there was a special budget, which included a 4,000 billion yuan plan to kick-start the economy. Secondly, there was the expansionary monetary policy led by the People's Bank of China, which involved lowering interest rates in concert with the world's other leading central banks in the Autumn of 2008. These measures were aimed at reducing the Chinese economy's dependence on external demand – its main weakness. The re-launch plan thus took the form of massive infrastructural investments, while the monetary policy allowed the banks to continue to provide credit to companies and individuals. In a parallel move, the government speeded up reform of the health and social security systems in order to stimulate domestic demand in the medium to long term.

1 On the co-ordination of economic policies between the world's leading economies, see Mathieu Duchâtel's essay in the current issue, "Global governance and the G20: more power for China".

The analysis in *Caijing*[2] sets out the re-launch plan's defects with regard to employment. According to Cai Fang, the priority given to "safeguarding growth" (保增长, *Bao zengzhang*) can come into conflict with the goal of improving the situation in the labour market. He is especially critical of the attitude of the provincial authorities, which have sometimes been tempted to neglect unemployment in favour of short-term growth rates. Since provincial governors are effectively assessed on the basis of growth rates, they channel investments towards the largest wealth-creating sectors while encouraging the maintenance of wide profit margins, thus reducing employment levels.

China's success in keeping growth rates above 8% and the prospects for its economy in 2010 seem to offer proof of the effectiveness of the crisis measures. In addition, the economic upturn in the leading developed countries ought to sustain the "external demand" component of China's growth. Also writing in *Caijing*, Hu Shuli[3] argues that the most pressing task for China is to think about how to set a date for ending the stimulus measures. She believes that low interest rates could have disastrous consequences. By lowering interest rates, China has allowed its economy to continue to grow. But the expansion of credit provision has had two negative effects: a growth in the number of dubious debts, which weakens the balance sheets of the commercial banks; and the risk of high levels of medium-term inflation. In fact, these two problems already existed before the crisis, which is why *Caijing* emphasises the need for a strategy that would allow the Chinese economy to follow a path of balanced growth.

In this respect, the exit strategy that *Caijing* argues for is a liberal one. Hu Shuli believes that "History shows the state makes many errors of judgement about the economic situation" (政府对经济形势的误判史不绝书, *Zhengfu dui jingji xingshi de wupan shibujueshu*). It should therefore proceed "with extreme caution" (慎之又慎, *Shen zhi you shen*). She suggests, for example, that private enterprise should take a greater share in financing investments and that companies should have easier access to the financial markets. There is a notable absence of any reference to the effectiveness of one of the main elements of the Chinese plan for boosting the economy, that is, the stimulation of domestic demand (扩大内需, *Kuoda neixu*). While *Caijing* repeats the government's line on the success of the national investment programmes that have been launched since November 2008, it does not mention family consumption and its effects on growth rates in 2009.

The growth forecasts for 2009 suggest some very positive results from the government's plan to boost the economy. *Caijing* thus emphasises the need for a staggered withdrawal of the stimulus measures, particularly in the monetary area. However, it also notes that certain international economic indicators show that any adjustment in economic policy must be approached with caution and be subject to a set of preconditions.

Firstly, the situation in the labour market is worrying. According to *Caijing* the dangers of a "recovery without employment" (无就业复苏, *Wu jiuye fusu*) call for specific measures to be taken. It argues that the main threat facing the Chinese economy is no longer low growth but high unemployment. Unemployment affects three particular sections of the population: labourers in the countryside, university graduates and rural migrant workers. There are also two important aspects to the employment question: from an economic point of view, poor employment figures have a negative effect on the already sagging domestic demand and on longer-term growth prospects; from a political point of view, an excessively high rate of unemployment, even if only conjunctural, undermines the social consensus.

The need to maintain employment levels in the short term puts pressure on the Chinese government to maintain the stimulus measures.

The journal calls for the government to regularly publish employment figures and to adopt international statistical standards in order to make comparison easier. It also proposes further breaking down unemployment statistics, in particular by taking into account employment rates and hours of work, in order to provide a more accurate reflection of situation in the labour market[4].

It further argues that the US recessions of 1990-1991 and 2000-2001 contain important lessons for the current situation. On both occasions, the return to growth took the form of a jobless recovery, mainly labour-intensive manufacturing industry moved elsewhere. China is now facing a similar problem, that is, how to maintain a comparative advantage in the labour-intensive industrial sector. That sector is currently concentrated in the eastern and south-eastern provinces. As a result, the western and north-eastern provinces have in recent years experienced a labour shortage and rapid increases in wages. An internal relocation of industrial activities could thus help to resolve the tensions in the overall national labour market. This process would be a domestic version of the developmental model known as the "flight of wild geese".[5]

2 Cai Fang is head of the research centre on the economics of labour and economic demographics at the Beijing Academy of Social Sciences.

3 Hu Shuli comes from a family of journalists and graduated from the department of journalism at Beijing People's University in 1978. She set up *Caijing* in 1998 and was its chief editor until November 2009, when she resigned following a conflict with the magazine's owners, the Stock Exchange Executive Council (SEEC), over resources and editorial independence.

4 In fact many labourers, mainly migrant workers, have left the labour market and are no longer registered in the national statistics. The official statistics for 2009 put China's rate of urban unemployment at 4.3% (i.e. 0.3% higher than in 2007). "Employment: an urgent and unavoidable priority", *Caijing* website, August 31 2009

5 The "flight of the wild geese" was a theory of economic development put forward in 1937 by the Japanese economist Kaname Akamatsu. A country begins its development by focusing on low-tech production, which is gradually abandoned in favour of high added value products,

The persistent problems in the labour market are a reflection of the "unstable" character of China's return to growth one year after the collapse of the western and Japanese financial markets. According to *Caijing*, China must take into account the measures adopted by its main trading partners and especially the policy of the US Federal Reserve. For if the People's Bank of China were to raise its leading rates before the Fed, this could result in massive inflows of capital that would destabilise the economy still further through pressure on exchange rates, increased dependence of the economy on foreign investments, and overheating. It is therefore difficult for China to take the initiative.

In an interview with *Caijing*, the chairman of China International Capital Corporation (CICC), a state controlled investment bank, said that China's monetary policy had to take four factors into account: inflation, economic growth, employment, and the balance of payments. In his view, the model to be followed is the response to the crisis in the early 2000s. The Federal Reserve began to raise its rates in June 2004, followed that October by the Bank of China.

At the same time, *Caijing* stresses the importance of devising a real monetary strategy that could anticipate the reactions of the country's main partners. Most economic indicators seem to point to a higher risk of inflation, which is increased by an expansionist monetary policy, in other words, a return to price rises for raw materials, sustained economic growth rates in 2009, and massive state investments. *Caijing* quotes public expressions of anxiety by Ma Jun,[6] the Chinese economist in charge of the China region for Deutsche Bank. In his opinion, the risk of inflation is greater than the problem of capital flows. He therefore proposes a gradual increase in interest rates, preferably before the first inflationary pressures appear.

The current debate over the right time for withdrawing the largely monetary measures to kick-start the economy, which have been in place for nearly a year, seems to reflect the government's success in its struggle to control the crisis. At the same time, it highlights the persistence of the main problems besetting the Chinese economy - above all inflation and unemployment - which will be just as acute in the years to come. Although it is widely accepted that the measures have had positive macro-economic results, there is a debate in the Chinese press about the strategy for exiting the crisis. The deeper structural problems of the Chinese economy, on the other hand, will have to be dealt with later.

thus allowing another country to concentrate on low-tech production to launch its own development in its turn. .

6 Ma Jun is the chief economist at Deutsche Bank. He is an expert on China, Hong Kong, and Taiwan, and has worked for the World Bank and the IMF

2. The public sector is back in favour

by Candice Tran Dai

Sources:
Ye Tan, "Only by strengthening the external supervision of the State enterprises can their appetite for funds be restrained", *Nanfang zhoumo*, September 2, 2009.
Shen Liang, Wang Xiaoqiao, and trainee journalists, "Ferocious State enterprises: an era of limitless expansion for the State enterprises", *Nanfang zhoumo*, August 19, 2009.

Launched in the years after 2000 by the former Chairman Jiang Zemin and Premier Zhu Rongji, the "Go Global policy (走出去, *zouchu qu,* literally "way out") was given formal expression in the tenth and eleventh Five-Year Plans, covering the periods 2001-2005 and 2006-2010. The aim of central government was to create favourable conditions for the international deployment of Chinese enterprises and to encourage Chinese investments in foreign markets. In recent years, Chinese enterprises have become increasingly dominant despite a few notorious setbacks that, however, so far do not appear to have dampened their desire to expand internationally. The Global Fortune 500 listing for 2009 includes 34 Chinese firms, to which should be added three from Hong Kong, with the publicly owned oil group Sinopec in ninth position.[7]

Most of these Chinese firms are state-owned or "national" (中央企业, *Zhongyang qiye*) enterprises, as distinct from so-called private firms (民营企业, *minyin qiye*). They include not only businesses engaged in strategic sectors directly accountable to the central government, but also businesses belonging to local and provincial authorities and even partially privatised firms in which the state remains a majority shareholder or nominal owner.[8] In this respect, the state enterprises occupy a quite unique position in China's economic landscape and global development strategy.

Currently viewed as the spearhead of what some call the "Chinese model" (中国模式, *Zhongguo moshi*), state enterprises have never before experienced such a remarkable rate of expansion, either nationally or internationally. But their explosive growth raises certain questions, particularly about the principle of guotuiminjin (国退民进, literally "state enterprises withdraw, private enterprises come in"), which was originally understood as the basis of the shift to a market economy and therefore puts state enterprises right at the centre of the debate about economic reform in China.

Everything seems to indicate that state enterprises will continue to expand at the same intense pace as they have

7 For the *Global Fortune* 500 complete listing for 2009 see: http://money.cnn.com/magazines/fortune/global500/2009/full list/. .

8 See Jonathan R. Woetzel, "Reassessing China's state-owned enterprises", *The McKinsey Quarterly,* Strategy, July 2008.

until now. Central government has supported them since the beginning of the international economic and financial crisis. In August 2009, it further announced that "foreign currency reserves would be used to contribute to the enterprises' 'way out'". The mastermind behind this strategy is Li Rongrong, chairman of the State-owned Assets Supervision and Administration Commission of the State Council (SASAC), who announced a further boost to the state enterprises a little over a year ago.[9]

The SASAC was initially rather cool towards mergers and acquisitions, but has now radically changed it attitude. It is worth recalling in this context that its proclaimed objective is to reduce the number of state enterprises by the end of 2010. In July 2009, the SASAC established a third company to manage state assets, the Guoxin Asset Management Co. Together with the State Development and Investment Corporation (SDIC) and the China Chengtong Group, it has been given the difficult task of reducing the number of state enterprises.[10]

With the Chinese government actively promoting state enterprises, so-called private enterprises have had to get used to being neglected.

With the Chinese government actively promoting state enterprises, so-called private enterprises have had to get used to being neglected. The state enterprises are regarded as the main driving force behind China's development, even to the extent that, in order to clearly designate their key role in reforming the Chinese economy, they are beginning to be call themselves the "new state enterprises" (新央企, *xin yangqi*).

While the press does not question this predominant role in the economy, it does criticise the omnipotent and monopolistic character of the state enterprises. For example, the journalist Ye Tan criticises several structural weaknesses in the way state enterprises are managed and argues that external control over them needs to be strengthened. State enterprises enjoy extensive privileges: they have special access to sources of credit, a strong bargaining position over industrial prices and the right to make legislative proposals; they are not obliged to share profits and often enjoy lower taxation levels. Given these privileges, it is not clear to what extent they are really profitable - it is said, for example, that the reconstruction and proposed international expansion of state enterprises will cost 100 billion yuan. Their relationship with their tutelary authority, often called a "mother-in-law/son relationship" (婆婆管儿子, *popo guan erzi*), is also not always exemplary.

To sum up, the main criticism of state enterprises is that they have mostly developed at the expense of the nominally private firms, which are considered the truly vigorous forces in the country, and that they are not accountable. In the future, China's state enterprises should improve management, accept greater social responsibility and become more transparent.

9 This powerful commission was set up in March 2003 under the direct control of the State Council, and is in charge of completing the restructuring of the largest of the state enterprises. It is currently responsible for 169 state enterprises, including the largest ones. Thibaud Voïta, "Reform - and return - of the State enterprises", in *China Analysis* 3, January-February 2006, pp. 9-11. See also Thibaud Voïta, "The response of the private sector: innovation and internationalism", *China Analysis* 21, January-February 2009.

10 *Economic Observer (Jingqi guancha bao)*, Number 427, July 13, 2009.

3. A different currency debate: a regional role for the Renminbi?

by Jean-François Di Meglio

Sources:
Xie Taifeng,[11] "Conflicting views on internationalising the renminbi", *People's Daily*, International Edition, August 6, 2009.
"Internationalising the renminbi: discussions over the domestic and external aspects", *Shanghai dengquanbao*, June 4, 2009.
Zhang Yihui, "RMB + HKD = the creation of an Asian monetary zone", *Wenweipao*, August 14, 2009.
"The conditions are already in place for the renminbi to become an international currency", *sina.com*, August 5, 2009.
Cheng Huasheng,[12] "Assessing the internationalisation of the renminbi in the aftermath of the world financial crisis", May 7, 2009.

For several months now, the Chinese press has been debating the future of the renminbi. The above articles confirm the sudden emergence of issues related to China's international financial role in general and the role of the renminbi in particular. At a time when the crucial problems of the solvency of the international system seem to have been overcome, this is at once paradoxical, logical, reasonable - and yet surprising.

It is paradoxical for two reasons. Firstly, some journalists and researchers (like Chen Huasheng and Shen Mingao[13]) have approached this issue, which was at first purely "monetary" and financial, as a political one. Secondly, the question of internationalising the currency seems to have been raised before considering its convertibility. Xie Taifeng is the only one of the analysts discussed here to have referred explicitly to the issue of the currency's full convertibility, while most writers take for granted the questionable view that the liberalisation of the movement of capital has already made the renminbi convertible.

The debate about the future of the renminbi is logical because all of the analysts discussed here take note of the role played by China in stabilising the international monetary system and also refer to what happened in the rest of Asia when the "newly industrialised countries", above all Japan, faced the classic fundamental questions over the basis for their international transactions, the parity of their own currency, and its use in such transactions. These writers also refer to the case of Japan, whose ambiguous role in the financial sector in Asia provides both a positive and a negative example. The debate is also logical in its remarkable balance in weighing the costs against the advantages of the situation, and in its objective assessment of the risks involved in revaluing the renminbi, which are naturally at the heart of the debate.

The debate is also reasonable, because the emergence of an "RMB or a RMB-JPY area" and complete globalisation are understood to require a gradual approach (typical of the reforms in China) and a suitable time frame for it to be put into effect.

However, the debate is surprising in the sense that there is a generally frank expression of opinions about the sensitive political questions affecting the highest levels, in particular the mention of a possible "RMB-JPY area". The high level of expertise in addressing the different parameters of the monetary equation shows that the Chinese are very aware of the problems. However, equally surprisingly, a Sino-centric viewpoint predominates, as if the decision only depended upon China's options and not on the creation of a new international financial system (which Xie calls "Bretton Woods 2") and on external factors, as well as on elements of internal governance, for example the capacity to fix the "proper" exchange rate, to follow it through, and to intervene.

In the first article, Xie Taifeng writes that "if we study the administrative methods used to expand trade conducted in RMB, we note that it is a 'curtain raiser' for a larger struggle leading to the internationalisation of that currency (人民币国际化大战揭开初步, *renminbi guojihua dazhan jiekai chubu*)". He observes that expanding the renminbi exchange area raises numerous problems: China has not yet prepared the terrain and the surrounding internal and external conditions are not yet favourable. On the other hand, he says, it makes sense to begin analysing the main elements in the debate. On the one hand, there are positive elements in a prospective internationalisation. The most important of these is the status of the currency: in the case of the US dollar, the fact that it is able to influence the financial markets, and the decisions related to them, is inseparable from its status as a "world currency (世界货币, *shijie huobi*). The internationalisation of the RMB could create comparable opportunities for China.

Internationalisation would also earn China income from international financial operations. According to Xie Taifeng, the final objective of internationalisation is not only to establish the renminbi as an international reserve currency, but also to clear the way for capital exchanges and the income to be earned from them. Not being obliged to resort to another currency for commercial and non-commercial exchanges would bring manifold advantages to China. For example, all the risks arising from currency exchange would be reduced and the costs of managing exchange reserves would be lowered.

11 Xie Taifend is a professor at the Capital University of Economics and Business.
12 Cheng Huasheng is a researcher at the Shanghai Academy of Social Sciences. The views expressed in this article are the author's personal opinion.
13 Shen Mingao is an economist for the journal *Caijing*.

On the other hand, this process would turn the renmimbi into a completely convertible currency. Of course, that would have a positive influence on China's financial markets and their global standing, but the expansion in the global demand for the currency could bring inflation in its wake. Monetary controls would become more difficult and the Bank of China would have increasing problems in dealing with capital flows into China from abroad.

The second article looks back at the establishment of the "Qualified Foreign Institutional Investors" system[14] in 2002, when China opened up to short term capital flows. The question of internationalising the renmimbi is closely linked to what has happened in Southeast Asia, because currency internationalisation is a major component in the development of East Asian countries. In the case of many developed countries, a floating rate of exchange became possible as soon as the currency was internationalised.

> The renmimbi has reached the stage of "regionalisation" [...]ten more years will be needed before it is able to achieve the status of an international currency.

In the context of the Asian crisis, the small countries' dependence on the dollar facilitated the inflow of foreign capital. Currently it is Chinese savings that enable the US consumer to make purchases on credit. Thus the increase in China's foreign currency holdings, of which 60% are in US dollars, is not only an economic problem but also a political one. If the renmimbi rises in value, the competitiveness of Chinese goods will fall.

A study of previous situations similar to that of the renmimbi today offers some interesting lessons. In the 1980s, the Japanese yen acquired international status and underwent constant appreciation. Its internationalisation was brought to a halt by the "lost decade", although it is possible that this internationalisation was actually the cause of those lost years and of the stock market crash in particular. China's foreign currency reserve problem, on the other hand, arises from its trade surplus, which has increased since the Asian crisis. But stockpiling excess currency serves no purpose for China. Neither the US nor the European Union has such large reserves, except in gold. Nor, the author suggests, should China.

Hong Kong has amply fulfilled its role as a logistical and financial intermediary within the "one country, two systems" arrangement. However, with the increasing rate of globalisation and the development of mainland China, that role could become less important. Although Hong Kong may be on the way to becoming the second leading world financial centre by next year, it conducts most of its operations in US dollars. Mainland China is developing more rapidly than either Hong Kong or the US, but it is also the weakest of the three centres from a financial point of view. Without reinforcing its financial position, China will be unable to take its place as a world leader. In the coming ten years, the internationalisation of the renmimbi must take place on the basis of establishing a free trade area that would include China and Hong Kong.

The third article argues that internationalising the renmimbi is a long-term project that requires the establishment new instruments. This article follows the ideas of Shen Minggao, an economist, and Xiao Geng, the director of research on political economy at Tsinghua University. In their view, there are three prerequisites for internationalisation of the renmimbi. Firstly, China should pay for imports in renmimbi, after which it will be possible for foreign trading partners to make their payments to China in renmimbi. Secondly, the relative importance of each country must be taken into account; the currency to be used should depend on that country's economic role. Thirdly, the use of a national currency as an international reserve currency should depend on the financial health of the country in question.

The fourth article, on the website sina.com, begins by declaring that China is a major trading power that is about to overtake Japan in terms of economic strength. The internationalisation of the renmimbi will help China to attract more foreign investment, but as long as its financial markets remain underdeveloped, such internationalisation will not be possible. For the moment, the article goes on, the renmimbi has reached the stage of "regionalisation". Given what happened to the yen after passing that stage, ten more years will be needed before it is able to achieve the status of an international currency. For this the development of Shanghai will be crucial.

The financial crisis has raised serious questions about the ability of the US to go on exercising leadership over the global financial system. Since 2000, the economic and financial policy of the US has relied on its ability to attract foreign capital and trade. The measures put in place since the 2008 financial crisis have stabilised the situation, but they create difficulties for the dollar and threaten its role as the leading reserve currency. According to Shen Minggao, the dollar remains a major currency even after the financial crisis, but its global role is diminishing. Hu Jintao, Wen Jiabao and the governor of the Bank of China have all recently reiterated the need to reform the international financial system. A future system might include the combined use of the dollar, the euro, and some Asian currencies such as the renmimbi and the yen, which might serve as a reserve currency for other countries.

In the fifth article, Chen Huasheng reminds us that in order to internationalise the renmimbi, China needs to take several other steps. It needs to reform the floating exchange rate, make the Bank of China independent, create greater transparency in currency transactions, entrench market

14 A system that allows foreign financial agencies to have access to domestic stock markets.

mechanisms more deeply entrenched and develop a genuine financial market in renmimbi. According to Chen Huasheng, the renmimbi must be regionalised before it is internationalised.

4. Global governance and the G20: more power for China

by Mathieu Duchâtel

Sources:
Ding Gang,[15] "Can the G20 be institutionalised?", Xinhuanet, September 27, 2009.
Liu Ming,[16] "The influence of the G20 is increasing, but its real status is still undecided", Shanghai Academy of Social Sciences website, September 29, 2009.
Xu Mingqi,[17] "Prospects opened up by the Pittsburgh summit: the new distribution of voting rights at the IMF is probably the main achievement", Wenhuibao, September 26 2009.
Zheng Kemin,[18] "Views on the replacement of the G8 by the G20", Xuexi shibao (Study Times), October 12, 2009.

China's role in the G20 meeting in London last April led many western commentators to place a lot of faith in its ability to help resolve the crisis. There is no doubt that the G20 summit allowed China to enhance its international image as a responsible world power. Many people in Europe stressed that its participation in the G20 gave it a standing nearly equal to the US. Some thought that Beijing thus had a major influence on the deals struck in London and at the subsequent summit in Pittsburgh in September.[19] But it now appears that the role that China played was overestimated. In fact, China's weak currency policy over the last few months clearly shows the limits of the multilateral solutions and of the co-ordination of economic policies announced at the G20 last year.[20]

The Chinese researchers and column writers discussed here have very different views of the G20. There are some points of agreement, including the trend towards greater co-operation in managing the world economy, which underlines the shift in the balance of power between the members of the G7 and the emerging economies; a belief that the voting reforms at the IMF and the World Bank were the main achievement in Pittsburgh; and a perception that the implementation of the agreements depends entirely on national economic policies. Finally, these writers are critical, albeit in varying degrees, of US attempts to shift the debate away from the regulation of financial markets and onto the

15 A columnist for the *People's Daily* who specialises in international affairs.
16 Vice-chairman of the Department of Asian Pacific Studies at the Shanghai Academy of Social Sciences.
17 Vice-chairman of the Department of Global Economic Studies at the Shanghai Academy of Social Sciences.
18 A regular contributor to *Xuexi shibao*, the weekly journal of the Party central school, a crucial institution for training cadres and attempting to adapt socialist ideology to the challenges of the contemporary world.
19 See for example Jacques Attali, "Replacing the G8 by the G20 is a defeat for Europe", *State*, September 27th 2009.
20 Paul Krugman, "The Chinese Disconnect", *New York Times*, October 22, 2009.

international trade imbalance. These commentators do not see the imbalance as a real problem and support the Chinese government's opposition to protectionist measures.

However, these analysts also disagree on various issues, including whether the G20 should be a permanent body for regulating the global economy and in particular on whether it could be either instrumentalised by the G7 countries or, on the other hand, be used by emerging powers like China to rebalance world governance. Xu Mingqi even argues that the G20 is an empty shell that does nothing to change US domination of the world via the institutions set up at Bretton Woods.

All of the analysts are in favour of establishing a fairer way of managing the world economy by sharing power between developed and the emerging economies. Thus they see the existence of the G20 as a victory and a vindication of the long-term goals of China's intellectuals and diplomats. For Ding Gang, for example, the G20 is a "historic necessity" (历史必然性, *lishi biranxing*) produced by an imbalance that could not continue, "While the financial crisis arose from the imperfections in the financial regulations in the industrial countries, spreading from there to the rest of the world, those same countries are no longer able to manage such problems on their own," he writes.

Zheng Kemin likewise believes that the Pittsburgh summit has established the permanent status of the G20 as the main multilateral agency for handling international economic issues. This sounds like the death knell for the West's domination of global economic governance – assuming, that is, that the G7, set up in 1975, really did play that role. But in Zheng's view, the economic crisis has merely laid bare a shift in the global balance of power that was already taking place. Above all, it created a widespread recognition in the developed countries of changes that, until then, had been hidden. Zheng argues that, following a crisis caused essentially by the burst of a speculative bubble in the financial and real estate markets of the advanced countries, China and the other large emerging economies are now beginning to act as a motor for global renewal.

Ding Gang believes the G20 will play an extremely positive role in enabling the world to emerge from the crisis. He says that, because of the greater role given to the emerging economies, it was possible to limit the effects of the crisis and lay the groundwork for regulation of the international financial system. However, for Ding Gang, the G20's greatest success is that it has helped to create a basis for mutual trust (互信, *huxin*) between the participants. After creating a new framework for global governance in London, the G20 began the more difficult task of co-ordinating economic policy in Pittsburgh. Ding Gang is optimistic that, despite their different developmental priorities, the G20 states can be successful in this task if they communicate with each other more.

However, Ding Gang's apparent optimism undercut by his conclusion, which emphasises how difficult such co-ordination of economic policy will be in the current post-crisis situation. In Ding Gang's view, states should focus their co-operative efforts on three main areas: macro-economic regulative measures, a regulatory system for the financial markets, and the struggle against protectionism. This list of priorities does not include monetary policy and exchange rates or aid to those developing countries not represented in the G20.

Zheng Kemin also draws up a positive balance sheet for the Pittsburgh summit. He welcomes the fact that the G20 has finally provided the opportunity to give greater weight to the emerging countries at the IMF, where their share of the vote will go up by 5%, and at the World Bank, where their share will increase by 3% (Liu Ming also stresses this point). The G20 also agreed on a supplementary $500 bn financial package to support the new IMF borrowing agreements. In addition, it agreed to the removal in 2010 of compulsory funds from financial establishments and began co-ordination on capping the salaries of bankers and on regulating the derivatives market. It also resolved to conclude the Doha round of talks during 2010.

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In Zheng Kemin's opinion, the G20 was an opportunity to create a consensus, but it was also an intellectually honest assessment of the state of the world economy. Although the first signs of recovery have appeared, it is still fragile. In his view this is because of high rates of unemployment and falling consumption. He agrees that there is a need to continue to co-ordinate policies aimed at recovery but says now is also the time to consider ending the special crisis measures. This latter point shows how difficult such co-ordination is; both the US and the UK have rejected the idea of lifting the measures to stimulate their economies.

Zheng Kemin writes that the G20 also revealed a split between the US and the UK on the one hand, and Japan, China, Germany and France on the other, over whether or not to continue the economic stimulus package and over the timing of strategic measures for exiting from the crisis. No sooner had the Hatoyama government come to power in Japan than it condemned the breadth of the Abe recovery plan, while in Germany Angela Merkel emphasised the risks of inflation.

However, the debates focused mainly on the best way to restore the balance of the world economy. President Obama proposed a new mechanism to limit the trade surpluses of China and Germany. According to the proposal, countries with a trade deficit could take protectionist measures if such surpluses went beyond a certain limit. Obviously, as Zheng points out, the introduction of such measures would be unacceptable to both China and Germany. He argues that by putting international trade on the agenda, Washington was trying to limit restraints on international finance, which go against US interests. He emphasises that Angela Merkel was quite right to remind the summit that its objective was the regulation of global finance, not the building of a new global economic order.

Hu Jintao's main concern was the threat of protectionism. For the Party general secretary, whose concerns are echoed by Zheng Kemin, there were three priorities. The first was to maintain support for consumption in all the world's major economies and for domestic demand while paying close attention to any signs of incipient inflation. The second was to continue reform of the international financial system. The third was to overcome economic inequalities between the North and the South.

According to Zheng Kemin, the G20 has already become, in his words, "the main forum for global discussions" (首要全球性论坛, *shouyao quanqiuxing luntan*), but it is not yet a forum for making international law. The agreements that it makes are not legally binding and it has no provisions for enforcing them. It is sustained only by the good will of all its participants. Under these circumstances, China's strategy should be directed at protecting its national interests and increasing its ability to influence world affairs (提高中国影响力, *tigao zhongguo yiingxiangli*).

Liu Ming also emphasises the success of the Pittsburgh summit before going on to criticise it vehemently. He says many important steps forward (重要突破, *zhongyao tupo*) were taken, each participant was able to achieve their proposed objectives and the benefits were shared quite fairly. But he also believes that the summit's achievements are extremely fragile and only represent a first step in rebuilding the global economic system. The real success of the G20 will depend on the willingness of the advanced countries – that, is the G7 - to accept a change in the international order commensurate with the actual shift in the balance of power taking place.

However, Liu Ming says, the Western powers are not ready for such a change. Admittedly, they have agreed to make concessions in terms of financial regulation, but that is only because of their extreme dependence on the emerging economies for production and supply, for achieving a balance of payments, and for returning to global growth. In the sphere of international security and the major political questions, the Western countries wish to continue dominating the world through an invisible version of the G8. For example, the Pittsburgh summit was dominated by the US, whose economic problems were given priority. The Europeans were unable to get climate change and sustainable development on the summit's agenda and got only a symbolic agreement on the regulation of international finance.

Liu Ming doubts whether the G20 will survive a return to growth in the US. But although it lacks administrative structures to enforce its decisions, he says the G20 might nonetheless serve the G7 as a vector of influence for spreading operational rules. He also praises the reform of voting rights at the IMF and the World Bank, but points out that the US and other western powers retain a comfortable majority. Until the US has agrees to a thoroughgoing reform of the Bretton Woods agreement, the dollar will remain the principal reserve currency and the Federal Reserve will go on playing its role as banker to the whole world. Under these circumstances, he says it will be some time before the emerging economies can define the rules of the international economic and financial system.

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Xu Mingqi sees Pittsburgh as a summit "of different points of view, different expectations, and different post-summit assessments in each country" (各方意见不一，期望值不同，会后评价各异, *gefang yijian buyi, qiwangzhi butong, huihou pingjia geyi*). He admits there were some concrete achievements, including the voting reforms at the IMF. But the real long-term measure of how successful the summit was will be the economic policies of all the participating states. Specifically, the test will be how well they are able to co-ordinate measures to stimulate the economy and to exit the crisis, whether they are able to prevent protectionist measures and how much they increase aid to developing countries.

In Xu Mingqi's view, China's priorities at the summit were to prevent protectionism and to reform voting at the IMF. But while the majority of the participants made anti-protectionist statements, he believes that this was a purely symbolic victory, since no statement of principle in favour of protectionism could have any appearance of legitimacy (站不住脚, *zhanbuzhujiao*) in the modern world. And, as mentioned above, the Obama administration sought to shift the debate, which was to have focused on the regulation of the financial markets, onto the Chinese, German and Japanese trade surpluses.

There is a considerable gap between a liberal institutional approach, according to which the G20 could become an effective agency in co-ordinating the economic policies of the major world economies, and a realist approach, according to which multilateral summits are unable to regulate relations between the major world powers. According to the latter approach, an attempt to find points of common interest between the G7 countries and the emerging economies (two blocks that are themselves far from homogeneous) runs a real risk of satisfying only temporarily the shared desire for a "sustainable return to growth". The G20 won't prevent future tensions over China's monetary policy and the protectionist counter-measures that it may well provoke.

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