China Business & Finance

China’s influence on global finance grows as US scales back input

Superpowers’ goals diverge, with PBoC aiding trade while Trump retreats into isolation

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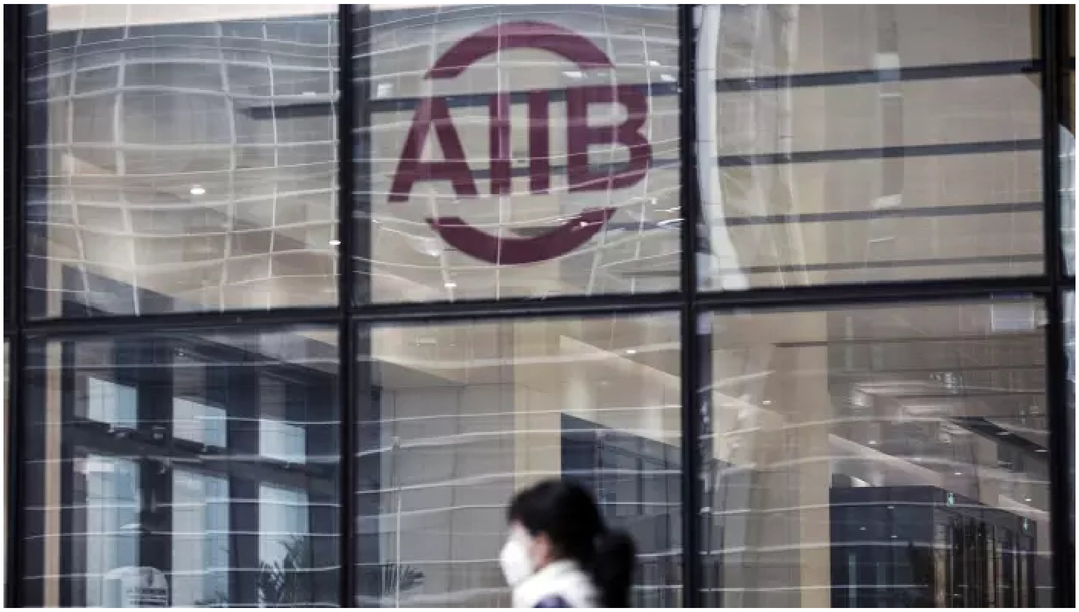

Ireland, Canada, Ethiopia and Sudan are understood to be among nations set to join the Asian Infrastructure Investment Bank © Bloomberg

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World finance ministers will next month descend on Washington for the spring meetings of the International Monetary Fund and the World Bank. For the first time since they were founded, it is not clear that some ministers will be welcomed.

This month, Donald Trump, US president, submitted a budget that cut World Bank contributions by $650m and reduced US participation in the IMF.

As the US scales back its participation on the global stage, China has been scaling up. Ever since the financial crisis, Chinese institutions have been providing lifelines to foreign countries and billions of dollars in development finance.

China’s central bank, the People’s Bank of China, is playing a growing role in providing a backstop for international liquidity. In the wake of the financial crisis, Zhou Xiaochuan, the PBoC governor, raised eyebrows when he said “the desirable goal of reforming the international monetary system . . . is to create an international reserve currency that is disconnected from individual nations and is able to remain stable in the long run, thus removing the inherent deficiencies caused by using credit-based national currencies".

In addition to strong words, the PBoC governor has taken some steps. According to a forthcoming paper by Daniel McDowell, a professor at Syracuse University, the PBoC has made available about $550bn in local currency swaps around the world.

As Eswar Prasad, a Cornell University economist, has noted in a new book, these swaps do not mean the renminbi is taking over. The US dollar is still the world's major currency and its Federal Reserve made unlimited amounts of dollars available in the wake of the crisis. That said, China's swaps are huge, helping to facilitate trade and may pave the way to bigger things to come.

In addition, China is also leading by example. In a step more in tune with what the framers of the Bretton Woods agreements intended, the PBoC has been re-regulating capital flows to mitigate financial instability and prevent a huge devaluation in its currency. At the same time, the Trump administration is pledging to roll back the financial regulations put in place after the crisis.

China has emerged as a leader in development finance as well. The global wing of China's national development bank, the China Development Bank, has a loan book of close to $400bn. Its partner, the Export-Import Bank of China, holds approximately $300bn. The two have a larger basket of assets than the World Bank and all the regional multilateral development banks combined.

In addition to these two banks, China has created about $116bn in bilateral and regional funds, such as the Silk Road Fund, that will invest in China's "Marshall Plan", the Belt and Road initiative. Other vehicles include the China-Latin America and the China-Africa Development funds, which are providing support for infrastructure and industrial transformation.

Of course, China has also taken the lead in creating two new development banks — the Asian Infrastructure Investment (AIIB) and the New Development banks — that begin with $50bn in start-up capital but aspire to have close to $350bn by 2020.

What is more, China's institutions appear to be more flexible. As Justin Yifu Lin, former chief economist at the World Bank, notes in a new book he co-wrote (*Going Beyond Aid: Development Cooperation for Structural Transformation*), China's development institutions blend concessional and non-concessional financial instruments with grants and commercial sector involvement in creative ways that are unimaginable for Washington-backed institutions.

Jin Liqun, head of the AIIB, recently told the Financial Times: "Now that China has developed, it is our turn to contribute."

On many levels, China's contributions could not come at a better time. The financial crisis proved that the IMF and the Fed need more firepower to prevent and mitigate a crisis. What is more, the world economy needs to invest $6tn a year over the next 15 years to plug gaps in developing country infrastructure and to rebuild the neglected infrastructure of industrialised countries. And although great progress has been made, there are still more than 700m people living in extreme poverty on the planet.

The Trump administration's proposed cuts to global economic institutions appear to be yet another sign of a US retreat into isolationism. Rather than withdrawing, Washington should be leading the way to embrace China's efforts and figure out ways to co-ordinate with, and complement, China's new global economic prowess.

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