THE EVOLUTION OF CHINA'S ECONOMIC CLOUT - 1990-2020

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Introduction

2018 marked the 40th anniversary of China's reform and opening up policy. Four decades of reform have transformed China from one of the poorest countries in the world to now the second largest economy that accounts for 1/3rd of global growth. Over 800 million people have been lifted out of poverty and the country has achieved middle income status. A few provinces of China have achieved advanced economy income levels. Today China's expanding footprint worldwide is visible from Asia Pacific to Africa and beyond through the Belt and Road Initiative infrastructure projects. President Xi Jinping in a speech to mark 40 years of market reforms in December 2018, said that "*China's development does not pose a threat to any country, no matter how far China develops, it will never seek hegemony*." Further President Xi Jinping said that China is committed to the multilateral trading system and further opening of its economy, saying that no one is in a position to dictate to the Chinese people, what should or should not be done.

President Xi Jinping's thoughts have been enshrined into the Communist Party charter and were elaborated in his three and half hour speech at the 19th Communist Party National Congress held in October 2017, seated next to him were his predecessors - Presidents Jiang Zemin and Hu Jintao. The October Communist Party National Congress declared China's entry into the "new era" and laid out a strategic vision for a "great modern socialist country" by mid 21st century. China's developmental challenge has evolved from 'meeting the people's basic needs' to their 'ever growing needs for a better life', as it sought to transform the economy from 'high speed to high quality' growth. The 3 critical battles that needed to be fought were addressing financial risks (with a goal of stabilizing the debt to GDP ratio in 3 years), eliminating absolute poverty and tackling pollution.

One of the President's key allies, Wang Qishan, said that the indiscriminate separation of the Party and Government affairs had in the past led to the weakening of the party's leading role. Wang said "*upholding the Communist Party's leading role is the paramount political principle for contemporary China*." The 19th Communist Party National Congress called for strengthening the Party's role in every aspect of public life. The Chinese authorities have implemented major institutional restructuring to implement the reform agenda. Communist Party Central Committees in key areas of structural reforms have been formed. The Committees have been given a role in policy making and oversight. The newly established Financial Stability and Development Committee will be responsible for inter-agency coordination, merging the banking and insurance regulators and restructuring the financial regulatory framework. New Government agencies have been setup for international aid and market regulation.

Amidst competing visions for global leadership, the United States has been a strong critique of China's policies. At the November 2017, Pacific Summit at Port Moresby, Papua New

Guinea, the Vice President of the United States said that "*The United States, a democracy is a better partner than authoritarian China. Know that the United States offers a better option. We don't drown our partners in a sea of debt, we don't coerce, compromise your independence. We don't offer a constricting belt or a one-way road. When you partner with us, we partner with you and we all prosper*." On the additional tariffs of US $ 250 billion imposed by the United States on Chinese goods, Vice President Pence said that "the United States will not change course unless China changes its ways." China has been reiterating in multiple fora, that its international infrastructure drive is a win-win progress, and is not designed to serve any hidden political agenda, not targeted against anyone and it does not exclude anyone.

In 2020, in the midst of the Corona Virus Pandemic, there has been a lot of criticism of the Chinese policies. President Donald Trump has moved to blame China for the massive corona virus spread in the United States. He said, "*This is worse than Pearl Harbor. This is worse than the World Trade Center. There's never been an attack like this. It could have been stopped in China. It should have been stopped at the source and it wasn't."* While trade talks between the 2 countries are still on track, it is clear than there exists an ideological gulf that separates the 2 Nations.

In the words of Fareed Zakaria, "*China is a repressive regime that engages in thoroughly illiberal policies, from banning free speech to interning religious minorities. Over the last 5 years, China has intensified its political control and economic statism at home, and abroad it has become a competitor to the United States*." Zakaria further says that the new consensus on China's economic behavior holds that China has forced multinational companies to transfer their technology, has subsidized its "national champions", and has placed formal and informal barriers in the path of foreign firms to enter Chinese markets. Economists have accused China of using the open international economy for strengthening its statist systems, forced technology transfers, unfair trade practices, limited access for foreign firms with industry and trade organized to achieve specific nationalist goals.

China: the 1990's

Since the initiation of economic reforms, China's economic growth has been marked by periods of cyclical surges in economic activity and inflation followed by periods of retrenchment, with 2 cycles in 1980s and 1990s ending in hard landings. Particularly notable is the 1986-90 cycle, which began with the relaxation of monetary and fiscal policies. Inflation rose to 19 percent in 1988, and efforts to curb inflation meant growth slowed sharply. The 1991-97 cycle was initiated by a rise in central and local government spending and easing of bank credit. By 1992, an investment boom was witnessed with GDP growth exceeding 14 percent. Liberalization of food prices and public sector wages led to massive inflation. Inflation peaked at 24 percent in 1994.

China adopted policy measures to cool the economy. These steps included an increase in interest rates, tightening central bank credit to banks and limiting investment approvals. China eventually achieved a soft landing of the economy with inflation in single digits by 1996 and reduced food prices. The credit boom of 1991-97 cycle led to weaknesses in financial sector, rise in non-performing loans in the banking system as banks had funded State Owned Enterprises with little regard for credit risk.

Table 1: China – The 1991-97 Economic Cycle (in percent change)

	1991	1992	1993	1994	1995	1996	1997
GDP	9.2	14.2	13.5	12.6	10.5	9.6	8.8
Fixed Investment	13.2	26.2	36.7	14.4	11.5	11.8	9.3
Fiscal Balance	-2.2	-2.3	-2.0	-2.7	-2.1	-1.6	-1.8
Consumer Prices	3.4	6.4	14.7	24.1	17.1	8.3	2.8
Domestic Credit	20.2	22.8	38.9	26.1	22.5	21.5	16.3

The Asian Financial Crisis

The East Asian financial crisis left China largely unaffected. The Chinese economy fared well. GDP growth was marginally lower than the previous years of 9 percent, inflation was at a 5-year low, exports grew at 20 percent contributing to a US $ 40 billion trade surplus, foreign direct investment was US $ 45 billion and foreign exchange reserves reached US $ 139 billion by the end of the year.

Yet in the region there was gloom. Severe economic recession was witnessed in the crisis hit countries of East Asia further aggravated by the Russian crisis and the financial strain in Latin America. As global recession threatened, China called for concerted global action for strengthening the architecture of the international financial system. China recommended that the IMF should establish a mechanism for monitoring short-term capital flows and movements of speculative capital. They also supported strengthening of the Fund's early warning system based on enhanced information disclosure and transparency.

Dai Xianglong said that the Chinese Government had taken a highly responsible stance during the Asian Crisis and turbulence in the international financial markets. Further he said that great efforts were made to preserve the financial stability in the Hong Kong SAR. He said:

> "*First China sustained its rapid economic growth. Against the backdrop of a substantial slowdown in exports of Asian Countries, we have adopted a vigorous fiscal policy and increased money supply appropriately to expand infrastructure investment. Secondly China has maintained the stability of the RMB exchange rate. Thirdly China has taken measures to expedite structural reforms and to prevent and reduce financial risks*."

Despite the optimism of Dai Xianglong, there were several critiques. Nicolas R. Lardy[1] said that China's financial and banking system suffers from inadequate central bank independence and lax regulation of commercial banks. Three of the four largest banks did not even report their consolidated balance sheets. Non-performing loans are classified by lenient standards than international norms and there existed losses due to fraud, corruption and other lending irregularities.

Despite these vulnerabilities it was felt that China was not affected by the Asian financial crisis as the currency was not convertible for capital account transactions. China's capital flows were largely for direct investment with a long term horizon. There was hardly any exposure of foreign capital flows to bank deposits, bonds, stocks or any other financial assets which could be sold in the market instantly.

The 1998 Asian crisis focused on the need for fundamental structural reform in China – money losing State owned enterprises and weak banks. Efforts in this direction included reorganization of regional branches of the People's Bank to reduce political interference and injection of 270 billion RMB into the four largest state owned banks. The classification of non-performing loans was aligned more closely with international standards, and the central bank tightened supervision and regulation of banks and financial institutions.

The Dai Xianglong Years

Dai Xianglong served as the 10th Governor of the People's Bank of China from 1995 to 2002. His star began rising in 1993 when his mentor Zhu Rongji became the Governor of the People's Bank of China and appointed Dai as Senior Vice Governor and then as Governor from 1995. It was in his tenure that the reorganization of the People's Bank of China (PBC) was undertaken. The PBC removed all its provincial and municipal branches which were headed by local politicians and established regional branches to strengthen independence of the Central Bank. Reform of Commercial Banks was pursued with the establishment of 4 asset management companies to purchase the non-performing assets of wholly state-owned commercial banks thereby reducing the commercial banks' non-performing loans. The PBC established a supervisory council in each commercial bank, adopted international loan classification and accounting standards and recapitalized the banks.

Dai Xianglong focused on stabilizing the balance of payments and the RMB exchange rate. To boost domestic demand, the PBC undertook 9 interest rate cuts in Dai's tenure earning him the moniker "the governor who cuts interest rates." Strong growth and strong export performance were witnessed all through his tenure – above 7 percent growth and 20 percent growth in export performance.

Dai Xianglong's[2] views on the role of the international reserve currency, fund surveillance and capital account liberalization represented a roadmap for future Chinese policy makers. He said that

[1] Nicholas R. Lardy., "China and the Asian Financial Contagion" Foreign Affairs July/ August 1998 pg 78-88

[2] Dai Xianglong., Statement at the Fifty-Third Meeting of the Interim Committee of the Board of Governors of the International Monetary System, September 26, 1999 Washington DC (www.imf.org)

> "*The current financial system cannot solve the balance of payments imbalance, which has repeatedly been the cause of the international financial crises. To solve the problem of an international reserve currency, the international community should consider the additional allocation of SDR's and create conditions to increase their use, and strengthen the Fund's function of providing liquidity to its members*."

China also considered that regional financial cooperation to be a helpful complement to the existing international financial system. Economic integration in the Asian region was represented by the Chiang Mai initiative. China became an active participant in financial cooperation based on currency swap arrangements introduced among ASEAN countries and China, Japan and Korea. In 2002, as a net debtor and low income country China made contributions to reducing debt burdens of HIPCs and the poorest Nations.

The Zhou Xiaochuan Years

Zhou Xiaochuan served as the 11th Governor of the People's Bank of China from 2003 to 2018. He was consistently ranked as the most influential policy makers of his generation and oversaw China's transition as the second largest economy in the world. A man praised for his intellect and diplomacy, Governor Zhou is called "China's most able technocrat." Zhou Xiaochuan served as a member of Chinese Communist Party's Central Committee and was a strong advocate for greater regulation of banks and maintaining higher reserves. Governor Zhou called for global financial reforms particularly the inclusion of the renminbi in the SDR basket of currencies. In his tenure China's rising clout on the global economic stage was witnessed with the significant buildup of foreign reserves at the People's Bank of China.

Zhao Xiaochuan's long tenure can be divided into 3 distinct phases

(a) The 2002-2007 period wherein he strove for exchange rate flexibility, capital account liberalization and reform of the banking system at a time when China had favorable medium term prospects for maintaining strong growth and continuing its integration into the global economy.
(b) The 2008-2010 period in which China had to formulate a response to the global financial crisis and put in place policies for rebalancing of growth towards private consumption. It was a period when China urged the IMF to consider the inclusion of the RMB in the SDR basket to improve the attractiveness and liquidity of the SDR as a reserve asset.
(c) The 2010-2017 period in which China pursued policies of Renminbi Internationalization and financial sector reform. In 2010, the IMF rejected the RMB's attempt to enter the SDR basket. But China did not give up and intensified its push. Finally in November 2015, the IMF accepted the RMB into the SDR basket, assigning it 10.92 percent of the total weight, below the US Dollar, the Euro, but above the Yen and the Pound Sterling.

China: Selected Economic Indicators 2000-2015

INDICATORS	2000-2007	2008-2010	2011-2014	2015-2017
Real GDP	10.5	9.8	8.1	6.8
Consumer Prices	1.7	2.8	3.2	1.8
Unemployment Rate	3.9	4.2	4.1	4.1
Current Account Balance	4.4	5.9	2.1	1.9
Gross Official Reserves (billions US $)	1018	2445	3606	3146
Nominal GDP (billions RMB)	16466	36018	56812	81344

Exchange Rate Flexibility and Capital Account Liberalization

On January 1, 1994 China introduced a market based, unified and managed floating exchange rate system. Under the new system, certain banks were authorized to sell and purchase foreign exchange. On December 1, 1996 the renminbi became convertible for current account transactions. In the inter-bank-market the PBC limited the daily movement against major currencies, +/- 0.3 percent around a daily announced reference rate. For capital transactions, exchange controls were applicable. China imposed restrictions on domestic investments by qualified foreign institutional investors, restrictions on foreign borrowing plans of government departments, controls on FDI and investments on derivative transactions for purposes of speculation.

Post the Asian Financial Crisis, China[3] adopted an exchange rate policy that fostered economic and financial stability while maintaining healthy, rapid economic growth. It was felt that exchange rate reforms and institutional reforms were integral parts of the overall reform endeavor and it was important to identify proper sequencing to carry out both these reforms. Full renminbi convertibility was a stated goal, and it was to be achieved through a gradual and deliberate approach. The reform of the exchange rate was to be carried out in tandem with a gradual approach to capital account liberalization given the weaknesses in the financial system.

On June 21, 2005 China instituted a reform of the renminbi exchange-rate regime by moving to a managed floating exchange rate regime based on market supply and demand and with reference to a basket of currencies. This reform step had profound significance for maintaining macroeconomic and financial market stability. The Chinese government took measures to cultivate and develop foreign exchange markets. Hedging instruments were developed. Enterprises were given incentives to retain more foreign exchange and some

[3] Statement by Zhao Xiaochuan Governor People's Bank of China at the International Monetary and Financial Committee Dubai dated September 21, 2003

relaxations in capital account restrictions were given. The RMB exchange rate moved in both directions against the US dollar. By March 31, 2006 the RMB had appreciated 3.2 percent against the dollar. The real effective exchange rate of the renminbi rose by 8.1 percent in 2005.

Banking Sector Reforms

The Chinese authorities placed banking sector reform at the center of their overall policy agenda. Recapitalization and restructuring of the Bank of China, the China Construction Bank and the Industrial and Commercial Bank of China were pursued. China injected US $ 45 billion into recapitalization of Bank of China and China Construction Bank. Moneys were transferred from international reserves to Central Huijin Investment Company, to finance recapitalization. A Central Banking Regulatory Commission (CBRC) was established. Performance assessment indicators, external oversight and strengthening corporate governance of banks were pursued.

The period 2003-10, China strengthened bank's balance sheets, internal control systems, governance and credit risk management in state banks. Chinese government provided financial support to restore capital adequacy and full provisioning for NPLs. Shortly thereafter, the operating profits of Bank of China and China Construction Bank improved. China allowed foreign ownership of Banks with Bank of America and HSBC procuring stakes in Industrial and Commercial Bank of China and the Bank of Communications respectively. The CBRC took steps to monitor large exposures and introduced a deposit insurance scheme.

China also focused on the activities of the Agricultural Bank of China (ABC) and the Regional Credit Cooperatives (RCC). Given the huge scale of operations and exposure to the agricultural sector, restructuring of the ABC and the RCCs was pursued.

By 2006, China was witnessing strong GDP growth of 10 ¼ percent, fixed investment was nearly 30 percent, trade surplus had surged to US $ 135 billion, foreign exchange reserves reached US $ 895 billion. It was expected that GDP growth would easily exceed 10 percent, rural incomes would continue to rise and consumer credit facilities expand. Inflation was below 2 percent. China was undertaking a range of reforms in the banking sector, fiscal sector reforms like adoption of VAT, higher social sector allocations for health, education and pensions while accelerating the development of capital markets.

Financial Sector Reforms

The Financial Systems Stability Assessment (FSAP) of China's Financial sector was undertaken as part of the Article IV consultations by the IMF in 2011. The FSAP underscored the importance of careful sequencing of Financial Sector Reforms to be undertaken given the interconnections between the reform processes. The five major areas covered by the FSAP included exchange rate flexibility, monetary policy framework, improvements in regulation and supervision, financial market development, interest rate liberalization and capital account liberalization. There were serious concerns of a growing mountain of debt, shadow banking practices and massive stock market swings.

Then came the Global Financial Crisis of 2008-10, which changed the world's perception of China's economic miracle.

China's response to The Global Financial Crisis 2008-2010

The Global Financial Crisis of 2008-2010 confronted China with the question of international currency that will secure global financial stability and facilitate world economic growth. China felt that issuing countries of reserve currencies were constantly confronted with the dilemma between achieving their domestic monetary policy goals without carrying their international responsibilities. Zhao Xiaochuan[4] pleaded for reform of the international monetary system that yielded win-win results for all stakeholders.

> "*Special consideration should be given to giving the SDR a greater role. The SDR has features and potential to act as super-sovereign reserve currency. More over an increase in SDR allocation would help the Fund address its resources problem and the difficulties in the voice and representation reform. The scope of using the SDR should be broadened, so as to enable it to fully satisfy the member countries demand for a reserve currency*."

Persisting with its call for reform and future mandate of the IMF, China pressed ahead for immediate quota and voice reform. At the 12th Meeting of the IMFC at Istanbul, Dr. Yi Gang[5] said that

> "*The current financial crisis, which originated in developed countries, has resulted in substantial losses for countries of the world. The failure of major international financial institutions to issue timely early warnings highlights the consequences of its misfocused surveillance. Only through the acceleration of fundamental reforms will the major financial institutions be able to discharge the mandate assigned to it by member countries. The persistently misaligned quota shares and underrepresentation of emerging market and developing countries hamper Fund governance and even-handed surveillance. It is critical that the Fund complete in a timely manner the reform objective announced by the G-20 leaders, namely a shift of atleast 5 percentage points of the quota shares in favor of emerging market and developing member countries. Building on quota reform, we support the broader reform of Fund governance. Emerging Market and Developing Countries should also have greater participation in management and staff.*"

In 2009 the world heard China's voice in a period of crisis as it represented the only country with a significant current account surplus and trade surplus and a near double-digit growth.

China's response to the Global Financial Crisis 2008-2010 comprised of 3 broad strands – a major fiscal stimulus, an extraordinary credit expansion and re-pegging the renminbi to the US dollar. There was an increase in spending on capital projects and a 31 percent increase in credit. Growth picked up in 2nd quarter of 2009 and reached 9.1 percent, inflation remained modest, and reserve accumulation was rapid, reaching over US $ 40 billion/ month. The

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[4] Zhao Xiaochuan: Reform of the International Monetary System dated 23/3/2009 (www.pbc.gov.cn)

[5] Statement of Dr. Yi Gang, Deputy Governor of the People's Bank of China at the 12th Meeting of the IMFC Istanbul dated 6/10/2009 (www.pbc.gov.cn)

balance of payments saw dramatic changes with a fall in export volumes and foreign direct investment. There was an export rebound and by July 2009 exports were above their pre-crisis level with particular strength in electronics and light manufacturing. China's fast paced recovery had significant positive trade spill-overs to the global economy. The economic recovery enabled further reform of the renminbi exchange rate regime. On July 19, 2010, the People's Bank of China announced a return to the managed float exchange rate regime.

2011 SPILLOVER REPORT

In 2011, the IMF formulated a spillover report that highlighted the significance of China's influence on the world economy. The report said that as the world's most central trader, China's capacity to both transmit and originate real shocks was rising, and therefore clearly China had an important stake for the world in its stability. Its export oriented growth model was seen as a source of stresses and economic rebalancing was essential. Currency appreciation was important to the process of rebalancing. A failure to rebalance the growth model would imply unprecedented increases in export market share.

China launched a number of policies like "Going Global", "One Belt One Road", "RMB Internationalization" and "Made in China 2025" to provide impetus to capital flows.

Going Global urges Chinese firms to take advantage of the booming world trade to invest in global markets. Going Global seeks to move the Chinese economy to an innovation-driven economy and has 2 high profile initiatives – Belt and Road and Capacity innovation.

The Belt and Road Initiative or the Silk Road Economic Belt and the 21st century Maritime Silk Road is a China centered regional connectivity network which is financed by AIIB up to USD 160 billion (one trillion yuan) comprises of 6 land corridors, the largest of which is the China-Pakistan Economic Corridor which costs USD 62 billion in infrastructure projects to modernize Pakistan's transportation network, energy infrastructure and economy. There is a maritime silk road to foster collaboration in South East Asia, North Africa, Oceania and through South China sea, South Pacific Ocean and the Indian ocean area. In the eyes of protagonists, the Belt and Road Initiative has great potential for both China and participating countries since it will help fill large and long-standing infrastructure gaps in partner countries, boost growth prospects, strengthen and increase employment.

The IMF recommended that China's transition to a sustainable consumption-based growth is desirable benefitting the global economy and reducing longer term risks, even if it entails a medium term slowdown. However, the IMF said that given its size, high investment rate, high import content of its investment and exports, a slowdown in China is likely to have strong global spillovers. The negative spillovers will weigh on global growth but the effects will vary with the country's level and type of exposure to China. China's rebalancing away from investment has contributed to a slowing demand for and lowering of prices of commodities. Financial spillovers from China are on the rise through strong trade linkages and rapidly rising financial linkages.

Renminbi Internationalization

From 2011, China facilitated a gradual increase in the international use of the renminbi. 28 bilateral currency swap agreements were signed and RMB clearing banks were established in

14 countries and regions. There was a buildup in renminbi deposits in Hong Kong SAR and an increase in issuance of renminbi denominated "dim-sum bonds". There was also a relaxation of capital controls to allow the return of offshore renminbi to mainland China. The expansion of the international use of the RMB has occurred largely in the Hong Kong SAR which has an open capital account, highly regarded legal system and strong regulatory oversight provided by the Hong Kong Monetary Authority. The Bank of China acts as the clearing bank and a payment infrastructure has been created. Sales of renminbi financial products were also conducted in London as part of the plans to expand the offshore renminbi business to other financial centers.

At the 3rd Plenum of the 18th CPC Central Committee[6] in 2013, it was announced that China would seek to "speed up the process toward capital account convertibility." China introduced partial or full convertibility on 35 out of 40 items on the IMF's classification of capital accounts. Zhao Xiaochuan says that China has adopted the concept of managed convertibility, while retaining capital account management in four items, which are widely adopted by most countries.

The RMB was officially included in the SDR currency basket on October 1, 2016. The Chinese authorities felt that it was a significant milestone in the process of RMB internationalization and an acknowledgment of the progress in China's economic development, reform and opening up. They also felt that it's was step that would help increase the representativeness, stability and attractiveness of the SDR and improve the international monetary system. China published its foreign reserves, balance of international payments and international investment positions in US Dollar and SDR terms and issued SDR denominated bonds in China.

On December 22, 2017 the monetary authorities of Japan and China approved allowing Japanese Corporations to issue RMB based bonds – the Panda bonds in China. That said, Japan remained reluctant to join the RMB internationalization.

Despite China's efforts for RMB internationalization, the dollar will remain the preeminent global reserve currency. The structure of political and legal institutions and the limited financial market development make it difficult for the RMB to become a major reserve asset. Despite China's efforts, the RMB's use in international transactions fell by about 30 percent between 2015 and 2016.

Quota and Governance Reforms at the IMF

On December 18, 2015, the United States Congress approved the 2010 Quota and Governance Reforms of the IMF. The Managing Director of IMF said:

> "*The United States Congress approval of these reforms is a welcome and crucial step forward that will strengthen the IMF in its role of supporting global financial stability. The reforms significantly increase the IMF's core resources, enabling us to respond to crisis more effectively and also improve IMF governance by better*

[6] Statement of Zhou Xiaochuan, Governor of the People's Bank of China at the 31st meeting of the IMFC Washington DC dated April 18, 2015

reflecting the increasing role of dynamic emerging and developing countries in the global economy."

Following the Quota and Governance Reforms, the Fund's quota resources increased to about SDR 477 billion from SDR 238.5 billion. More than 6 percent of quota shares shifted to dynamic emerging market and developing countries from over-represented member countries. China became the 3rd largest Member after United States and Japan. However the Chinese authorities continue to feel that the 2010 Quota and Governance reform has not significantly closed the gaps between calculated quota shares and their actual weight in the global economy. Hence China has called for continued reform momentum in completing the 15th general review of quotas within the agreed time.

IMF Quota Reform

Post the IMF quota and governance reforms implemented in 2015. China's influence on the IMF Executive Board has grown. China issues statements on almost all topics coming before the Executive Board. It has a presence in the IMF management. Zhu Min was appointed as Special Advisor to the Managing Director from May 3 2010 to July 25, 2011 and then was appointed as the 4th Deputy Managing Director.

Tao Zhang was appointed as the 4th Deputy Managing Director of the International Monetary Fund on August 22, 2016 having served as Executive Director on the IMF from 2011 to 2015. Tao Zhang represents the elite Chinese bureaucracy well versed with the Fund's program design, review and execution. As Deputy Managing Director Tao Zhang has the institutional support, the stature and credibility to influence IMF decisions.

Tao Zhang's positions as Acting Chair and Deputy Managing Director have been supportive of Low Income Countries. In a Conference in Port of Spain he assured the Caribbean Prime Ministers of the IMF's deep commitment to helping Caribbean countries in navigating the challenges of low oil prices. Further he has supported the international community and the IMF to provide assistance and encouraged IMF staff to refine their recommendations to make policy more effective in addressing LIC's development needs.

Tao Zhang identified several African countries namely Chad, Mozambique, Republic of Congo, Ghana and Mauritania as countries with elevated debt distress and advised them to undertake fiscal adjustment programs to deliver stronger economic performance. He has assured IMF support for advising low income countries on how best to balance borrowing to finance development and manage debt related risks, roll out the revised low income debt sustainability framework and strengthen technical assistance in critical areas such as public debt reporting and management. As Acting Chair and Deputy Managing Director Tao Zhang has pressed for timely completion of reviews and disbursements.

Presence in International Institutions

China's has strategically positioned itself to set-up new international institutions where it wields considerable influence. China has a voting share of 6.09 percent in the International Monetary Fund and 5.5 percent in the Asian Development Bank. It is the 3rd largest member in both institutions. Further China is a member of the African Development Bank, the

Caribbean Development Bank, the Inter-American Development Bank and the European Bank for Reconstruction and Development.

China led the establishment of the BRICS New Development Bank in July 2015 and established a contingent reserve arrangement to address short-term balance of payments crisis. The New Development Bank is also mobilizing resources for infrastructure and sustainable development projects in BRICS and other emerging economies and developing countries. The New Development Bank is projected to grow from a paid up capital of US $ 10 billion in 2015 to US $ 90 billion by 2027 by admitting new members and additional capital.

The Asian Infrastructure Investment Bank (AIIB) was established in 2016 and by 2019, AIIB membership reached 100 member countries. As the first new multilateral development bank in a generation, since the European Bank for Reconstruction and Development, the AIIB represents a successful model for south-south cooperation in infrastructure development, embracing technology to improve common efficiency. In several areas the AIIB competes with the World Bank and the Asian Development Bank, although the Chinese would present the initiative as one complementing the efforts of exiting institutions.

China successfully hosted the 2016 Hangzhou Summit of the G20 leaders. The Hangzhou consensus of the Leaders of G20 was based on a vision to strengthen the G20's growth agenda forging synergy in fiscal, monetary and structural policies; promoting global trade through greater openness and inclusive growth.

China has succeeded in establishing new international financial institutions and also reforming the international financial architecture developed by the west. Its spokespersons project these efforts as likely to lead to a more integrated Asia in the coming years. It is of-course also the case that counter measures to this discourse are also there, especially to the Belt and Road Initiative.

The Belt and Road Initiative

The single biggest investment is the Belt and Road initiative which is a massive project involving the funding and construction of a system of roads, railways, oil and natural gas pipelines, fiber-optic and communication systems, ports, and airports. The Belt and Road Initiative will create new forms of connectedness across much of Central Asia and Europe and lead to greater interdependence and enhanced growth for States in these areas. China has defined the BRI as a "win-win" through the creation of an economic system that's mutually beneficial for all participants. As of August 2018, 70 countries have signed contracts with China for projects related to the BRI. China has enshrined the BRI in its Constitution – a signal that the Communist Party views it more than a regular foreign policy.

In implementing the BRI projects, China has taken up more than 900 projects, 80 percent of which are contracted to Chinese firms. Chinese State owned enterprises now run 76 ports in terminals in 34 countries including Pakistan, Sri Lanka and Greece. Chinese State Owned Enterprises have made several high risk investments in strategic ports, railway track construction and road construction projects. China's BRI initiative has created deep interdependence. The Marshall Plan which created a system of deep and complex interdependence between the United States and Europe, is the closest analog to the BRI in promoting structural power.

China is pursuing a number of Free Trade Agreements as part of a long term multilateral approach to be included in the institutional infrastructure of the BRI. The Sino-Swiss FTA might be considered a benchmark, a gold standard in the context of the BRI. The Swiss Government's position has been "include many trading partners in the FTA, the benefits of FTA increase". The BRI gives China the narrative to collapse bilateral FTAs into multilateral arrangements to maximize welfare benefits. It is likely that in coming years the Swiss trade with Kazakhstan will increase because of BRI.

The Sino-Polish Comprehensive Strategic Partnership of 2016 and the Polish decision to join the AIIB have significant geopolitical consequences. Further the SREB countries (Czech Republic, Bulgaria, Slovakia and Poland) signed a comprehensive strategic partnership agreement with China during President Xi Jinping's visit to Warsaw in June 2016.

The China - Central Asia - West Asia corridor connects the China-Kazakhstan railway to Uzbekistan, Turkmenistan, and Iran. The involvement of the 5 Central Asian Republics in the BRI is very profitable by ensuring economic and political benefits, with trade increasing to US $ 34 billion in 2015 and China financing large energy sector projects in Turkmenistan and Kazakhstan. The Central Asian Pivot of the Modern Silk Road is Kazakhstan. President Nazabayev has highlighted the complementarity between the BRI and Kazakhstan's economic policy "The Bright Road", with both aiming to create transport infrastructures integrated with big international railway and roads.

The Economist has said that 'if not a debt trap, Chinese investment in infrastructure is often a diplomatic one'. The Economist cites the Malaysian BRI project of East Coast Rail link which costs US $ 20 billion financed entirely by Chinese loans and constructed by Chinese workers, which has resulted in Malaysian debt shooting up. The Centre for Global Development has listed 23 countries, involved in BRI at significant debt distress. These include Pakistan, which is facing a balance of payments crisis, Myanmar, Sri Lanka and Maldives. The US President Donald Trump has depicted China as out to bankrupt weak governments, to erode sovereignty and dictate terms: "debt trap diplomacy."

The World Bank estimates that the cumulative BRI expenditure upto 2019 stands at US $ 575 billion. The World Bank has further said that the risks on the BRI projects is exacerbated by the limited transparency and openness of the initiative and weak economic fundamentals and governance of several participating countries. 12 of the 43 BRI countries face elevated debt levels and could face further deterioration in the medium term on debt sustainability. The World Bank has also identified Governance risks due to non-adherence to international good practices like open and transparent procurement, with BRI projects being allocated to firms best placed to implement them. There exist environmental risks with the BRI transport infrastructure estimated to increase carbon dioxide emissions by 0.3 percent world-wide and by 7 percent or more in some countries as production expands in sectors with higher emissions. There also exist social risks with an influx of workers related to an infrastructure project could cause gender-based violence, sexually transmitted diseases and social tensions.

So far two-thirds of the Chinese spending on completed BRI projects has gone into the energy sector and transport, roughly accounting for US $ 144 billion and US $ 304 billion respectively. It is important to note that China has established itself as a central player in the BRI corridor economies with a rising share of Chinese imports being witnessed in these economies. In 2017, the BRI corridor economies witnessed 27% and 37% of China's exports of infrastructure related exports of iron and steel respectively which represented an increase of 15% and 17% over the pre-BRI period of 2013. 66% of the total BRI investments are expected in 7 countries – Indonesia, Malaysia, Pakistan and the Russian Federation accounting for 50% of the total. The major projects include the China-Mongolia-Russia Economic Corridor, the China-Pakistan Economic Corridor and the Vietnam National Highway.

The Corona Virus pandemic has affected Chinese economy severely and the impact is likely to be felt in BRI corridor projects. It is unlikely that China will be in a position to provide BRI corridor economies with low cost loans. Several projects are likely to witness time and cost over-runs and several projects may necessitate a review for economic viability.

2018 Beijing Summit of the Forum on China Africa Cooperation

China has announced a total of US $ 60 billion financing to Africa, in the form of Government assistance, financing and financing by financial institutions and companies. This includes US $ 15 billion, of grants, interest free loans, and concessional loans, US $ 20 billion, of credit loans, the setting up of US $ 10 billion special fund for development financing and US $ 5 billion special fund for financing imports from Africa. Further Chinese companies have been encouraged to finance US $ 10 billion, of investments into Africa. After the 2015 Johannesburg Summit, China had committed US $ 60 billion, of financing for Africa which had been delivered. China has identified 8 major initiatives for collaboration – industrial promotion, infrastructure connectivity, trade facilitation, green development, capacity building, health care, people to people exchanges and peace and security. Further China has called for aligning the Belt and Road initiative projects in Africa with the African Union's Agenda 2063. The stated aim is to build a stronger China-Africa community with a shared future.

Recent Developments

President Xi Jinping has said "what we now face is the contradiction between unbalanced and inadequate development and the people's ever growing needs for a better life". As China seeks to transform the economy from high speed to high quality growth, it faces the challenges of fostering new growth engines, promoting innovation, industrial upgrading and further opening up. China will have a important role in upholding the international trading system and will remain a major international creditor through the Belt and Road Initiative. In response to the trade tensions with the United States, China seeks to intensify its policy easing and stimulus measures. These include lowering entry barriers on financial services and autos, reducing import tariffs for a wide range of consumer goods and loosening sectoral restrictions on foreign investment. Further as part of the accelerated rebalancing efforts China seeks to deepen fiscal structural reforms including higher spending on health, reforms in personal income tax to further boost consumption and reduce income inequality, simplify labor mobility from rural to urban areas and substantial carbon tax to tackle air pollution.

China's Current Macroeconomic Scenario

The momentum of the Chinese economy has remained strong. GDP growth has been in the range of 6.7-6.9 percent for the last 11 quarters. Inflation has remained at 2 percent and unemployment rate has fallen. Corporate profits are being witnessed; domestic and external conditions have remained favorable with reduced capital outflows and exchange rate pressure. China is carrying US $ 3.1 trillion foreign exchange reserves.

The strategy is to shift from high speed to high quality growth. The five-pronged approach for this is to rein in credit growth, accelerate rebalancing efforts, increase the role of market forces, fostering openness and modernizing policy frameworks towards financial regulation. There has been a visible shift to the new economy with growth rebalancing towards service sectors. Health care and education have been opened to private investment and land reforms have been undertaken to grant property rights to rural residents. There has been a continued reduction in steel and coal capacities. Housing inventories have come down significantly with the social housing programs.

Monetary policy is one of the most important means through which China manages the economy. Its effect is transmitted through the financial system, the core of a modern economy. China's exchange rate policy has played a key role in achieving the macroeconomic objectives of price stability, growth, full employment and a balanced BOP account.

The RMB has been internationalized on a market oriented basis and ranks fifth worldwide as a global currency of payment at the end of August 2018, accounting for 2.12 percent of the global market. RMB reserves held by countries stood at USD 194 billion as of June 2018 and over 60 foreign central banks and monetary authorities have included RMB in their official foreign exchange reserves. China's focused on opening up the financial sector and has made headway in establishing a rules based financial sector, with the enactment of the Banking and Insurance laws.

The Corona Virus Shock

China was hit hard by the Corona Virus pandemic with over 82,885 confirmed COVID 19 cases and 4633 deaths as on May 7, 2020. The Chinese government imposed containment measures, social distancing and strict quarantine for workers. The terrible human suffering came with significant economic costs. A severe Corona Virus shock comparable to the Great Financial Crisis of 2009 is visible in China. A series of fiscal and monetary policy measures have been put in place as industrial production slumped by 25 percentage points and retail sales by 15 percentage points. China has given a fiscal stimulus of RMB 2.6 trillion or 2.5 percent of GDP. Enhanced spending on epidemic prevention and control, production of medical equipment, disbursement of unemployment insurance to migrant workers, tax relief and waived social security contributions have been announced.

The People's Bank of China has tried to ensure financial stability with a liquidity injection of RMB 3.33 trillion into the banking system. Delays in loan repayments, credit support measures for SME's, additional lending support for corporates and easing of housing policies have also been announced. Given the global nature of the outbreak, the depressing global demand for Chinese goods is unlikely to make economic recovery smooth.

With post Corona Virus pandemic growth projections at their lowest levels since 1992, a banking crisis looms. Banking has been amongst the most profitable sectors with the large gap between lending and borrowing rates. Under the surface of the large bank profits, is the possibility of the emergence of a mountain of bad loans as industrial profits peter out.

The Trade War

Amongst the most contentious issues that face the global economy is the trade war between the United States and China. The United States launched an investigation into Chinese trade policies in 2017. It imposed tariffs on billions of dollars worth of Chinese products and Beijing has retaliated in kind. In December 2018, after months of trade hostilities, both countries agreed to halt trade tariffs to allow for talks.

So far, the United States has imposed three rounds of tariffs on Chinese goods totaling more than US $ 250 billion with duties ranging from 10 percent to 25 percent and covering a wide range of industrial and consumer items from handbags to railways equipment. Beijing has hit back with tariffs on US $ 110 billion of US goods, accusing the United States of initiating the largest trade war in economic history. China has targeted products including chemicals, coal and medical equipment with levies that range from 5% to 25%.

China has sought to ease trade tensions with the United States by lowering of entry barriers for financial services and import tariffs on a wide range of consumer goods and autos, and shortening the negative list on foreign investments. The direct impact of the tariffs announced to date has been limited but could be amplified with further rounds of retaliation through financial and investment channels. Amongst the major opening up measures are plans to open financial services to foreign investment including raising foreign ownership cap to 51% and removing the cap in 3 years. Manufacturing sector has been comprehensively opened to foreign competitors and import tariffs have been cut from 17.3% to 7.7% on a selection of consumer goods such as food, health products, medicines, clothes and shoes.

Currency is the flashpoint of the US and China's trade war. The United States says that China unfairly keeps its currency low to help boost its exports. Beijing says it is trying its best to keep the Yuan stable. The Chinese currency does not work like other global currencies, which are freely traded. China is the only major economy with a currency policy consistent with a reference rate policy. The People's Bank of China sets the reference rate as a guiding point every day. The Chinese Yuan has dropped to a decadal low and is trading at around 7 Yuan/ Dollar. The last time the US Dollar traded at for 7 Yuan was during the 2008 global financial crisis. The American President had lashed out at China during his Presidential campaign for manipulating its exchange rate to boost Chinese exports and for the trade deficit with China.

There has been broad consensus amongst Chinese policy makers and implementers, the External Experts and Regulators that China should move towards a flexible exchange rate sooner rather than later. It is expected that the Yuan will weaken below 7/ US Dollar within the next 6 months. The weak Yuan raises concerns of capital outflow risks as it loses the yield advantage over dollar rates. That said, capital outflows remained moderate in 2018. Chinese three month yields are currently 11 basis points below the US yields, a sharp down turn from being 250 basis points higher early in 2018. China's stated policy has been to stabilize the market expectations and Yuan depreciation is viewed as comprehensive monetary easing.

The International Monetary Fund has said that the Renminbi remains broadly in line with the fundamentals. The IMF has also said that with US $ 3.1 trillion foreign exchange reserves China is in a position to allow a gradual transition to a floating exchange rate. Further the IMF has said that the level of reserves ranged between 100 percent and 260 percent.

Conclusion

China's financial clout is manifest in the RMB's inclusion in the SDR basket of currencies. From merely supporting the IMF's various policy measures, China's positions have become far more strident following the IMF's Quota and Governance Reform. In 2017, it has called on the IMF to continue its quota and governance reforms to ensure that the IMF is strong, quota based and well resourced. It has further said that the IMF should continue improving its surveillance capacity, enhance its research and put forward suggestions on key and common challenges faced by member countries and provide early warning signals. There remains a huge domestic economic policy agenda, which China needs to address, and the implications of its policy decisions will have a lot of impact on the global economy.

China has actively promoted Renminbi internationalization, positioning itself as an alternative to the US Dollar as the predominant currency for Asia. China has also made bilateral efforts for increasing the use of RMB through swap agreements, with RMB offshore markets and clearing banks in key financial centers. The importance of the Renminbi in the international transactions has increased with the inclusion in the SDR currency basket. There has been rapid and aggressive promotion of RMB internationalization. That said, the RMB is yet to emerge as the leading currency of Asia. As has been said by leading scholars, it can be concluded at this stage that '*no other international currencies compete at present with the dollar and the euro. The enhanced international role of the renminbi is a live future possibility*.'

2019 marks the 100th anniversary of the May Fourth Movement which was long coopted by the Chinese Communist Party. The origins of the Chinese modern State lay in the anti-imperialist outcry against Imperial China's supine response to the Treaty of Versailles handing over German held parts of China including the Port city of Qingdao to Japan, resulting in intellectual ferment and the birth of the Communist Party in 1921. It also marks 30th anniversary of the Tianenmen protests. As China seeks to play a global economic leadership role to compensate for the United States retreat, the United States speaks of "debt trap diplomacy" as Governments across Latin America, Africa and Asia struggle to repay loans extended by China. The US-China bipolar world order should be ready for a period of recurring tensions and fierce competition.

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AUTHOR INTRODUCTION

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