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# The United States and China in the Global Economic Order

Amy Studdart and Ye Yu

*The Center for Strategic and International Studies (CSIS) and the Shanghai Institutes for International Studies (SIIS), with the generous support of the China-U.S. Exchange Foundation (CUSEF), conducted research in mid-2015 examining what the United States and China think about the emerging global economic order, what the two sides agree on, what each side is doing to improve the order, and—where there is no agreement—how the two sides can manage their differences. This paper distills the takeaways from those conversations.*

The global economic order is undergoing tectonic shifts: globalization, the rise of emerging economies, and rapid technological change. Those shifts are taking place in an atmosphere of financial instability, a continued struggle to boost global growth, climate change, and persistent development challenges. As a result, the institutions that manage the international economy—the World Bank, the International Monetary Fund (IMF), and the World Trade Organization (WTO)—are under strain. While they have helped to produce unprecedented prosperity across the world, questions have arisen about their continued effectiveness and legitimacy.

Change within the global economic order is nothing new. The order as it is today is unrecognizable to that developed at the end of the Second World War, a result of both transformative changes and smaller ongoing evolutions. In 1973, the "Nixon Shock" cancelled the convertibility of the U.S. dollar to gold, replacing it with floating fiat currencies, the system that exists today. The year 1993 saw the establishment of the European Union, and 1999 saw the creation of the European economic and monetary union, transforming one of the centers of the global economy and creating a new model for economic cooperation. In 1995, the WTO replaced the General Agreement on Tariffs and Trade (GATT), multilateralizing the process through which trade liberalization occurs. There have also been numerous free-trade agreements (FTAs), multilateral development banks, and the establishment of regional forums, such as the Asia Pacific Economic Cooperation (APEC), Association of Southeast Asian Nations (ASEAN), and Mercosur in Latin America, all of which have changed the way the world's economies relate to one another.

The years since the 2007–2008 financial crisis, however, have seen more demand for transformative change than has been the norm, and more debate between major economies about what those changes should be. The G20 displaced the G8 (now G7) as the principal grouping through which the global economy is managed, recognizing the increasing centrality of emerging economies. The shift away from the WTO trade liberalization process toward the proliferation of bilateral and multilateral free-trade agreements, which started after the breakdown of the 2003 WTO talks, has become even more pronounced. A host of new institutions that reflect the growing economic clout and ambitions of emerging countries, most notably the China-led Asian Infrastructure and Investment Bank (AIIB) and the BRICS (Brazil, Russia, India, China, and South Africa)-led New Development Bank, have been established. The United States and China, as the world's two largest economies, are at the center of these developments. One way or another, these two countries are responsible for much of how the global economic order evolves.

The idea of the Thucydides trap—that a rising power will inevitably come into conflict with the dominant power—has gained traction as the U.S.-China relationship has hit various tension points. In the context of the global economy, at least, this seems less of a threat than has been suggested. The United States is the established power, but it is not a status quo power, and has demonstrated openness to reform and change. China is a rising power, but it has largely followed the rules-based order. The two sides overwhelmingly share a common interest in maintaining a high-functioning, stable, and representative economic order. They are also deeply economically interdependent. China is the United States' second-largest trading partner after Canada; the United States is China's first. These factors have been evident in the approaches that both the United States and China have taken to the global economy. Both have treated the international order as something that must be adapted to and shaped, and both have worked to reform their domestic economies to adapt to the reality of how the global economy functions.

But we also need to learn how to manage competition and tension. The two sides have structural and perceived differences in interests. Across the three pillars of the existing global economic order—trade, international finance, and development—there have been notable areas of disagreement. In development, the establishment of the AIIB has been a source of tension, a subject we address in further depth later in this paper. The failure of the U.S. Congress to approve IMF reform has weakened the legitimacy and functionality of the institution designed to make the international financial system work. The Chinese push to internationalize the renminbi (RMB) has caused debate, with some arguing that it will help stabilize the financial system and others suggesting that reforms must be implemented before the RMB can work as a truly international currency. On trade, China and the United States are pursuing separate but overlapping mega-regional agreements. Domestic policies, too, are playing into both the bilateral relationship and the two sides' roles in the global economic order: China's antimonopoly law, for instance, has irked the previously reliably supportive U.S. business community, and the volatility in commodity markets has been partially attributed to U.S. monetary policy.

In China, many view globalization as having entered a third phase. Phase one was dominated by Great Britain and phase two by the United States. This current, third phase is more complicated, and is instead about newly emerging economics and established economies finding a way to work together. In navigating that shift, the existing system needs to be made to work, but it also needs to be upgraded to suit an evolving world.

While the global economic order is anything but tidy, for the sake of clarity we have distilled the substance of our U.S.-China discussion following the three pillars of the Bretton Woods system: trade, finance, and development. There is a great deal of excellent research and analysis available on each of these subjects in both China and the United States. Our intent is not to duplicate those efforts but is instead to distill the areas of agreement and disagreement among the scholars with whom we discussed these issues.

## Trade

Historically, one of the major areas of cooperation between China and the United States has been at the World Trade Organization. At the turn of the twenty-first century, the United States worked with China to facilitate its accession to the organization—which not only saw China liberalize its markets, but also helped to bring about domestic reforms that took on many of China's vested interests and paved the way for China's double-digit growth to continue into the 2000s. However, while both sides have largely respected the existing rules and processes of the WTO, the two have often been at odds in negotiations to further liberalize global trade, historically at the Doha Development Round, but now with their pursuit of parallel regional FTAs.

The collapse of the 2003 Doha talks ushered in a new age of bilateral and regional trade deals, the result of an impasse between developed and developing countries about what issues the Doha Round should address. In the aftermath of the 2007–2008 financial crisis, bilateral and regional trade negotiations became even more of a priority as countries around the world looked for economic initiatives that would support increased growth and productivity at home. The United States invested its energy in negotiating the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP). China negotiated a host of bilateral agreements with, for instance, Canada, South Korea, and Australia. China is still negotiating the Regional Comprehensive Economic Partnership (RCEP), an initiative to unite ASEAN FTAs within one framework. Notably, none of those signature agreements include both the United States and China, and the talks between Beijing and Washington over a bilateral investment treaty (BIT) have progressed slowly.

The lack of cooperation between the United States and China on trade is partially the result of competition in the bilateral relationship, and partially to do with disagreements about the pace and breadth of liberalization. While the two sides agree that further liberalization is essential to their domestic economic well-being, the devil is in the details. The majority of those details lie in the substance of trade liberalization—tariffs, state-owned enterprises, intellectual property rights, procurement, etc. Given that working out compromises on those issues is the precise intention of trade negotiations, our conversation focused instead on the format those negotiations should take in the aftermath of TPP and RCEP.


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WASHINGTON, DC 20036
TEL. (202) 887.0200
FAX (202) 775.3199

We noticed a split between our Chinese and American colleagues on how central the WTO should be to the trade-liberalization agenda. While both sides agreed that the organization was theoretically still the fairest and potentially most productive format through which to pursue liberalization, the American scholars were more concerned that the challenges that have stymied efforts with the Doha Round are likely to remain for the foreseeable future—despite the political and economic pressure that the mega-regional and bilateral free-trade agreements are putting on historically protectionist countries. The Chinese scholars, on the other hand, were more inclined to believe that there was still hope for the Doha Round, especially given the present state of the global economy and the increasing willingness of the large developing countries, including China, to compromise and invest political capital in order to be a part of the trade-liberalization agenda. In explaining Beijing's openness to being part of the TPP, a Chinese scholar described deeper trade liberalization as creating "the economy of the future."

None of our colleagues, Chinese or American, advocated for a return to the pursuit of the "single-undertaking" version of the Doha Round, where no part of the deal is fully agreed to until the whole deal is done, despite a continued belief on both sides that this would represent the ideal format for continued liberalization. Instead, recognizing that the political conditions that have upended previous efforts at single-undertaking remain, proposals for multilateral progress came in the form of support for piecemeal solutions like the Trade in Services Agreement (TiSA) and Information Technology Agreement (ITA), and opening up trade agreements like TPP, RCEP, and TTIP to new members after the negotiations are concluded.

With the exception of the European Union, the United States and China are the two largest trading powers in the world. Both sides have an interest in supporting a more open trading system. As the willingness of developing countries to engage in economic partnerships with both the United States and China has shown, there is little appetite for choosing between the two as economic partners. Whether through the U.S.-China BIT, a return to a modified version of the WTO process, or by stitching together the various minilateral trade initiatives, U.S. and Chinese leadership in the global economy means that the two sides working together to develop a realistic agenda for progress is a necessity. In reality, this will likely mean pursuing all three options—although not at the same time. While scholars recognized that negotiating the BIT will be a challenge, they agreed that it still represents the most politically and economically feasible option on the table. Policymakers on both sides should earnestly invest in the BIT as a demonstration to the world that the United States and China can work together to liberalize global trade and investment regimes.

## Financial Architecture and the International Monetary System

The first G20 summit in November 2008 marked the start of unprecedented financial cooperation among the world's major economies. United by a common interest in addressing the financial crisis and creating a more capable, robust financial system, the creation of the G20 recognized that the global economy had changed, and that navigating it would require a new, more inclusive institution. The G20 has since remained an important forum, but as the financial crisis has become less acute, so too has the impetus for cooperation. The U.S. Congress has yet to pass the IMF reform agreed to at the London G20 summit in April 2010; trade imbalances persist; the August 2015 devaluation of the renminbi has again led to suspicions that China might be manipulating its currency; and China and other emerging countries are struggling to cope with the spillover effects of the monetary policies of the industrialized world.

Even before the financial crisis, it was clear that the international financial system was in need of readjustments. For the second time since the establishment of the Bretton Woods system, trade imbalances had once again become the norm, and accusations of currency manipulation were being leveled in multiple directions. Our discussions took place several months before the August renminbi devaluation, when most economists believed the RMB to be valued correctly, if not slightly overvalued. Even so, the scholars involved in this project were uniformly concerned that currency manipulation would again become a big issue in the U.S.-China relationship, as evidenced by the debate in the U.S. Congress over including currency-manipulation provisions in TPP. While the TPP debate was notionally about Japanese currency manipulation, the link to previous currency problems that the Congress has consistently raised about China was clear. If our governments fail to get ahead of the issue, it will likely be addressed through domestic political rather than international mechanisms, to the detriment of the global financial system and the U.S.-China relationship. The IMF, which theoretically has clear rules against currency manipulation, has neither defined criteria of what constitutes currency manipulation nor a mechanism to disincentivize bad behavior. Suggestions as to how to address the issue ranged from expanding the WTO rule prohibiting subsidies to include currency undervaluation to creating a currency equivalent of the WTO international dispute-resolution panel.

Several of the Chinese scholars involved in this project shared concerns that had been circulating in China regarding U.S. manipulation of commodity markets. When our discussions were taking place, oil prices were continuing to collapse, to the surprise of Chinese and other analysts. While the root cause of collapsing oil prices was likely a complicated confluence of factors—from the conflict in Ukraine to slowing economic growth to the shale gas revolution—conspiracy theories in China argued that the United States had orchestrated the trend. This was not the dominant opinion in China at the time, but it did reflect underlying concerns about U.S. dollar dominance in the global financial system. The bulk of international commodities trade is denominated in U.S. dollars, a major source of U.S. monetary power.

RMB internationalization has been on the cards since at least 2009, when China signed a series of currency swap agreements with central banks from the European Central Bank to Uzbekistan. Since then, steps toward internationalization have continued apace. The year 2015 has been a landmark, however, for the internationalization agenda. China hopes to see the RMB included in the IMF's Special Drawing Rights (SDR) basket of currencies, which currently includes the U.S. dollar, euro, pound sterling, and yen, but does not include the RMB. The SDR basket is reviewed once every five years, which had meant that China would need to wait until 2020 to be included if a decision in its favor was not made by November 2015. The IMF has since decided to extend the deadline for implementation until September 30, 2016, with IMF officials publicly claiming that the extension is due to internal timing issues. Over the course of


1616 RHODE ISLAND AVENUE NW
WASHINGTON, DC 20036
TEL. (202) 887.0200
FAX (202) 775.3199

our discussions, all scholars agreed that it would benefit both the global financial system and the United States and China domestically to see the RMB internationalize and become a freely usable currency. Disagreements, however, came over the pace of internalization, and the extent to which China's domestic reforms need to be enacted before doing so makes sense. Several of the American scholars argued that before the RMB could be a properly functioning international currency, China would need to enact more market-oriented monetary policy, open up capital accounts, and create strong regulatory supervision. The Chinese scholars argued in return that while all of that might be true, the domestic reforms already underway will move things forward substantially, and that inclusion in the SDR basket need not come at the end of that process.

In all of this discussion, the role of the IMF was very present. While awareness of U.S. political realities means that the failure to pass IMF reform is not directly harming the U.S.-China relationship as much as it might, it is undermining the role of the IMF vis-à-vis China as well as in the global financial system writ large. Not only are the reforms essential to giving the IMF the resources it needs, the failure to pass the reforms is worsening the institution's legitimacy crisis. One of the most radical reforms suggested by various Chinese colleagues was the removal of effective veto power for any one member country in the Bretton Woods institutions. While this is politically infeasible, the suggestion reflects concern that important facilitators of global economic cooperation can essentially be held hostage by the political vagaries of a single economic power, despite broader international consensus. Unsurprisingly, U.S. and Chinese scholars agreed that passing IMF reform is essential to reversing the trend toward fragmentation in the international financial system.

Despite the failure of the Congress to pass IMF reform, the International Monetary Fund is still a strong institution. However, the IMF will need better tools, alongside increased legitimacy and political capacity, to address all of the increasingly important challenges that fall within its remit. Passing IMF reform will hardly be a silver bullet for addressing all the ills of the international financial system, but it is a necessary first step. A globally respected, well-functioning, and properly resourced IMF is the best institution the world has for these purposes, and there are no plausible alternatives on the horizon. As such, the single most pressing issue at stake in the U.S.-China relationship in international financial architecture is the passing of the 2010 IMF reforms. Delays will only encourage further workarounds and lost legitimacy at the IMF.

## Development

The bulk of this project took place in April 2015—a month after a senior White House official accused the United Kingdom of "constant accommodation" of China in response to the UK's announcement that it would join the AIIB. As a result, our discussions about development largely focused on infrastructure investment and the rationale behind the AIIB. While much of the tension around the AIIB's establishment was a function of bad politics rather than substantive disagreement, the political fracas exposed the extent of the trust deficit between the

United States and China when it comes to the latter's role in the global economic order. The decision to establish the bank marks a turning point in how China positions itself as an economic actor in the region. In addition, the bank itself—given its size and potential capacity—could lead to a restructuring of the development landscape in Asia, a region in which there have traditionally been few multilateral players.

U.S. investment in multilateral development institutions had been waning in the years leading up to the establishment of the AIIB. This was partly to do with financing. While many of today's multilateral development banks (MDBs), including the World Bank and the Asian Development Bank (ADB), were established either by, or with, strong support from the United States, the Congress's enthusiasm for the banks has been steadily diminishing. Without congressional support, the United States has struggled to fulfill existing financial commitments to MDBs, let alone increase funding. As a result of its reduced financial capacity, the United States has been looking increasingly to public-private partnerships to pursue development goals. Another, related, challenge has resulted from questions about the efficacy of multilateral development banks. In the past, several "white elephant" projects involving well-practiced banks with high investment standards have resulted in serious environmental degradation, labor abuses, and corruption. While there have been fewer high-profile cases of a similar nature more recently, experience has led some in the U.S. development policy community to exercise caution when it comes to MDBs.

For China, on the other hand, the appeal of establishing an MDB in Asia seemed obvious. A 2009 ADB study estimated that Asia would need $8 trillion of infrastructure investment between 2010 and 2020 in order to realize its growth potential. Meanwhile, China was looking for new sources of growth and new places to invest its trillions of dollars in foreign currency reserves. While the AIIB would address neither problem completely, it could be a part of a solution. In addition, investing resources in a multilateral institution like the AIIB would help Beijing demonstrate that the country was ready to play a more responsible role in global economic governance, something the West and China's neighbors had been encouraging for years.

The U.S. Treasury's concerns about the AIIB focused largely on two issues: standards and governance structures. On the question of governance, some feared that China's political system would mean that it would be unlikely to avoid using the bank to serve Chinese interests at the expense of recipient countries. There was concern that China's intent was to retain as much leverage as possible in the institution. That China would retain a veto power and that the first president of the bank would be Chinese was, to some extent, expected. However, the news that the bank was considering not having a resident board to oversee the decisions of management represented a significant deviation from standard MDB practice. While the architects of the AIIB viewed this as a step toward greater accountability and efficiency, others saw it as an effort to escape meaningful oversight. In this lies the nub of not only a disagreement between the United States and China, but a fundamental tension within existing development banks. While, in this case, the United States prioritized strong checks and balances, the architects of the AIIB wanted to ensure that the management of the bank was held responsible for the success or otherwise of projects, and that those projects could be seen through efficiently.


1616 RHODE ISLAND AVENUE NW
WASHINGTON, DC 20036
TEL. (202) 887.0200
FAX (202) 775.3199

This is also the case with standards. In the best-case scenario, standards ensure that investment decisions weigh environmental, social, and other costs against financial benefit. While some principles can be applied consistently across investments, the relative value of an environmental cost, for instance, is context dependent. One of the scholars we discussed this with cited the example of coal projects. In a community where the most viable energy supply is coal, a standard that prevented the development of fossil-fuel sources would likely result in either the coal plant being supported by a less scrupulous investor, or there being a continued energy-supply problem. As a result, neither the World Bank Group nor Chinese overseas investment institutions have uniform standards on environmental protections that apply across the board. Standards are again an issue in which the division is not only between the United States and China, but within the larger MDB community.

Given the scale of the infrastructure gap in Asia and beyond, it is possible (and desirable) that other emerging institutions, government-led and otherwise, will also step in to help address the infrastructure gap. As such, while the AIIB is now of less concern to the United States than it was initially, there could still be some benefit to MDBs and investment actors to share best practices. To some extent, this happens informally already. The AIIB, World Bank, and ADB have all agreed to work together, and much of the AIIB's staffing comes from other MDBs. This is less the case with other investment vehicles. When the Chinese Investment Corporation was first established, for instance, it suffered from a lack of international expertise and, as a result, took several years to become the professional institution it is today. State-owned enterprises have suffered from similar challenges. As such, most of the scholars involved in this project agreed that there was the scope to establish a formal mechanism to facilitate the sharing of best practices and encourage mutual accountability between investment actors.

## Conclusion

The vertical nature of international politics and the horizontal nature of economics have always made the management of the global economy a challenge. It was a tension present at the birth of the Bretton Woods institutions, and it has manifested itself in every trade negotiation or debate about currency manipulation since. Globalization and the diffusion of economic power, however, are making the threat of that tension more present. While all sides recognize that greater cooperation between major economic powers will lead to more prosperity, the lack of trust, and the inability of any one power to dictate terms, means that further economic integration is becoming increasingly difficult. One of our colleagues in this project, Professor Fang Jin, described the challenge to the global economic order as a vicious circle: the perception that existing institutions are ineffective and unrepresentative is encouraging major economies to find ways to work outside the system, which will in turn make the institutions less capable of creating policy and evolving, making them seem ineffective and unrepresentative. Ultimately, the United States and China will need to work together to stop that circle. For the U.S. government, this will mean investing the requisite amount of political capital necessary to make space at the table, including working with the Congress to approve reforms to institutions like the International Monetary Fund. For China, it will require an earnest implementation of its domestic economic reform package, and patience when it comes to the politics and bureaucracy of reforming the global economic order.

*Amy Studdart is deputy director and fellow on the William E. Simon Chair in Political Economy at the Center for Strategic and International Studies (CSIS) in Washington, D.C.. Ye Yu is associate professor and assistant director of the Institute for World Economy Studies at the Shanghai Institutes for International Studies (SIIS).*