

China thinks the Washington Consensus is dead!

by Laurence Brahm

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Bankers and economists in Beijing are saying that the Washington Consensus is dead. U.S. Treasury Secretary Timothy Geithner awoke to this during his recent China trip. Addressing a Peking University student audience he declared, "In the United States, we are putting in place the foundations for restoring fiscal sustainability." When he said that China's assets were "very safe in Washington," students laughed.

The tectonic plates of the global financial system have shifted. The post-colonial order created at Bretton Woods irreparably cracked, together with Wall Street, in September 2008. Time has come to replace it.

An early move in that process began March 23, 2009, when China's Central Bank Gov. Zhou Xiaochuan called on the International Monetary Fund to expand the basket of special drawing rights (SDRs). The next move occurred on May 3, when China, with Japan, Korea, and ASEAN, announced a \$120 billion regional currency stabilization fund, expected to be renamed the Asian Monetary Fund.

China is pragmatic. The lesson from its economic transformation is that there are no models and people know what works best for them. No single economic model is necessarily correct for all developing countries. Moreover, those rising out of poverty could care less about adherence to models. China has proved that consultants from the IMF and World Bank are not needed, and local solutions can work more effectively than imported ideas. Developing nations now want to set a new agenda for themselves.

They began to do that June 16, when Brazil, Russia, India, and China (known as BRICs) met in Yekaterinburg, Russia, to discuss settlement currency options to the dollar. The dollar fell sharply the next day. On June 19, China's Central Bank issued its 2009 China Financial Stability Report. Suggestions included decoupling from the dollar and calling for a supra-global currency. The next day, the dollar dropped again. That makes politicians and analysts in Washington squeamish. Many are concerned about and guessing what kind of global financial order China envisions, and the role it wishes to play.

China is finding out for itself. Its leaders react to change rather than orchestrate it. Their paramount concern is domestic stability. They race to secure resources globally to fuel the high growth rates. Social factors other than consumption are dismissed as politically inconvenient. China is not driven by a visionary agenda, but by the practical need to secure resource imports and commodity exports through stabilization of the dollar. With stability precarious, China is seeking alternatives.

The *yuan* settlement agreements and recent dollar asset sell-downs are practical responses to China's predicament.

China is on the cusp of becoming very developed, with the economic clout to have a global voice. While no BRIC nation believes it will become the next superpower, each wants a say in building a new consensus. Current circumstances are an opportunity to reengineer a multi-faceted financial order stabilized through its diversity. Regionalism is on the rise.

It will be four years before the IMF can undergo the "structural adjustment" it has preached to developing countries. But China knows better than everyone else that there is always a way around bureaucratic rules. If you cannot become a shareholder, then be a creditor. So when the IMF decided on July 1 to issue \$150 billion in SDR bonds, the BRIC nations bought in, with Russia and Brazil purchasing \$10 billion each, and China taking the lion's share, an additional \$50 billion.

This is the first IMF-issued bond that is sensitive to the dollar. Beijing's purchase of IMF bonds represents a shift by openly reducing dollar assets. The BRICs' underwriting of this SDR bond issue is a clear step toward creating a global reserve currency. By buying one-third of the issue, China becomes a creditor of the IMF, and gets more say in the institution.

China has reasons for wanting leverage. The IMF is often charged with being the tool of U.S. policy; China may be about to change the global financial architecture by financing the IMF into compliance on issues that irk Beijing. The IMF has continuously called on China to adjust its currency upward. The IMF's recent Article No. 4 Consultation Report accuses China of undervaluing its currency and calls for the revaluation of the *yuan*. China refuses.

Chinese economists feel this crisis gives China room for further financial reform. Within this context, China's *yuan* will rise and become the international currency. At least that is what many in Beijing think; others are skeptical and feel the dollar can't be replaced in the short-term as the global reserve currency. They warn that promoting such an idea is detrimental to China's relations with the U.S. Nonetheless, China's economic leaders agree that the SDR should one day replace the dollar as global reserve currency, even though the debate over when this occurs continues.

China has given the developing world a new response profile. Rather than argue with the IMF policy, make the IMF your debtor. The IMF has little choice but to listen. At any rate, America and Europe cannot afford to purchase the IMF's new SDR-issued bonds. China can. Bretton Woods established the IMF as the world's bank of reserve. It looks like China is positioning to become the bank of reserve to the IMF.