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US-led vs. China-led Economic Architecture: Case for a new Bretton Woods?

By Pradumna B Rana

Synopsis

With the US and China locking each other out of the economic architecture that they have helped to design, the case for a New Bretton Woods has strengthened.

Commentary

The Bretton Woods agreement, 70 years old this month, had established institutions to promote law and order in international economic relations: the IMF to promote macroeconomic stability, the GATT (and its successor, the WTO) to ensure an open trading environment, and the World Bank to provide development finance for poverty reduction.

The smooth operation of this rules-based global economic architecture led by the US contributed to the unprecedented economic growth and prosperity worldwide in the post-World War II period.

Declining legitimacy of the US-led architecture

In more recent times, however, this architecture has lost much of its legitimacy because world trade and GDP shares of emerging markets especially those in Asia have risen more rapidly than their shares in IMF quotas. For example, China accounts for 13.6% of the global economy (in terms of purchasing power parity) but its voting power is only 3.8% less than that of the Benelux countries.

It is not that the IMF Management and Washington have not made the effort. In November 2010, the IMF Management had proposed what it labelled as the “most fundamental governance overhaul in the Fund’s 65-year history”. If approved the proposal would have reduced some of the quota misalignment at the IMF, fulfilled the G20 pledge to transfer 6% of the quota to dynamic emerging markets, and given China the third largest voice in the IMF. However, despite the strong support of President Barack Obama, the proposal remains stuck in the US Congress. The cost of this delay is rising.

An important consequence of the slow progress in reforming the governance of the IMF has been the move from a centralized to a decentralized global economic architecture where regional institutions are being established to deliver international public goods in parallel with “senior” global institutions. For example, in the area of macroeconomic stability, where the IMF is regarded as the global financial

safety net, there are the European Stability Mechanism, the Arab Monetary Fund, and the Chiang Mai Initiative Multilateralization (CMIM) as the regional safety nets. This trend complicates the governance of the global economy and leads to duplication of efforts and wastage of scarce resources.

Evolving China-led Regional Architecture in Asia

The situation has been aggravated further by the evolution of the China-led architecture in Asia. The recent establishment of New Development Bank (NDB) by the BRICS (Brazil, Russia, India, China and South Africa), and the soon to be established Asian Infrastructure Investment Fund (AIIF), both financed mainly by China, are signs that the country wishes to play a greater role in the global economic arena befitting its position as the number two – and the soon to be number one - economy in the world. Establishing institutions dedicated wholly to providing infrastructure loans and guarantees is innovative as they were lacking in the global architecture. But China's recent moves also reflect its frustration at being unable to obtain a greater voice at the IMF and World Bank.

Other components of the emerging China-led regional architecture are the recently established \$100 billion Credit Reserve Arrangement (CRA) or the “mini IMF” among the BRICS to tide over members in financial difficulties and the Chinese desire to steer infrastructure development (both maritime and land-based) on the Silk Roads without western influence. Going forward, we can expect more such initiatives from China.

While the China-led regional architecture in Asia does not pose a real threat to the IMF, World Bank, and the ADB, it locks out western countries – just as western countries have locked out China - and further complicates the governance of the global architecture. The ADB has projected that Asia requires \$800 billion till 2020 for developing infrastructure compared to the total lending by the ADB of \$15 billion a year, roughly half of which goes for infrastructure finance. With an authorized capital of \$100 billion, when expanded from the present \$50 billion, the NDB could lend about \$15 billion a year. There is, therefore, ample room for everyone. Also, the CRA is not a fund that can be used to stem an impending financial crisis but a network of bilateral swaps with an absence of clearly-specified rules on when they can be utilized.

A New Bretton Woods?

What should be done? The issue could be resolved if the IMF and World Bank could work together with China-led regional institutions in a complementary and seamless manner. The “troika” model, where bailout packages are designed, financed, and monitored jointly by the European Central Bank, European Commission, and the IMF, is a good example. But it is unlikely that such an approach will be possible in Asia as it would require the IMF to work jointly with the CMIM and the ASEAN+3 Research Office. This is because Europe is special to the IMF and Asia is not. Europe, which occupies 10 out of the 24 chairs at the IMF Board, has the second largest voice in the IMF. If so, 70 years on, we need a New Bretton Woods led by a select group from truly “systemically important countries” of the world and not the motley bunch that comprises the G20.

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