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US-led vs China-led Institutions: Need for New Bretton Woods

By Pradumna B Rana

Synopsis

Complementarity between US-led and China-led institutions requires the ratification of the 2010 IMF governance reforms by the US Congress. As this is unlikely to happen any time soon, we need to start thinking of a New Bretton Woods.

Commentary

IN THE three-round match between the United States and China over influence in the Asian regional architecture, Round 2, which was played several months back, went in China's favour. Countries like Britain, Korea, and Australia broke ranks with the US and 57 countries from around the world including Germany, France, Iran, the United Arab Emirates, and Nepal applied to be the founding members of the Asian Infrastructure Investment Bank (AIIB).

Japan has so far stuck to the US but it has indicated that it remains interested in joining the AIIB which is the financing arm of China's new "One Belt, One Road" policy. Initially the US had attempted to dissuade potential applicants by citing poor governance and due diligence capacity at the proposed institutions. But it made a dramatic turnaround in mid-April when US Secretary, Jack Lew visited Beijing.

Humiliation of US

Lew mentioned that while Washington remained concerned about AIIB's governance, there was "enough infrastructure need for the new and existing institutions". He went on to add that the US would be willing to work with the AIIB through existing financial institutions such as the ADB and World Bank. A few days later the World Bank's US-appointed president vowed to find "innovative" ways to work with the AIIB and welcomed it as a "major new player" in the world of development finance. This is Round 2 of the humiliation of the US by China.

Less well-known is Round 1 of China's (and Japan's) humiliation of the US which occurred in the aftermath of the Asian financial crisis of 1997-1998 when the US and US-led IMF had shot down proposals to establish the Asian Monetary Fund (AMF). At that time, IMF surveillance had failed to adequately identify the risks posed by the uneven pace of capital account liberalisation in the region and the extent of banking sector weaknesses.

The IMF had, therefore, initially misdiagnosed the Asian financial crisis and prescribed inappropriate policies which exacerbated the impacts of the crisis and led to a free-fall of currencies, fanned the contagion, and plunged the region into a sharp recession. This had led countries in the region to initiate regional “self help” measures to take things under their control.

Although the AMF was stillborn, the region has established a US\$240 billion crisis management fund called the Chiang Mai Initiative Multilateralism (CMIM) and the ASEAN+3 Macroeconomic Research Office which is the “independent surveillance unit” for the CMIM. The idea of the AMF has not been forgotten and keeps coming up every now and then.

Round 3 of the China-US game is presently being played out in the area of international trade. We have the US-led Trans-Pacific Partnership (TPP) which locks out China and the ASEAN-led (and China-led) Regional Comprehensive Economic Partnership (RCEP) which locks out the US.

Progress in TPP Negotiations

Hopes were high of a breakthrough in the TPP when the negotiators met in Hawaii end-July, because the US President had been given the fast-track authority to smoothen the way through the legislature for the TPP. Yet after much fanfare and encouraging initial reports the ministers ended their negotiations by releasing a joint statement that merely committed to further talks. The talks reportedly stalled over a range of issues, including auto, dairy and sugar exports, and protection of next-generation drugs.

Round 3, therefore, hangs in the balance. This is because unless the negotiators can conclude a deal soon, it will be impossible to get it ratified by the US Congress this year. By that stage the US presidential election is likely to overshadow trade talks and TPP approval may have to wait until the next presidential term. If TPP disappoints or worse still it is not concluded at all, it will be another major setback for the US in Asia as it is the economic arm of President Obama’s “pivot” to Asia.

Although in a game of baseball, three strikes means “out”, this is not the case in global and regional diplomacy. It only means that the US’ clout in the region will be reduced and the sparring between China and US will continue in the future. China-led institutions in Asia will also not pose a threat to the well-established IMF or the World Bank. They will, however, complicate global economic governance and make it more complex.

Complementarity or a New Bretton Woods?

What should be done? The issue could be resolved if the IMF and the World Bank could work together with China-led institutions in a complementary and seamless manner. A case in point is the troika approach in the eurozone where bailout packages are designed, financed and monitored jointly by the EC, European Commission, and the IMF. But such an approach might not be possible in Asia. This is because while Europe is special to the IMF and World Bank, Asia is not. Europe, occupies 10 out of 24 chairs in the IMF and World Bank Board, while Asia is under-represented. The Managing Director of the IMF has always been a European.

It appears that the necessary approval of the US Congress of an agreement to reform the governance of the IMF reached at the G20 Summit in Korea (to give greater voice to China and other emerging markets and make the selection of its head merit-based) may be indefinitely delayed. Last December, Christine Lagarde, the Managing Director of the IMF, announced “As requested by our membership, we will now proceed to discuss alternative options for advancing quota and governance reforms...”

If US-led and China-led institutions cannot take joint decisions and work with each other in a complementary manner, 70 years after the original Bretton Woods agreement, we need a New Bretton Woods led by a select group from the truly “systemically important countries” of the world.

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