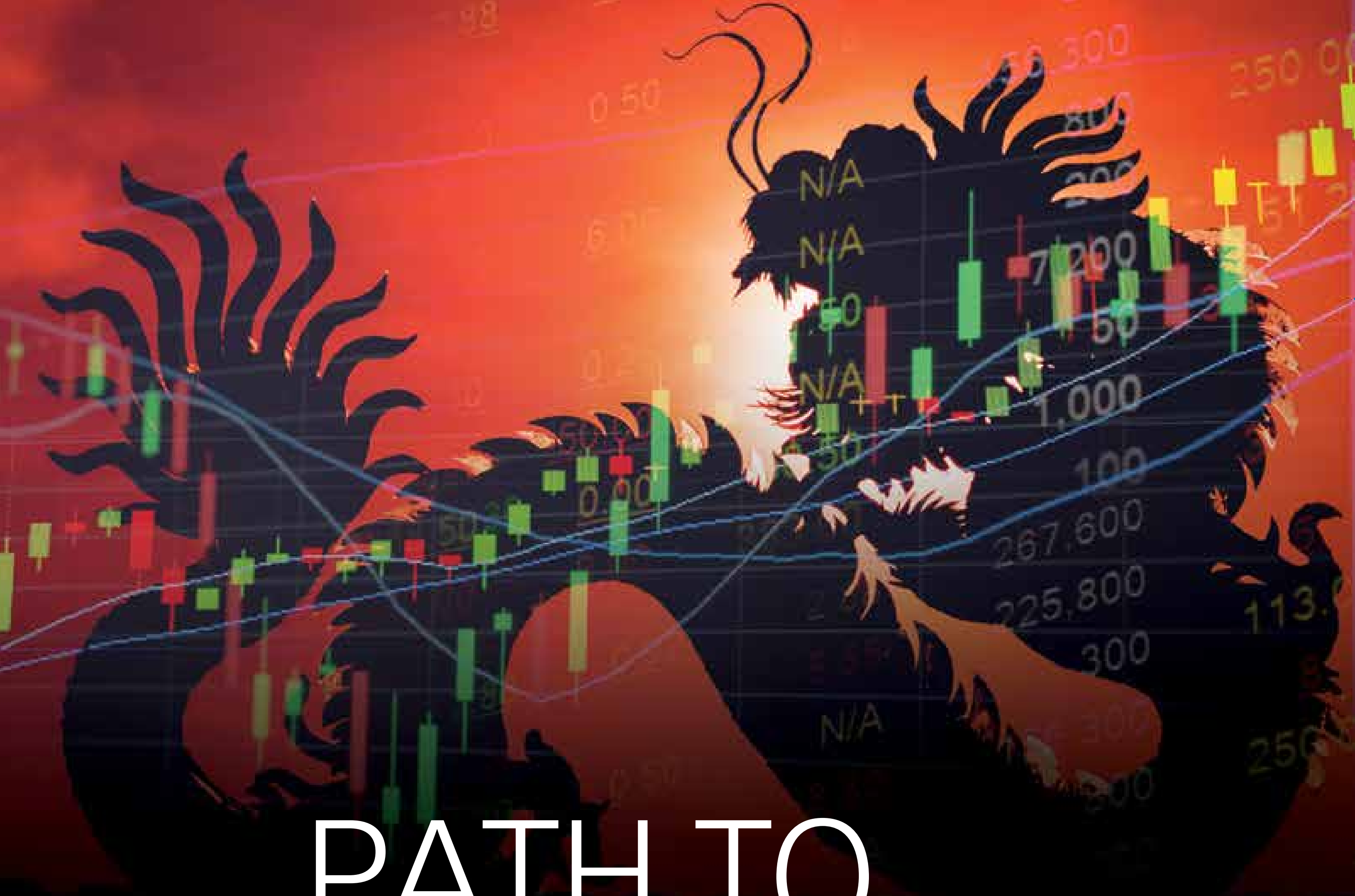


PATH TO INFLUENCE

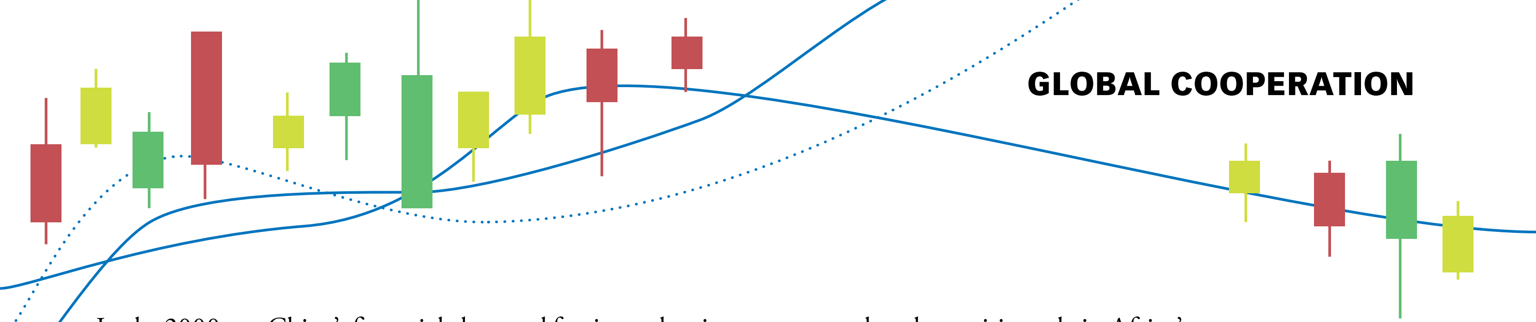
China employs a multipronged approach to enhance its role in setting the global economic and political agenda

Eswar Prasad

China is an economic superpower. It is the second-largest economy in the world, with an annual GDP of $11.5 trillion. It has annual domestic savings of more than $5 trillion and a stash of foreign exchange reserves of about $3 trillion. It is a net creditor to the rest of the world to the tune of $1.8 trillion.

Yet for all its vast financial resources, China remains a middle-income economy, with a per capita GDP only one-fifth that of richer economies such as the United States. Moreover, the country's global economic and geopolitical clout is only gradually beginning to catch up to its sheer economic size.

History is replete with examples of countries that have punched above or below their weight in global finance and geopolitics depending on how well they deploy those resources. Until fairly recently, for example, countries much smaller than China, such as the United Kingdom and Switzerland, were seen as far more influential in global finance and geopolitics. But that is changing fast. China is a case study in how to learn by doing and seize opportunities to gain greater influence.



In the 2000s, as China's financial clout and foreign exchange reserves grew, it began using its resources to increase its spheres of economic and political influence—offering investments, aid, and various forms of financial support to other economies. The recipients of this largesse were its neighbors in Asia as well as some economies in Africa, Latin America, and the Caribbean with large stocks of natural resources that China craved for its manufacturing machine.

Over the past decade, China's cumulative investment has been about $290 billion in sub-Saharan Africa and $160 billion in South America. China has given money to countries that have not been able to raise capital in international financial markets or are loath to turn to Western institutions and countries. When China's President Xi Jinping visited Pakistan in 2015, he announced $46 billion worth of financial support for energy and infrastructure projects. His visit to Africa that year culminated in a new China-Africa strategic partnership featuring cooperation in areas such as industrialization, infrastructure, green development, and public health. China offered $60 billion in funding support in grants, loans, loan write-offs, and development funds.

China has maintained that it adheres strictly to a principle of noninterference in other countries' internal affairs, especially when it comes to political matters, and that its aid and investment do not come with any conditions, such as economic reforms. As Xi put it at a summit in Johannesburg: "China supports the settlement of African issues by Africans in the African way."

China's economic activities abroad have stimulated vigorous debate about whether its money has been a net benefit for recipient countries—whether China was exploiting the countries to which it was giving aid or loans and, even worse, whether that money was propping up corrupt regimes, enriching venal officials, and creating a debt burden that would come to haunt those countries.

Some studies have contended that high levels of Chinese aid have had a harmful effect on human rights and on economic development across Africa. Other studies have argued that aid from China is, in fact, oriented toward poorer countries, although mostly resource-rich ones. Chinese investors do seem more willing than Western countries to invest in countries that are politically unstable. Overall, the academic evaluation is mixed—Chinese money has in some ways played a positive role in Africa's economic development, but with significant risks and costs to some sectors.

China's investments in, and aid to, Africa and Latin America have strengthened its economic and political linkages with countries on those two continents. However, such commercial and charitable endeavors often have not been viewed favorably by the international community and, sometimes, even by the recipient countries themselves. The use of Chinese labor and materials in many of these projects has limited their local employment and industrial development benefits.

China's leaders recognized that a shift in the nature of China's international economic relationships would help promote their economic and geopolitical ambitions more effectively. The Chinese are quick learners, taking a pragmatic approach and adjusting strategy when circumstances demand it.

China now employs a multipronged approach to setting the global agenda. First, it is gradually increasing its influence in international institutions and even establishing a toehold in those where it does not have a direct and immediate interest. This allows China to change the rules of the game from the inside. Second, it is setting up multilateral institutions where it gets to call the shots, which allows it to control the rules of the game and also serves to subtly catalyze changes in the existing institutions. Third, it is joining with other like-minded countries to establish institutions that are meant to build trust and stronger economic linkages with countries that it sees as partners as well as potential competitors. Fourth, it is using other arms of the state, including state-owned banks and development agencies, to increase its global financial reach and power.

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Changing existing institutions

The first element of China's global strategy involves increasing its influence in existing multilateral institutions. As part of changes to reflect the increasing weight of emerging market economies

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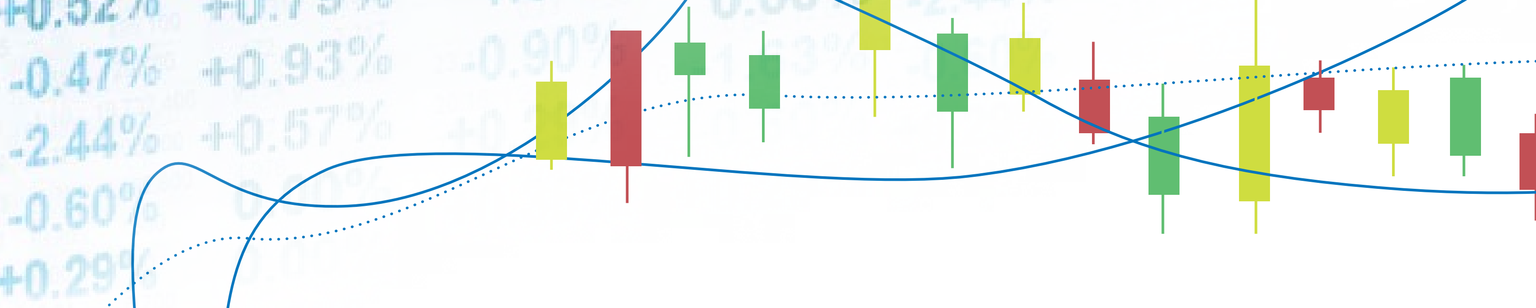

in the world economy, China's voting share at the IMF was recently increased from 3.8 to 6 percent, compared with 16.5 percent for the United States and 6 percent for Japan. At the World Bank and Asian Development Bank, two other major international financial institutions, China has voting shares of 5 percent and 6 percent, respectively. These shares are higher than in the past but below China's 15 percent share of global GDP.

China has also begun marking its presence in regional international financial institutions, such as the African Development Bank, the Caribbean Development Bank, and the Inter-American Development Bank. China accounts for the largest share of Africa's trade. For many Latin American countries, it has become the largest export market. China's presence in these regional institutions allows it to play a modest but easily scalable role in the economic governance of these regions.

China seems willing to engage existing institutions on their terms, rather than seeking changes as the price of entry. In 2001, China signed up for membership in the World Trade Organization (WTO), gaining much greater access to foreign export markets in exchange for a commitment to open its markets to foreign companies and investors. Now that China is a large and powerful member of the WTO, it can play a greater role in influencing how the organization defines and applies rules for international trading.

In January 2016, China joined the European Bank for Reconstruction and Development (EBRD). The institution's mandate requires that it assist only those countries "committed to and applying the principles of multi-party democracy [and] pluralism." Strikingly, China was willing to sign up for EBRD membership although the mandate seems inconsistent with the tenets of the Communist Party of China. One interpretation of this willingness is that China's version of democracy differs from what the West thinks of as free and open democracy. Another plausible interpretation is that China is open to compromise when it seeks membership in existing institutions. Over time, it then subtly exerts influence from the inside rather than through brute economic or political force from the outside.

China is now actively asserting its presence in international finance by bankrolling new institutions. Its leaders recognized that China could put its money to good use by financing infrastructure projects in Asia—a crying need for countries in the region that lack the funds to undertake large investments. This need spawned the Asian Infrastructure Investment Bank (AIIB), intended to finance infrastructure projects such as roads, railways, and airports in the Asia-Pacific region.

The AIIB now has 80 members and a capital base of $100 billion. China has contributed $30 billion, the largest amount by far of all the members, and has a voting share of 28 percent. The headquarters is in Beijing.

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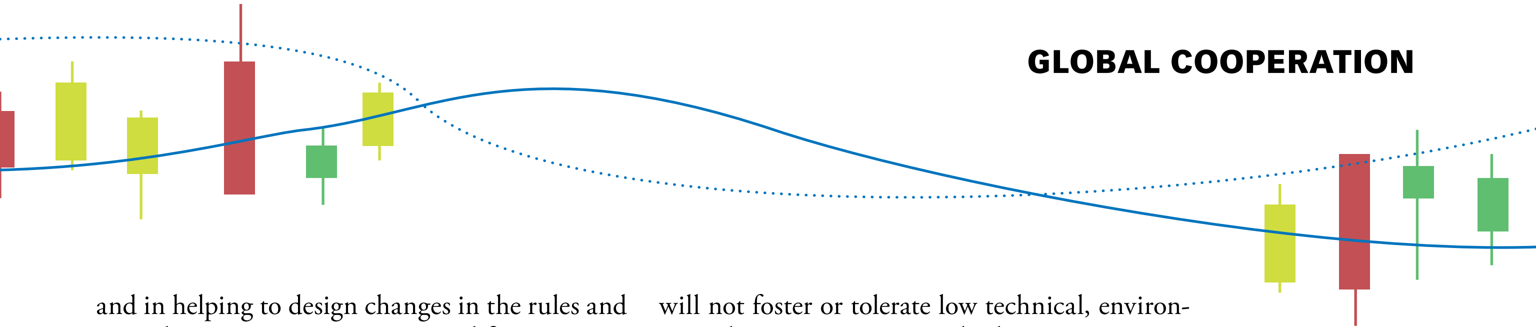
China has asserted that the AIIB will feature a lean bureaucracy and swift decision making and that it will improve on the governance of existing international financial institutions. The governance structure has many positive elements, including a simple and transparent formula for setting country voting shares and the absence of any single country's veto power over major decisions (at the IMF, by contrast, the US voting share is large enough to give it veto power). Moreover, developing and emerging market economies, which dominate the Asian bank, are likely to have a greater voice than at other international financial institutions.

The AIIB highlights China's impatience with marginal changes in the rules of global governance. It is now grabbing the reins and seeking to rewrite the rules, but in a way that ostensibly improves on the existing order, which China and other emerging markets see as having been defined by and mainly serving the interests of the major advanced economies.

Like-minded partners

China has also taken a leadership role in a group of major emerging market economies called the BRICS (Brazil, Russia, India, China, South Africa). The BRICS economies account for nearly one-quarter of world GDP and roughly two-fifths of the world population. These countries are demanding a greater say in the running of major institutions



and in helping to design changes in the rules and procedures governing international finance.

There was skepticism about whether the BRICS had enough shared interests to be more than just a talking shop. China saw its opportunity to lead. And it seized the opportunity.

In July 2015, the BRICS set up a $50 billion institution, the New Development Bank, headquartered in Shanghai, to promote sustainable development in the five countries. Each member has equal voting shares and no veto power over decisions made by a majority. At the same time, the BRICS established a foreign exchange reserves pooling arrangement among themselves—the Contingent Reserve Arrangement. The overall size of the pool is $100 billion, with China contributing $41 billion.

The BRICS appear to have succeeded despite skepticism about their ability to cooperate on global economic issues because they lack fully congruent—and often have conflicting—economic and geopolitical interests. Fostering stronger financial linkages between key emerging market economies and creating alternatives to the existing global financial architecture help emerging market and developing economies chip away at the dominance of advanced Western economies. With its vast financial resources, China has become the first among equals in this group.

Silken gift or noose?

In 2013, Xi proposed two major economic initiatives—the Silk Road Economic Belt and the 21st-Century Maritime Silk Road. The two have come to be referred to jointly as the Belt and Road Initiative.

The initiative covers, but is not limited to, the area along the ancient Silk Road, which was in fact a patchwork of roads, trails, and paths that facilitated economic and cultural exchange across Eurasia. The Belt and Road Initiative is envisaged as covering the continents of Asia, Europe, and Africa and connecting a large and disparate group of economies, from the economically vibrant and rich to those that are poor and have huge potential for economic development.

In December 2014, the Silk Road Fund began operation with an initial commitment of $40 billion and with the goals of following market principles and meeting or exceeding the best international standards of governance. China obviously wants to make it clear that Belt and Road projects will not foster or tolerate low technical, environmental, or governance standards.

The initiative, which has a financing goal of $1 trillion, neatly ties in the international expansion of China's influence with the development of the country's western and southern provinces, many of which are landlocked.

Some Chinese financial institutions also play a part in expanding the country's role in international finance. The China Development Bank, for instance, makes overseas loans to Chinese corporations operating abroad, as well as to foreign corporations. At the end of 2015, overseas loans totaled $328 billion, about one-fifth of the institution's overall loan portfolio. The Export-Import Bank of China allows the country to expand its influence abroad by providing financing for trade deals.

The strategy takes hold

China is clearly determined to exercise its role as a major global economic power through both direct and indirect means—influencing the existing world order but also trying to reshape the global monetary system to its own liking. The AIIB, for instance, helps Beijing put a stamp of legitimacy on China's operations to extend its spheres of economic and political influence, even while subtly influencing the rules of the game.

The AIIB is a textbook example of China's increasingly savvy and disciplined approach to international economic engagement, an approach that emphasizes constructive engagement rather than brute financial force. Beijing is using such institutions as a tool of international economic diplomacy that supplants China's earlier bilateral approach, which sparked resentment even among some countries that were recipients of Chinese financing.

China is becoming a leading member of the international community—not, as the West prefers, by being co-opted into existing institutions under the current rules of the game, but on its own terms and by enticing other countries into the system of rules it wants to dictate. FD

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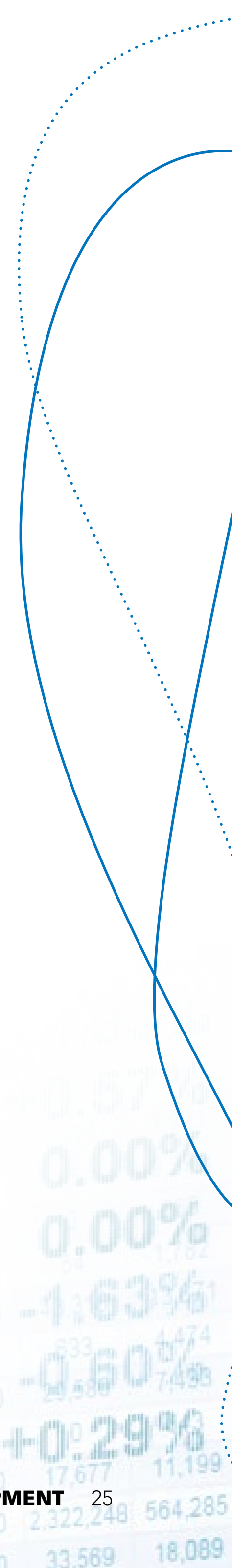
This article draws from the author's 2016 book, *Gaining Currency: The Rise of the Renminbi.*



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