

OCTOBER 2019

# Perspectives on the Global Economic Order in 2019

*A U.S.-China Essay Collection*

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A Report of the CSIS Simon  
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# Preface

**BY JOHN J. HAMRE AND CHEN DONGXIAO**

For many years, the Center for Strategic and International Studies (CSIS) and the Shanghai Institutes for International Studies (SIIS) have had a broad and productive relationship exploring critical issues in the U.S.-China relationship and in global affairs. Since 2015, we have cohosted the U.S.-China Dialogue on the Global Economic Order, a track 1.5 dialogue that has sought to build mutual trust, enhance communication, identify issues, and propose solutions. The series of semiannual workshops, alternating between China and the United States, has covered a wide range of topics, including trade, investment, finance, and technology. The dialogue has drawn scholars, former policymakers, and current officials from the United States and China across a wide range of institutions and disciplines.

This volume consists of a series of parallel essays on the global economic order by U.S. and Chinese scholars who have participated in our dialogue. The value of this text is found not only in the ideas presented by the essayists but also in the opportunity to “listen” to each other as we manage our differences and seek a shared reform agenda for the global economic order. This book starts the journey.

# 1 | Sino-U.S. Joint Action for Stabilizing the World Economy

## *Common Interests and Shared Responsibilities*

**BY CHEN DONGXIAO**

The Sino-U.S. relationship has come to a crossroads. There is something wrong with an operating system that is turning the most important bilateral relationship of the twenty-first century into a rivalry. Economic and trade bonds that have served as the ballast for the bilateral relationship have now become a major source of tension. Although President Xi and President Trump agreed to restart stalled trade talks during their recent G20 summit meeting in Osaka, fending off a near head-on collision, growing distrust and occasional open hostility have defined the overall relationship in the past few years.

In Washington, a perceptible fundamental shift in the mainstream view has it that China is the leading revisionist power challenging the U.S.-led international order. Quite a number of U.S. observers believe that “engagement” has failed miserably and that Washington needs to change course before it is too late. Some extreme—but not uncommon—views even call for decoupling with China.

In Beijing, although there is no new edition of an official, coherent strategy vis-à-vis the United States except for some general statements urging strategic patience and perseverance amid growing tensions, a prevailing view is that China has to fully prepare itself for a hostile United States standing in the way of China’s peaceful rise. Some Chinese strategists believe that the recent U.S. policy shift is the product of the superpower’s long-standing inclination to either divert attention to or overstate external threats at a time of growing internal problems such as economic stress and social unrest. These Chinese strategists argue against tit-for-tat responses. But those who do not believe the United States will abandon containment policy, and who see a reigning power containing a rising power as inevitable, are calling for more forceful countermeasures.

Indeed, the Sino-U.S. relationship has come to a point of no return. Yet we still don’t know where the growing strategic competition will take us. A hot war between China and the United States is inconceivable. But amid growing suspicion and anxiety, competition in trade, science, and technology has risen to the scale of trade and technology warfare, feeding speculation that Beijing and Washington are already locked in a new Cold War.



It is a serious misreading of our times if we look at the current bilateral relationship through the prism of hegemonic contest or ideological rivalry. We are equally misguided to start from the fatalistic thesis of a clash of civilizations. Mega-trends, such as increasing globalization and multi-polarization, mean that China and the United States are deeply embedded in a highly interdependent, interconnected, and, at the same time, increasingly vulnerable world economic system. Partial separation in trade and technology may be possible, but outright decoupling will be catastrophic not only for both nations but for the global economy at large.

It is somewhat comforting that the recently concluded G20 summit in Osaka sent some positive signals. Leaders of major economies have pledged to increase cooperation to promote global economic growth and join hands in an effort to build a “free, fair, non-discriminatory, transparent, stable, and predictable environment for trade and investment.”<sup>1</sup> They have also reaffirmed their commitment to innovation in the digital economy to achieve sustainable growth for the world economy.

China and the United States, the world’s two largest economies, need to increase policy coordination in at least three areas so that they can work with other stakeholders in a concerted effort to protect the global economic system from a variety of risks and disruptive forces.

First is mitigating the huge emerging impacts that innovations in the digital economy are having on the international financial and monetary systems. The G20 Osaka Leaders’ Declaration calls for monitoring developments related to crypto-assets and urges vigilance against existing and emerging risks. For example, as Chris Hughes, co-founder of Facebook, pointed out in a recent article in the *Financial Times*, if Libra—a new digital currency that could be used to send money around the world—is successful, it may shift power from developing world central banks toward multinational corporations and undermine the formers’ authority over national finances and economies, thus disrupting the whole global financial system.<sup>2</sup> Major economies, including the United States and China, cannot afford to adopt a wait-and-see approach. Central banks and international financial institutions like the International Monetary Fund (IMF) must take action now to strengthen regulation and monitoring to fend off systemic crises.

Second is striking a balance between science and technology cooperation and national security concerns. The history of science and technology advancement demonstrates that human capacity for information generation determines our ability to harness various forms of energy and is one of the most important driving forces behind civilization’s progress. The sum of human knowledge accumulated since the beginning of modern history has exceeded that of pre-historic times because scientists and technicians have been able to engage in worldwide exchange and communication more than at any time in human history. Chinese–U.S. science and technology research partnerships outnumber all other international pairings, and joint research programs increased by more than 80 percent between 2012 and 2015.<sup>3</sup>

A major theme of the Osaka G20 Summit was how to promote rule-making efforts to ensure the free and orderly flow of data amid growing attention toward a proper balance between informa-

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1. Gro Osaka Leaders’ Declaration,” G20 Information Centre, University of Toronto, June 29, 2019, <http://www.g20.utoronto.ca/2019/2019-g20-osaka-leaders-declaration.html>.

2. Chris Hughes, “Facebook co-founder: Libra coin would shift power into the wrong hands,” *Financial Times*, June 21, 2019, <https://www.ft.com/content/aa97ad20-91a0-11e9-8ff4-699df1c62544>.

3. Sujata Gupta, “Science superpowers find common ground,” *Nature* 539, S6–S9 (November 2016), <https://www.nature.com/articles/539S6a>; “Statistical Data of Chinese S&T Papers 2018,” Institute of Scientific and Technical Information of China (ISTIC), November 1, 2018, <http://blog.sciencenet.cn/blog-1557-1143946.html>.

tion freedom and national security concerns. As two leading forces propelling global science and technology advances, Beijing and Washington share the responsibility of helping foster international consensus on a new balance between advancing human knowledge through science and technology cooperation on the one hand and safeguarding national security on the other. It is also in their common interest to prevent the unjustified disruption of flow of information and ideas that may halt science and technology progress and reduce human welfare.

A third task for China and the United States is to manage the risks associated with weaponizing international finance and trade. At present, concerns are growing about excessive unilateralism in such forms as economic sanctions, punitive tariffs, and trade restrictions and about frequent exercises of extraterritorial jurisdiction over third-party economic activities. A growing tendency toward weaponizing fiscal and monetary tools will undermine public confidence in the stability and predictability of the international financial and trade systems. How can we reduce the risks of finance and trade weaponization and prevent the abuse of this weapon of mass disruption? Governments around the world need to take these issues seriously and constrain this growing tendency by strengthening regulation and oversight.

At this critical juncture in our bilateral relationship, only by re-identifying our common interests and challenges and redefining our shared responsibilities for a stable world economy can we overcome the zero-sum model of competition. The essays that follow lay out the reflections of both Chinese and U.S. experts on key aspects of this most consequential relationship.

## 2 | More Responsible Stakeholders

### *A Challenge to Washington and Beijing*

**BY MATTHEW P. GOODMAN**

No two countries are more responsible—in all senses of the term—for the current stress in the global economic order than the United States and China. Both Washington and Beijing have contributed to the weakening of the international institutions, rules, and norms that make up that order and have underpinned global prosperity for decades, and only Washington and Beijing have the power to reverse this trend. The responsible course for both is to stop doing harm, better manage their differences, and seek new areas for cooperation where they can.

Washington's contributions to the problem predate Donald Trump. Successive administrations failed to make an adequate case to the U.S. public concerning the benefits of U.S. leadership in the global economy. They did not do enough to ensure the effectiveness and legitimacy of the institutions that support the global order, including the International Monetary Fund (IMF), World Bank, and World Trade Organization (WTO). And, perhaps most important, Washington largely neglected U.S. workers dislocated by trade, technological progress, and other forces transforming the U.S. economy.<sup>4</sup>

Donald Trump has increased stress on the system by criticizing multilateral institutions and pursuing policies that violate the rules and norms these institutions were set up to promote. His use of broad, unilateral tariffs against allies and competitors alike has shaken an international order that the United States created and championed for more than seven decades. In pursuit of bilateral trade balance with China, he has unleashed forces that could produce at least a partial decoupling of the U.S. and Chinese economies.<sup>5</sup>

China has contributed in its own way to weakening the global economic order. While publicly stating its support for the institutions and norms of the existing system,<sup>6</sup> Beijing

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4. Edward Allen, *Failure to Adjust: How Americans Got Left Behind in the Global Economy* (Lanham, MD: Rowan & Littlefield, 2016), <https://www.cfr.org/book/failure-adjust>.

5. Finbarr Bermingham, "As Trade War Continues, Are the US and Chinese Economies Heading for a Messy Divorce?" *South China Morning Post*, June 20, 2019, <https://www.scmp.com/economy/china-economy/article/3015382/trade-war-continues-are-us-and-chinese-economies-heading>.

6. Xi Jinping, "President Xi's Speech to Davos in Full," World Economic Forum, January 17, 2017, <https://www.weforum.org/agenda/2017/01/xi-jinping-speech-davos-2017>.

has often violated the rules in both letter and spirit. Its large-scale subsidies to domestic firms fuel global overcapacity and stifle competitive markets. Beijing has tolerated, and in some cases enabled, widespread intellectual property theft. It has not done enough to ensure the transparency and sustainability of its Belt and Road Initiative (BRI) infrastructure investments.<sup>7</sup> And with a few notable exceptions, during the global financial crisis in 2008–09, it has rarely taken the lead in working with other countries to improve the existing order.<sup>8</sup>

To be sure, both Washington and Beijing have legitimate gripes about the existing order and each other's behavior in it. China has a point that, as the world's second-largest economy, it is still underrepresented in international institutions such as the IMF and World Bank. Beijing is also justified in chafing at Trump's unilateral tariffs. But the Trump administration is right to point out that China has largely abandoned the path of reform and opening and that its industrial policies are doing harm to the global economy. And widening inequality in the United States offers some validation for Trump's criticism of the multilateral order.<sup>9</sup>

But do these complaints justify undermining an order that by most objective measures has been hugely beneficial to both countries? The 500 million Chinese citizens who have risen from poverty to the middle class over the past four decades of China's integration into the global economy would surely say no.<sup>10</sup> The U.S. economy has also benefited enormously from the growing market opportunities and consumer choice that globalization has enabled. It is clearly in the interest of both China and the United States not to squander these gains by undermining the multilateral institutions and norms that have made them possible or by ratcheting up a damaging bilateral trade war. Instead, they should be working, individually and together, to try to repair the global economic order so that it produces more broadly shared benefits.

Job one is to stop doing harm. This means that both Washington and Beijing should pull back from their current tit-for-tat trade escalation and reduce the uncertainty this is creating for the global economy. The Trump administration should redirect its energies from pointing out the flaws of multilateral institutions, especially the WTO, toward constructive reform of those bodies. The Trump administration should stop violating the very rules the United States helped create, which are one of the few bulwarks against bad behavior by other countries. For its part, Beijing should pare back its harmful industrial policies, remove obstacles to market competition in China, and raise the standards of its Belt and Road investments.

Second, Washington and Beijing should draw sharper lines around the areas where competition between them is unavoidable. At the moment, trust is so low that almost everything the other side does is viewed through the lens of strategic rivalry. During the

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weforum.org/agenda/2017/01/full-text-of-xi-jinping-keynote-at-the-world-economic-forum/.

7. Jonathan E. Hillman, "China's Belt and Road Is Full of Holes," CSIS, *CSIS Brief*, September 4, 2018, <https://www.csis.org/analysis/chinas-belt-and-road-full-holes>.

8. Jaime FlorCruz, "U.S.-China Relations in Focus at 'G-2' Summit," CNN, April 2, 2009, <http://www.cnn.com/2009/WORLD/europe/04/01/g20.china.us/>.

9. "Income Gini Ratio of Families by Race of Householder, All Races," St. Louis Federal Reserve Bank, updated September 13, 2017, <https://fred.stlouisfed.org/series/GINIALLRF>.

10. China Power Team, "How Well-off Is China's Middle Class?" China Power, CSIS, April 26, 2017, <https://chinapower.csis.org/china-middle-class/>.

previous 40 years of engagement, the two sides were able to identify the most contentious issues—say, Taiwan or human rights—and focus their differences there. Today’s competition over critical technologies is arguably the area where the real differences between the two sides are greatest. Washington and Beijing should make a conscious effort to lower the temperature on other issues where the stakes are not as high.

Third, managing the differences that remain will also require effort and imagination. Both sides should identify their red lines and use targeted tools to defend their interests in a transparent manner. Having defined the range of technologies that are critical for national security, for example, Washington should use its investment-screening and export-control mechanisms in a targeted way to protect those “crown jewels” while preserving the generally open U.S. climate for investment and innovation. For its part, Beijing should act more transparently to defend its interests rather than using the informal, coercive tools it often uses today. The two sides should meet more regularly at all levels to discuss and try to resolve their differences.

When they meet bilaterally and in regional and global forums, Beijing and Washington should also look for areas where they might be able to cooperate. They could start with working together to fix flaws in existing institutions such as the WTO. There is an array of other transnational challenges—including sustainable infrastructure investment, energy security, and global health—on which the United States and China have strong incentives to cooperate.

Finally, each side should double down on domestic policies that would strengthen its own economy and create the conditions for healthier competition. For the United States, this means investing in domestic infrastructure, skills for the twenty-first century workforce, and basic research. For China, it means returning to the path of reform and opening, from which it has drifted over the past decade.

When he was deputy secretary of state in 2005, Robert Zoellick famously called for China to act as a “responsible stakeholder” in the global system.<sup>11</sup> He might just as well have applied the term to a United States that was already retreating from its traditional role as champion of the liberal international order. In today’s time of stress, it has never been clearer that both the United States and China have a profound stake in that order; what they both need to do is act more responsibly in updating and upholding it.

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11. Robert B. Zoellick, “Whither China: From Membership to Responsibility?” Remarks to National Committee on U.S.-China Relations, New York City, September 21, 2005, U.S. Department of State Archives, <https://2001-2009.state.gov/s/d/former/zoellick/rem/53682.htm>.

# 3 | The Belt and Road Initiative

## *How China and the United States Could Avoid Conflict and Promote Cooperation*

**BY ZHANG HAIBING**

The Belt and Road Initiative (BRI) launched six years ago has met with a lot of suspicion and criticism abroad, especially from the United States. Research reports by U.S. think tanks raise a range of concerns about the BRI, including its influence on geopolitical rivalries, economic competition, human rights, and, in particular, its impact on the existing U.S.-dominated international order.<sup>12</sup> In comparison, Chinese think tanks in their research tend to regard the BRI as more of a new approach to development cooperation, a solution to the bottleneck problem of infrastructure construction and financing, and a development approach with the aim of promoting systematic cooperation in multiple areas, particularly on the UN 2030 Sustainable Development Agenda.

Since the launch of the BRI, divisions between China and the United States have deepened rather than diminished. Trade frictions between the two countries have also led to the rise of “BRI threat” rhetoric in the United States, where worries about the Silk Road Economic Belt and Maritime Silk Road (as well as the new Digital Silk Road) have been increasing continuously. It seems impossible that the United States will change its negative views of the BRI in the short and even medium term. In that case, it’s important for China to consider how to implement the BRI against this background. Is there any possibility for China and the United States to cooperate in BRI-related areas?

### *Implementing the BRI Despite Disagreement of the Two Countries*

At the Second Belt and Road Summit, President Xi Jinping presented the idea of making joint efforts to build the Belt and Road. This is in line with the historical development of

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12. Jonathan Hillman, “China’s Belt and Road Initiative: Five Years Later,” CSIS, January 25, 2018, <https://www.csis.org/analysis/chinas-belt-and-road-initiative-five-years-later-0>; Daniel Kliman and Abigail Grace, “Power Play: Addressing China’s Belt and Road Strategy,” Center for a New American Security, September 20, 2018, <https://s3.amazonaws.com/files.cnas.org/documents/CNASReport-Power-Play-Addressing-Chinas-Belt-and-Road-Strategy.pdf?mtime=20180920093003>; Andrew Scobell et al., *At the Dawn of Belt and Road: China in the Developing World* (Santa Monica, CA: RAND Corporation, 2018), [https://www.rand.org/pubs/research\\_reports/RR2273.html](https://www.rand.org/pubs/research_reports/RR2273.html).



economic globalization, the need for transformation of the global governance system, and the strong desire of peoples around the world for better lives. “Looking to the future, we need to focus on prioritized projects and make great efforts in qualitative work. We will jointly paint a vivid and detailed ‘meticulous painting,’ and push forward the joint building of BRI toward the direction of high quality development.”<sup>13</sup> The so-called “meticulous painting” is a term used in comparison to the “grand synthesis,” which aims for more in-depth and detailed international cooperation under the BRI.<sup>14</sup> However, it will be a systematic challenge for China to realize the aim of this work. The following aspects show the difficulties and challenges China faces.

First, as the sponsor of the BRI, China must respond to international concerns about the initiative, including criticism from the United States. But the BRI should never be delayed or suspended due to criticism. We need to solve these problems and bridge these divisions in the process of further deepening BRI-related work. For instance, in specific infrastructure cooperation projects, China can make more efforts to increase transparency and enhance communication and dialogue on social issues such as environmental protection and labor rights while releasing public information appropriately.

Second, the time is ripe to discuss the alignment and innovation of standards and rules. Criticism from the United States mainly focuses on the issues of debt unsustainability and the making of standards and rules in relevant financing areas. According to a study from the Center for Global Development (CGD), financing for BRI-related projects has plunged the following eight countries into serious debt crises: Djibouti, Maldives, Laos, Montenegro, Tajikistan, Kyrgyzstan, and Pakistan.<sup>15</sup> Among the eight countries, the potential debt crises in Djibouti, Maldives, and Pakistan could bring negative geopolitical consequences for the United States and its allies. A report from the Center for New American Security emphasizes the fact that all of the world’s major lenders except China are members of the Paris Club, which has provided coordinated and sustainable solutions to the insolvency problems of borrowing countries.<sup>16</sup> There is concern that non-standard concessions infringing on the borrowing countries’ sovereignty may appear in China’s restructuring plans. China needs to take a balanced approach to solve BRI project investment and financing challenges, neither relying purely on its past experiences nor on international rules dominated by Western countries. On the one hand, China should learn from the past experiences of the Paris Club in dealing with sovereign debt crises and make efforts to expand cooperation with the Paris Club. On the other hand, based on its own practices and experiences, China can endeavor to innovate in the institutional settings and rules governing such issues as dealing with sovereign debt default, designing investment and financing plans, and setting up relevant guarantee mechanisms and oversight systems.

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13. “President Xi Delivers Keynote Speech at 2nd Belt and Road Forum for International Cooperation,” Xinhua News Agency, April 26, 2019, [http://www.xinhuanet.com/english/2019-04/26/c\\_138008377.htm](http://www.xinhuanet.com/english/2019-04/26/c_138008377.htm).

14. This is a metaphor used by President Xi Jinping meaning the BRI has developed from a proposal and vision into concrete activities. For more elaborations, please see “SCIO briefing on development of Belt and Road Initiative,” China.org.cn, August 28, 2018, [http://www.china.org.cn/china/2018-08/28/content\\_60716699.htm](http://www.china.org.cn/china/2018-08/28/content_60716699.htm).

15. Scott Morris, “China’s Belt and Road Initiative Heightens Debt Risks in Eight Countries, Points to Need for Better Lending Practices,” Center for Global Development, March 4, 2018, <https://www.cgdev.org/article/chinas-belt-and-road-initiative-heightens-debt-risks-eight-countries-points-need-better>.

16. Daniel Kliman and Abigail Grace, *Power Play: Addressing China’s Belt and Road Strategy* (Washington, DC: Center for a New American Security, September 20, 2018), <https://s3.amazonaws.com/files.cnas.org/documents/CNASReport-Power-Play-Addressing-Chinas-Belt-and-Road-Strategy.pdf?mtime=20180920093003>.

Third, compared with the launch of the BRI five years ago, China's current major concern is making the BRI more sustainable in the future. We need to be cautious about the negative impacts of accelerated process while taking a long-term vision of the BRI. President Xi's "meticulous painting" in his speech on how to push the BRI forward means that cooperation in BRI-related projects needs to target sustainability and quality. Such strategic thinking is critical for China to reduce its speed and think seriously about the various problems and challenges it has encountered in the past five years with the BRI. Doing so will lay a solid foundation for the work in the next five years.

### *Is Cooperation Possible between China and the United States on the BRI?*

The development of bilateral relations between China and the United States has already gone far beyond the pure bilateral scope, which has become a systematic challenge to the global system and international order. As the top two economies in the world, it is their responsibility to maintain stable bilateral relations. While preparing for the worst-case scenario, we still need to make great efforts to improve relations. Here the author wants to present five recommendations for potential cooperation between China and the United States under the BRI.

First, the next phase of the BRI should prioritize building China into a strong market for final consumer goods and services so as to alleviate the trade deficit pressure facing the United States as the final consumer market. China needs to invest more of its BRI resources into its own neighboring countries and try to build an industrial network centered on China as the final consumer market. This may reduce the overdependence of Southeast Asian countries on the U.S. market and also alleviate the trade deficit pressure on the United States such a dependent relationship brings. As one important institutional backup for the BRI, the China International Import Expo (CIIE) can play a more active role in assimilating a larger quantity of goods and services into China's consumer market.

Second, the United States needs to cautiously review its strategic perception of China and think seriously about whether it is in the U.S. national interest to define China as an adversary rather than a competitor-cooperator. But can it really reverse China's economic development prospects if the United States tries to contain China using the measures of a trade war or technological blockade? If China maintains stable economic growth despite U.S. efforts to "decouple" the two economies, such action will not just prove to be a great mistake for the United States but will also put U.S. companies at a great disadvantage in competing with companies around the world. If the Chinese economy stagnates under the pressure of "decoupling," it may further strengthen China's resolve to build an alternative international system parallel with the existing U.S.-dominated system, which may cause even greater damage to U.S. leadership internationally. For China and the United States, it is better to maintain dialogue and communication to avoid strategic misjudgment and a subsequent lose-lose outcome, even under the circumstance of lack of mutual trust.

Third, China and the United States can try to promote more trilateral cooperation under the BRI. As a collection of China's experiences in promoting domestic development and

South-South cooperation, the BRI differs significantly from the values and practices of North-South cooperation led by the United States. The two countries can try to foster trilateral cooperation covering broader issue areas, for instance, cooperation on corporate social responsibility in Asia, Africa, and Latin America; the regulation and control of financial risks related to infrastructure investment; and cooperation on global poverty reduction and disaster aid, among others.

Fourth, bilaterally, China has emphasized “equal” relations, while the United States has called for “reciprocal” relations. Both countries can consider dialogue on the alignment of rules governing BRI-related activities. The “reciprocity” stressed by the United States focuses on common rules while ignoring unequal status in capacity and ability. Although the United States does not recognize China’s claim to be a developing country, it cannot deny the great gap in capacities between the two countries and the dualistic economy of China. The “equality” stressed by China focuses on equal political status and cooperation, while maintaining that rules and norms should be set based on dialogue with due respect to the capacity gap and mutual respect. In order to mend this division, China and the United States may find certain existing institutions provide common ground for aligning specific rules and norms, including standards for high quality infrastructure, investment and financing, environment protection, and debt resolution.

Fifth, the two countries should consider the multilateralization of the BRI as a way to alleviate concerns over growing Chinese influence. Although China sponsors the BRI, it definitely does not just belong to China, and great efforts have been made to involve more actors such as the UN and World Bank. The United States has full capacity in promoting the governance and participation of the BRI through various multilateral forums such as the World Bank, IMF, and the G20. Non-participation means relinquishing its leadership role, which definitely is not in the long-term U.S. interest in the international system.

In conclusion, the bilateral relationship between China and the United States is the single most important pair of relations at present, and its systematic importance is universally recognized. As the world’s two largest economies, both China and the United States need adopt a more long-term strategic vision and have more patience while looking at each other. Their co-existence is not just important to these two countries but is also crucial to the common future of humankind.

## 4 | Infrastructure in Asia

### *Competition or Cooperation?*

**BY PETER RAYMOND**

The economies of Asia are collectively the world's largest, fastest growing, and most populous. According to the IMF's latest assessment, Asian economies represent more than 46 percent of global GDP on a purchasing power parity basis. By comparison, Europe's share stands at just 20 percent and North America's at slightly more than 18 percent. GDP growth rates for Asia are also nearly double those of the world as a whole, projected to reach 6.6 percent in 2020, compared with global growth rates of just 3.6 percent. Asia's growth rates are also more than three times greater than those for Europe and North America, which are projected at less than 2 percent each in 2020.<sup>17</sup> The world's largest concentration of people is in Asia, with India and China at well over 1 billion each. The region as a whole is projected to reach 4.6 billion people in 2020 or 60 percent of the estimated global population according to the UN's *World Population Prospects 2019*.<sup>18</sup>

Big, dynamic, and growing, Asia is already at the center of the global economy, even if it is not yet at the pinnacle.

Underpinning that growth is a remarkable story of infrastructure investment, trade, foreign direct investment, and conducive economic policies. For the United States alone, according to the State Department, two-way trade with the countries of Asia amounts to \$1.4 trillion a year, and U.S. foreign direct investment amounts to some \$860 billion.<sup>19</sup>

But Asia's ability to continue at this rate of growth and poverty alleviation will require considerably more investment, particularly in infrastructure.<sup>20</sup> The Asian Development Bank

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17. IMF, *World Economic Outlook*, April 2019 (Washington, DC: April 2019), <https://www.imf.org/en/Publications/WEO/Issues/2019/03/28/world-economic-outlook-april-2019#Full%20Report%20and%20Executive%20Summary>.

18. "World Population Prospects 2019," United Nations, <https://population.un.org/wpp/>.

19. "The Trump Administration's 'Free and Open Indo-Pacific': Issues for Congress," EveryCRSReport.com, October 3, 2018, <https://www.everycrsreport.com/reports/R45396.html>.

20. For a discussion of extreme poverty, poverty reduction results to date, and challenges ahead, see Max Roser

(ADB) estimates that through 2030, some \$1.7 trillion a year in infrastructure investment is needed in the region. The same report estimates that current investment rates will fall short by hundreds of billions of dollars.<sup>21</sup>

Infrastructure's role in enabling economic growth has been well documented.<sup>22</sup> And recently, infrastructure's potential for dual military and civilian use has gained increased public attention.<sup>23</sup> Perhaps less understood has been the relationship between infrastructure development and the efficiency and effectiveness of global supply chains.<sup>24</sup>

In today's interconnected world, competition increasingly takes place between global supply chains, which link and combine production from multiple nations into competitive products for domestic and international markets.<sup>25</sup> A nation's infrastructure assets can be definitional not simply for that nation's ability to participate in these supply chains but for shaping which supply chains the nation and its industries participate in most effectively. Some argue that we are entering a world of increasing economic rivalry between emerging Chinese and existing Western supply chains where the question of who sponsors infrastructure investment will shape which supply chains prevail.<sup>26</sup>

Thus, questions of economic development, military power projection, political influence, and global economic suzerainty form the backdrop for what is emerging as a global competition centered on the most economically dynamic region of the world—Asia. And infrastructure development is at the center of that contest.

In many ways, China's Belt and Road Initiative (BRI) set the context or parameters of the contest. Originally a means to export excess capacity from a slowing and maturing Chinese economy, the BRI has become a central pillar of Chinese foreign policy (written into the constitution at the 19th CPC National Congress in October 2017) and represents certainly the most ambitious and potentially most generous response to infrastructure needs in the region (estimates range from \$1 trillion to \$8 trillion).<sup>27,28</sup> The BRI has in many ways shaped the debate over infrastructure investment selection, financing, national sovereignty and economic development, regional security, and economic value chains.

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and Esteban Ortiz-Ospina, "Global Extreme Poverty," Our World in Data, March 27, 2017, <https://ourworldindata.org/extreme-poverty>.

21. Asian Development Bank, *Meeting Asia's Infrastructure Needs* (Manila, Philippines: February 2017), <https://www.adb.org/publications/asia-infrastructure-needs>.

22. See for example: IMF, *World Economic Output: Legacies, Clouds, Uncertainties* (Washington, DC: October 2014), <https://www.imf.org/external/pubs/ft/weo/2014/02/>.

23. For example, James Kynge et al., "How China Rules the Waves," *Financial Times*, January 12, 2017, <https://ig.ft.com/sites/china-ports/>.

24. For a discussion of infrastructure's role in supply chain efficiency see: David Jacoby and Daniel Hodge, "Infrastructure Investment: The Supply Chain Connection," *CSCMP Supply Chain Quarterly*, <https://www.supplychain-quarterly.com/topics/Logistics/scq200804infrastructure/>; See also: Xubei Luo and Xuejiao Xu, "Infrastructure, Value Chains and Economic Upgrades," World Bank, August 2018, <https://openknowledge.worldbank.org/handle/10986/30237>

25. Richard Baldwin, *The Great Convergence: Information Technology and the New Globalization* (Cambridge: Harvard University Press, 2016).

26. See Bruno Macaes, *Belt and Road: A Chinese World Order* (London: Hurst Publishers, March 1, 2019).

27. "9th CPC National Congress," Xinhua News Agency, <http://www.xinhuanet.com/english/special/19cpcnc/latestnews.htm>.

28. Jonathan E. Hillman, "How Big is China's Belt and Road?" CSIS, *Commentary*, April 3, 2018, <https://www.csis.org/analysis/how-big-chinas-belt-and-road>.

The West—the United States, Japan, Australia, and increasingly Europe—has responded to the BRI with a mixture of selective participation, vocal criticism, recommendations, and competing initiatives (though none at the potential scope and scale of the BRI). The BRI risks Western countries cite most often include issues of unsustainable host country debt burdens, poor project selection, limited transparency in procurement and financing, and social and environmental concerns. Behind these objections are deeper concerns regarding national and regional security, global economic competition, and the undermining of what is often referred to as the “rules-based” international order.<sup>29</sup>

China has been quick to respond to these criticisms with several programmatic changes while not slackening the pace of BRI investment. In May 2017, the IMF and the People’s Bank of China (PBOC) launched a program to jointly train BRI recipient country officials on financial management and procurement processes and in May 2018 convened a conference with key stakeholders to discuss core principles of BRI projects.<sup>30</sup> A year later, in April 2019, China announced a debt sustainability framework to guide investment decision making by China and recipient nations.<sup>31</sup> And in his opening remarks at the 2019 Belt and Road Forum, President Xi emphasized the importance of mutually beneficial, environmentally friendly, and financially viable BRI projects.<sup>32</sup>

During this same period, the United States announced its Indo-Pacific strategy, which includes an economic pillar with infrastructure as one of its key components.<sup>33</sup> The United States made a small initial commitment of \$113 million for the region but followed this shortly with legislation creating the U.S. Development Finance Corporation (USDFC) with a \$60 billion lending and investment capacity. In 2016, in part as a response to the BRI, Japan increased its commitment to its quality infrastructure initiative, pledging some \$200 billion for infrastructure development globally.<sup>34</sup> And in September 2018, following a report by 27 out of 28 EU ambassadors to China criticizing the BRI,<sup>35</sup> the European Union announced an Asia infrastructure plan that could mobilize as much as €300 billion for investments in the region.<sup>36</sup>

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29. “Assessment on U.S. Defense Implications of China’s Expanding Global Access,” U.S. Department of Defense, December 2018, <https://media.defense.gov/2019/Jan/14/2002079292/-1/-1/1/EXPANDING-GLOBAL-ACCESS-REPORT-FINAL.PDF>.

30. “IMF and the People’s Bank of China Establish a New Center for Modernizing Economic Policies and Institutions,” IMF, press release 17/170, May 14, 2017, <https://www.imf.org/en/News/Articles/2017/05/14/pr17167-imf-and-china-establish-a-new-center-for-modernizing-economic-policies-and-institutions>; “A Joint People’s Bank of China - International Monetary Fund High-level Conference on the Belt and Road Initiative (BRI),” IMF, April 12, 2018, <https://www.imf.org/en/News/Seminars/Conferences/2018/03/27/BJ-BRI>.

31. “Debt Sustainability Framework for Participating Countries of the Belt and Road Initiative,” Ministry of Finance, People’s Republic of China, April 25, 2019, <http://m.mof.gov.cn/czxw/201904/P020190425513990982189.pdf>.

32. “Highlights of Xi’s Keynote Speech at Second Belt and Road Forum,” CGTN, April 26, 2019, <https://news.cgtn.com/news/3d3d674e32636a4d34457a6333566d54/index.html>.

33. “Indo-Pacific Business Forum Highlights,” U.S. Chamber of Commerce, July 30, 2018, <https://www.uschamber.com/event/indo-pacific-business-forum-highlights>.

34. “Japan’s Prime Minister: Japan Will Pour \$200 Billion into Global Infrastructure,” *Nikkei Asian Review*, June 9, 2016, <https://asia.nikkei.com/Economy/Japan-s-prime-minister-Japan-will-pour-200-billion-into-global-infrastructure>.

35. Dana Heide et al., “EU Ambassadors Band Together against Silk Road,” *Handelsblatt*, April 17, 2018, <https://www.handelsblatt.com/today/politics/china-first-eu-ambassadors-band-together-against-silk-road/23581860.html?ticket=ST-584987-JRRQ36Uhl5FyLWgf72Z-ap2>.

36. Dana Heide et al., “EU Unveils Asia Infrastructure Plan, Denies Rivalry with China,” Reuters, September 19, 2018, <https://www.reuters.com/article/us-eu-asia/eu-unveils-asia-infrastructure-plan-denies-rivalry-with-china-idUSKCN1LZ1XF>.



Clearly the contest is on. But given these competing initiatives and the growing outcry in the West, is there room for cooperation between China and the West on infrastructure development in the region? Unequivocally, yes, and there are good reasons to cooperate. Even collectively, Chinese and Western initiatives do not fill the infrastructure funding gap the ADB identified. Moreover, outright competition between initiatives could be both inefficient in delivery and unmanageable for host countries forced to balance many competing project concepts and stakeholders. Further, cooperation offers the opportunity to build greater trust between China and the West, potentially reducing rising tensions regarding China's infrastructure and industrial policies.

Three immediate areas of cooperation would serve both China and the West while delivering significant benefits to the countries of the region. The first and most obvious is to expand the scope of projects undertaken jointly by Chinese and Western nations. There is already some progress here with Japan and China recently committing to jointly develop 50 projects in the region.<sup>37</sup> The United States, Australia, and members of the European Union could follow this example. A key condition for joint development, however, should be the adoption and use of global standards of transparency, procurement integrity, financing, and quality design and execution for each project.

Second, China should embrace for all BRI projects a set of standards by which projects would be transparently defined, prepared, procured, contracted, financed, delivered, and operated, as well as a mechanism for adjudicating disputes. Such standards in fact already exist and are in use throughout the world. They have been promulgated by the World Bank, UN, IMF, and other global institutions, and in fact, many are being adopted by the Asian Infrastructure Investment Bank (AIIB).<sup>38</sup> Open, transparent, and competitive scoping, contracting, and delivery of infrastructure projects would allow competitive market forces to determine the best bidder and the best value for those projects. And government officials would have a common framework from which to judge and compare project proposals and address disputes.

Finally, real work remains to be done to attract global pools of capital to infrastructure projects around the world. By some estimates, there is \$100 trillion in available financial assets between pension funds, insurers, and sovereign wealth funds.<sup>39</sup> Many of these funds seek financial returns, which are well suited to infrastructure investment. Yet the risks and complexity of infrastructure projects, particularly in emerging economies, have proven a barrier to greater investment from these sources of capital. China has already demonstrated its capacity to use financing to underwrite infrastructure investment in challenging environments. The financial markets in the West are the world's deepest and most

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37. Shiro Armstrong, "Japan Joins to Shape China's Belt and Road," EastAsiaForum, October 28, 2018, <https://www.eastasiaforum.org/2018/10/28/japan-joins-to-shape-chinas-belt-and-road/>.

38. See for example: "World Bank Signs Five Year Agreement to use FIDIC Standard Contracts," International Federation of Construction Consulting Engineers, <http://fidic.org/world-bank-signs-five-year-agreement-use-fidic-standard-contracts/>; "The New York Convention," New York Arbitration Convention, <http://www.newyorkconvention.org/>; "Standardized Agreements, Bidding Documents and Guidance Manuals," Public Private Partnership Legal Resource Center, World Bank Group, <https://ppp.worldbank.org/public-private-partnership/standardized-agreements-bidding-documents-and-guidance-manuals>.

39. Barry Benjamin, "Asset and Wealth Management Insights: Asset Management 2020: Taking Stock," PwC, June 2017, <https://www.pwc.com/gx/en/asset-management/asset-management-insights/assets/am-insights-june-2017.pdf>.

innovative. Structuring Chinese and Western risk capital into financial instruments that insure against key project risks has the potential to unlock billions of dollars in additional money for infrastructure projects globally.

These three areas of cooperation are all reasonably achievable. They would require compromises from both sides—China to agree to global standards and opening projects to competitive forces and the West to agree to joining with Chinese companies and financial institutions to design and deliver projects. Not all efforts will succeed, but that is the nature of infrastructure project development under normal circumstances.

What is also true is that these areas of cooperation will not eliminate the competition for economic value chains or necessarily diminish strategic military concerns, but they will make the contest fairer, not just for China and the West, but for the host nations and the people these projects are ultimately meant to benefit. And that truly would be a “win-win” for all.

# 5 | The Future of Global Reserve Currency

**BY MING ZHANG**

After the collapse of the Bretton Woods System, the U.S. dollar (USD) played the role of global reserve currency. Before the breakout of the U.S. subprime crisis in 2008, scholars and analysts were worrying about global imbalances. As long as the United States was facing persistent current account deficits and accumulating external debt, creditor countries (including China) worried about the potential large depreciation of the USD, which could improve the United States' external balance at the price of creditor countries' capital loss.

The U.S. Federal Reserve (Fed) began to carry out a zero interest rate and quantitative easing (QE) policy after the burst of the U.S. subprime bubble. Interestingly, the USD did not depreciate significantly in the decade following the crisis. One of the key factors supporting the USD exchange rate was persistently weak global economic growth after the crisis, commonly recognized as secular stagnation. However, ultra-loose U.S. monetary policy exacerbated global excess liquidity. During that time, most emerging market countries faced massive capital inflows, rapid local currency appreciation, and rising asset prices.

However, after the U.S. economic recovery, the Fed started normalizing monetary policy. The Fed exited the QE program at the end of 2014 and hiked its rate nine times from 2015 to 2018.<sup>40</sup> During this time, many emerging market countries faced large capital outflows, which pushed down both domestic asset prices and their currencies' exchange rates. To summarize, the emerging market world had to face the spillover effects of U.S. domestic monetary policy in both its expanding and contracting stages.

The story of the USD exposed the deep problems in a system in which a national currency plays the role of the global reserve currency. One problem was that, to satisfy global demand for international liquidity, the Fed had to keep issuing large amounts of USD. However, it would become more and more difficult for the U.S. government to stabilize

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40. "United States Fed Funds Rate," Trading Economics, <https://tradingeconomics.com/united-states/interest-rate>.

the USD exchange rate. (This was exactly the problem before the U.S. subprime crisis.) In fact, this problem is a generalized form of the Triffin dilemma. Moreover, the United States was motivated to issue more than enough USD to increase its own benefits. For example, the Fed could issue a larger amount of USD to pay the bills of real source imports, which constitutes a form of seigniorage. This was an exorbitant privilege for the USD, and other countries had to accept it.

Another problem was that U.S. domestic monetary policy exerted strong spillover effects on other countries because other countries did not want their own currencies to fluctuate violently against the USD. This can also explain why the Fed's monetary policy moves initiate global financial cycles.

The future global reserve currency must overcome the two problems of the current U.S. dollar-dominated system mentioned above. We expect that there might be a tripolar global reserve currency regime in the future, under which the USD, euro, and renminbi (RMB) could all play the role of the global reserve currency. The exchange rate between the above three central currencies should be floating, not fixed.

One of the major advantages of the multipolar reserve currency system is that a new competitive mechanism could be introduced to limit the over-issuance of certain reserve currencies, helping to stabilize the purchasing power of that currency. For example, if the Fed has over-issued the USD to satisfy U.S. domestic interests, investors would exchange their holdings of USD assets into euro- or RMB-denominated assets, resulting in the depreciation of the USD and the degradation of the USD's image as a global reserve currency. In other words, the introduction of other competitors could effectively limit the exorbitant privilege of a reserve currency-issuing country.

The multipolar reserve currency system should allow emerging market countries to better manage short-term capital flows if necessary, helping them to mitigate negative spillovers from reserve currency countries. For example, if Vietnam's economy is hot and facing inflationary pressure and European economies are facing a deep recession, to reduce the negative influence of the monetary policy easing of the European Central Bank, Vietnam's central bank could strengthen capital inflow management to resist potential hot money inflows. The freedom to introduce capital flow management could strengthen emerging market countries' monetary policy independence.

However, whether a multipolar global reserve currency system is more stable than a single reserve currency system is the subject of long and heated debate. For example, if most investors begin to buy USD and sell euros at the same time, the exchange rate of the USD against the euro would appreciate significantly, which might exert negative impacts on not only reserve currency-issuing countries but also other countries. The frequent and massive fluctuations of exchange rates between global reserve currencies might destabilize rather than stabilize the global monetary system.

The use of a brand-new global reserve currency could become a better alternative. For example, if all countries agree to use the IMF's special drawing rights (SDR) as the new global reserve currency, this could not only overcome the problems of using a national currency as the global reserve currency but also avoid the large exchange rate fluctuations

between different reserve currencies. Moreover, if a new global central bank is formed to issue the new global reserve currency, it could use the seigniorage to better provide global public goods. However, the creation and use of a new global currency would be much more difficult than introducing a multipolar currency regime because it would be very difficult to persuade countries to give up their right to issue domestic currency, especially with already successful and influential currencies.

It is very interesting that the evolution of the global reserve currency regime has always been driven by international crisis. Maybe in the future, a USD-related crisis would facilitate the transition from a USD-dominated regime to a multipolar reserve currency system. And in the distant future, a global financial crisis could push all countries to form a treaty to use a brand-new global reserve currency.

# 6 | Global Reserve Currencies

## *Currency Internationalization and the International Monetary System*

BY STEPHANIE SEGAL

The U.S. dollar has been the dominant global currency for the better part of the last century. Its position is supported by a range of factors, including the size of the U.S. economy and the reach of its trade and financial networks; the depth and liquidity of U.S. capital markets; and a history of macroeconomic stability and currency convertibility. Dollar dominance has also benefited from the lack of viable alternatives: the incomplete nature of the European monetary union; a shrinking population and uncertain debt dynamics in Japan; and the relative decline of the UK economy (to say nothing of the current political uncertainty) have undermined the euro, yen, and pound, respectively, as viable challengers to the dollar. Other attractive stores of value—the Swiss franc, Canadian dollar, and Australian dollar, for example—lack the scale to become a dominant global currency. The obvious challenger to dollar dominance is the Chinese renminbi (RMB), but its ability to rival the dollar will depend on policies in both countries.

### *The King is Dead, Long Live the King!*

Currency internationalization refers to the use of a national currency outside of the issuing country's borders. While many currencies are international—for instance, central banks hold “non-traditional reserve currencies” such as Swedish krona and Singaporean dollars in their foreign reserves—only a few currencies are widely used outside their borders as stores of value (reserves and other savings), units of account (denomination of contracts), and mediums of exchange (settlement of transactions). Among the traditional reserve currencies, which include the U.S. dollar, euro, yen, and pound sterling, the U.S. dollar is king. It consistently comprises more than 60 percent of global foreign exchange reserves and around half of all banking liabilities, and it is by far the most widely traded currency in global foreign exchange markets. The United States benefits from the dollar's position, borrowing and transacting in a “home” currency with little need to worry about exchange rate risk.<sup>41</sup> The United States also benefits from global demand for dollar-denominated

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41. This essay intentionally avoids exchange rate valuation and competitiveness issues, which should be part of a



assets, since foreign demand keeps borrowing costs (interest rates) lower and domestic consumption higher than they would be otherwise.

These benefits famously led France's finance minister to complain about the United States' "exorbitant privilege" in the last century. This critique was updated by the staff of the International Monetary Fund (IMF) in the wake of the Global Financial Crisis (GFC) who observed the "inherent weaknesses" of a system "wherein the reserve issuer runs fiscal and external deficits . . . and where there is no ready mechanism forcing surplus or reserve-issuing countries to adjust . . . lead(ing) to indebtedness, which in time could undermine the confidence that is the basis for its reserve asset status."<sup>42</sup>

Challenges to dollar dominance are not limited to fiscal and external deficits.<sup>43</sup> However, the concern that U.S. debt dynamics will threaten macroeconomic stability and lead to dollar depreciation—thereby undermining the attractiveness of the dollar as a reserve currency—merits policymakers' attention, especially considering that fiscal policy is largely within the government's ability to control. Yet, the most recent projection from the nonpartisan Congressional Budget Office estimates that the U.S. federal deficit is on track to "increase in nominal terms through 2029 and would be considerably larger as a share of the nation's output than its average over the past 50 years."<sup>44</sup> To date, the growing U.S. debt burden has not unseated the dollar, and it will not . . . until it does.

## *The (Future) Rise of the RMB*

Discussion of the RMB as an international currency dates back more than two decades. Researchers from the Chinese Academy of Social Sciences point to China's response during the 1997–1998 Asian Financial Crisis and its efforts to maintain currency stability as the "first time that China itself, as well its Asian neighbors, started realizing China's emerging influence" in the international monetary system.<sup>45</sup> RMB usage outside mainland China has slowly advanced, first with banks in Hong Kong gaining the ability to offer RMB deposit accounts and then with the issuance of RMB-denominated "dim sum" bonds outside the mainland. The GFC provided further impetus to Chinese policymakers to step up efforts at RMB internationalization and address their perception of China's vulnerability to a system "characterized by the domination of the U.S. dollar as the international reserve currency."<sup>46,47</sup>

Efforts to boost RMB internationalization gained even more steam in the run-up to the quinquennial decision by the IMF's board on the currency composition of the IMF's special

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broader discussion of the costs and benefits of reserve currency status.

42. Isabelle Mateos y Lago, Rupa Duttagupta, and Rishi Goyal, "The Debate on the International Monetary System," IMF Staff Position Note, November 11, 2009, <https://www.imf.org/external/pubs/ft/spn/2009/spn0926.pdf>.

43. Financial sanctions, efforts to promote the use of other national currencies, and decentralized financial technologies could also undermine the role of the dollar in the international monetary system. See for example: Stephanie Segal and Dylan Gerstel, "The Economic Impacts of Iran Sanctions," CSIS, *Critical Questions*, November 5, 2018, <https://www.csis.org/analysis/economic-impact-iran-sanctions>.

44. Amber Marcellino et al., "Updated Budget Projections: 2019 to 2029," Congressional Budget Office, May 2, 2019, <https://www.cbo.gov/publication/55151>.

45. Haihong Gao and Yongding Yu, "Internationalisation of the Renminbi," Bank for International Settlements, December 2011, <https://www.bis.org/publ/bppdf/bispap61i.pdf>.

46. Ibid.

47. China's substantial holdings of U.S. government and quasi-government debt, the by-product of China's exchange rate regime, leaves China vulnerable to losses on these assets. China also effectively imports U.S. monetary policy so long as it manages the nominal value of its own currency vis-à-vis the dollar.

drawing rights (SDR) basket in 2015. The board's decision focused on whether the RMB could be characterized as a "freely usable currency," a subjective assessment of "the breadth and depth of financial markets" to ensure that the SDR contains those currencies most representative of use in global trading and financial systems. Whereas the RMB was judged not to be "freely usable" in the 2010 review, the 2015 review found increasing international use of the RMB, albeit from a low base, and suggested that growing international use of the RMB was indicative of a durable trend.<sup>48</sup> On that basis, the IMF's board supported adding the RMB to the SDR basket, alongside the dollar, euro, yen, and pound sterling.

With the benefit of hindsight, the IMF's decision looks premature. Around the time the IMF's board agreed to include the RMB in the SDR basket, the Chinese authorities devalued the RMB, setting off capital outflows from China that the authorities could only stem by tightening capital controls, against the spirit if not the letter of the "freely usable" label.<sup>49</sup> While the data is incomplete—unlike other SDR currencies, China does not report RMB liabilities to the Bank for International Settlements—it appears that RMB usage outside China has grown only modestly. The RMB accounts for less than 2 percent of allocated central bank foreign exchange reserves, while a third-party Renminbi Globalisation Index has yet to recover to its September 2015 peak.<sup>50</sup>

On the other hand, recent announcements on the inclusion of Chinese stocks and bonds in global financial market indexes suggest China's halting steps to internationalize the RMB continue. In a recent blog post, IMF staff estimate that the combination of the inclusion of Chinese bonds in the Bloomberg Barclays Global Aggregate bond index plus the widely expected inclusion of Chinese bonds and equities in the FTSE and JP Morgan indexes will result in benchmark-driven portfolio inflows to China of as much as \$450 billion over the next two to three years.<sup>51</sup> However, international institutional investors have also stressed that future weight increases of Chinese assets in global indexes would require Chinese authorities to address a number of remaining market access questions, including restrictions on access to hedging and derivatives instruments.

The bottom line is that RMB internationalization will only occur at scale alongside Chinese capital account liberalization. As evidenced by incremental policy steps and decisions private participants have made, China is moving in this direction, with implications not just for China but for the entire international monetary system.

Among the questions still to be answered is how China will manage the opening of its capital account alongside the essential reform of its financial sector. And what will the addition of the RMB to the short list of global reserve currencies mean for systemic stability and to the current global leader that arguably has the most to lose?

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48. IMF, *Review of the Method of Valuation of the SDR—Initial Considerations* (Washington, DC: July 2015), [https://www.imf.org/~media/Websites/IMF/imported-full-text-pdf/external/np/pp/eng/2015/\\_071615.ashx](https://www.imf.org/~media/Websites/IMF/imported-full-text-pdf/external/np/pp/eng/2015/_071615.ashx).

49. "China Yuan Devaluation 2015," *South China Morning Post*, <https://www.scmp.com/topics/china-yuan-devaluation-2015>.

50. "Renminbi Tracker: How Global is the Renminbi?" Standard Chartered, July 20, 2019, <https://www.sc.com/en/trade-beyond-borders/renminbi-globalisation-index/>.

51. Sally Chen, Dimitris Drakopoulos, and Rohit Goel, "China Deepens Global Finance Links as It Joins Benchmark Indexes," IMF, IMFBlog, June 19, 2019, [https://blogs.imf.org/2019/06/19/china-deepens-global-finance-links-as-it-joins-benchmark-indexes/?utm\\_medium=email&utm\\_source=govdelivery](https://blogs.imf.org/2019/06/19/china-deepens-global-finance-links-as-it-joins-benchmark-indexes/?utm_medium=email&utm_source=govdelivery).

## 7 | MDBs as Critical Bridges for U.S.-China Global Interactions

BY YE YU

The strategic competition between the world's two largest economies seems to be playing out as a self-fulfilling prophecy. It has dramatically spilled over into multilateral fora since 2018. While the Trump administration is not prepared to recover its leadership in international organizations (IOs), former National Security advisor John Bolton helped lead an international campaign to prevent China from taking its place.<sup>52</sup> What is more contentious, several members of the U.S. Congress are pressing for action to curb Chinese influence in international standard-setting bodies for the next generation of mobile communications technology (5G).<sup>53</sup> Meanwhile, the World Trade Organization (WTO) is becoming irrelevant.

Multilateral development banks (MDBs) cannot escape from being affected by the escalating competition, either. But as operational IOs on the ground, they have more room to maneuver and can play a bigger role in bridging differences between the two countries.

### *U.S.-China Competition at MDBs: BRI Becomes the New Focus*

Different from the WTO, which mainly monitors trade rules, MDBs leverage these rules through money in a cost-effective way for their shareholders. After stagnating for more than a decade, MDBs have experienced a boom since the global financial crisis, with total assets growing from \$1.14 trillion to \$1.83 trillion between 2007 and 2016, an average annual growth rate of 5.5 percent.<sup>54</sup> With this expansion, tensions surrounding the MDBs have risen, too.

The United States and China have been debating two issues concerning MDBs for a long time, though with new intensity. The first concerns the eligibility of China and other

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52. Colum Lynch, "Bolton Builds Anti-China Campaign at the U.N.," *Foreign Policy*, April 3, 2019, <https://foreign-policy.com/2019/04/03/bolton-builds-anti-china-campaign-at-the-u-n/>.

53. John Eggerton, "Sens. Seek Report on China's Impact on 5G Standards," *Multichannel News*, March 4, 2019, <https://www.multichannel.com/news/sens-seek-report-on-chinas-impact-on-5g-standards>.

54. Ihsan Ugur Delikanli and Todor Dimitrov Roena Agolli, *Multilateral Development Banks: Governance and Finance* (New York: Palgrave Macmillan, 2018), 46.

upper-middle-income countries (UMICs) as borrowers from development banks. The United States is pushing hard for the World Bank and the Asian Development Bank (ADB) to graduate these UMICs, while China believes continuing engagement with these countries would be mutually beneficial, incentivizing the provision of global public goods. While the United States has not prevailed, on a bilateral front, it is requiring the newly announced U.S. International Development Finance Corporation (USDFC) to shift its lending toward lower-middle-income and low-income countries, avoiding UMICs. In contrast, both the China-led Asian Infrastructure Investment Bank (AIIB) and the BRICS bloc's New Development Bank (NDB), as well as many other MDBs, serve UMICs.

The second point of debate concerns China's increasing role as a shareholder in the MDB system. Phillip Lipsky argues that compared to the global monetary system, the global development system is more difficult to monopolize, as it has weaker network effects and therefore provides new actors with more attractive outside options.<sup>55</sup> This explains the rationale behind the establishment of the AIIB and NDB from the supply side. At the same time, the World Bank has been slow in its "voice" reform. The United States is not ready to let China surpass Japan to become the second-largest shareholder in the World Bank, let alone give up its veto power. This issue has flared up much less recently than during the global financial crisis 10 years ago, but it is unlikely to disappear for very long.

The 2018 World Bank capital increase package included a framework to address these two issues, under which China would agree to take on higher borrowing costs in exchange for another increase in its shares. However, another global development issue is emerging that has yet to be resolved and will probably have a far-reaching impact on U.S.-China interactions in the MDBs. This concerns China's Belt and Road Initiative (BRI).

Encouraged by the successful launch of the AIIB and NDB, China has been actively seeking support from all existing and new MDBs for joint efforts on BRI. The Chinese Ministry of Finance and eight MDBs signed a memorandum of understanding establishing the Multilateral Cooperation Center on Development Finance (MCDF) on March 25, 2019.<sup>56</sup> This kind of cooperation is certainly not welcomed by the United States, which is scrutinizing very carefully Chinese efforts to engage with the United Nations and other IOs on the BRI and moving to respond to them. Recently, a CSIS-led high-level task force on U.S. global infrastructure strategy recommended that the United States leverage the MDBs it leads to implement its Indo-Pacific strategy and invest in key infrastructure and technology standards so as to avoid Chinese dominance.<sup>57</sup> The United States is also prioritizing debt transparency initiatives in the World Bank and the IMF. The newly-established USDFC has also signed agreements with counterparts in Japan, Australia, the European Union, and Canada to align efforts in countering China's BRI. When the so-called strategic competition between the two countries expands from the bilateral domain to the global market, their interactions in the multilateral organizations are also evolving

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55. Phillip Y. Lipsky, *Renegotiating the World Order: Institutional Change in International Relations* (Cambridge: Cambridge University Press, 2017).

56. "Memorandum of Understanding on Collaboration on Matters to Establish the Multilateral Cooperation Center for Development Finance," Asian Infrastructure and Investment Bank, March 25, 2019, [https://www.aiib.org/en/about-aiib/who-we-are/partnership/\\_download/collaboration-on-matters.pdf](https://www.aiib.org/en/about-aiib/who-we-are/partnership/_download/collaboration-on-matters.pdf).

57. CSIS Global Infrastructure Task Force, *The Higher Road: Forging a U.S. Strategy for the Global Infrastructure Challenge* (Washington, DC: CSIS, April 2019), [https://csis-prod.s3.amazonaws.com/s3fs-public/publication/190423\\_Hadley%20et%20al\\_HigherRoads\\_report\\_WEB.pdf](https://csis-prod.s3.amazonaws.com/s3fs-public/publication/190423_Hadley%20et%20al_HigherRoads_report_WEB.pdf).

rapidly and shifting attention from China's own status to global development, with the BRI at the center.

## *MDBs Can Aggregate Chinese and U.S. Strengths*

Competition between the United States and China in the global development arena is not surprising, nor does it need to be overly generalized as a bad thing. As operational IOs, MDBs have an opportunity to act as a bridge between the two countries, maximizing their common denominators and mitigating the risks of harmful competition.

**First, MDBs deal with common and indivisible challenges facing the two countries.** As the recent G20 Eminent Persons Group on Global Financial Governance report noted, the core function of MDBs should be mitigating risks to crowd in private investment, especially for the provision of regional and global public goods.<sup>58</sup> Many risks, whatever the root causes are, are global and cannot be divided by country. This dynamic can drive cooperation most effectively during moments of crisis. In contrast, the U.S.-China bilateral trade interaction is deeply trapped by the debate over which side has gained more, making further cooperation very difficult.

**Second, MDBs enjoy more autonomy in balancing the two sides' interests.** MDBs, as formal and operational IOs, have developed a business model that relies more on the market than on shareholders. Their formal and informal power structures are also decentralized, meaning that management can better adjust MDBs' strategies based on their own institutional interests.<sup>59</sup> It is in their interest to partner with major bilateral initiatives to avoid marginalization, as in the Marshall Plan's implementation. MDBs can facilitate communication between the United States and China and channel the two countries' competition into supporting global development while standing in the middle. They have political space that can help them win the trust of both parties. For example, the World Bank just released its flagship report on the BRI, which presents a quite balanced position on its benefits and risks, despite the critical statements by Bank President David Malpass when he was a U.S. government official.<sup>60</sup> Malpass recently visited China and had a productive dialogue with Premier Li Keqiang on the next steps in China-World Bank cooperation. The cooperation between the AIIB and the World Bank and other U.S.-led regional MDBs also exemplifies the value of the banks' autonomy.

**Third, MDBs can combine the complementary advantages of the United States and China in the development arena.** Although the U.S. Indo-Pacific strategy and other bilateral initiatives overlap with the BRI geographically, the priorities and approaches of the two countries' strategies complement each other. For example, the United States is strong in the social and service sectors, while China is relatively good at infrastructure. While traditional shareholders' contributions to MDBs have stagnated, China has become

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58. G20 Eminent Persons Group on Global Financial Governance, *Making the Global Financial System Work For All* (October 2018), <https://www.globalfinancialgovernance.org/assets/pdf/G20EPG-Full%20Report.pdf>.

59. This theory was very well elaborated in Kenneth W. Abbott and Duncan Snidal, "Why States Act through Formal International Organizations," *Journal of Conflict Resolution* 42, no. 1 (1998): 3-32, <https://www.jstor.org/stable/174551>.

60. Michele Ruta et al., *Belt and Road Economics: Opportunities and Risks of Transport Corridors* (Washington, DC: World Bank Group, June 2019), <https://www.worldbank.org/en/topic/regional-integration/publication/belt-and-road-economics-opportunities-and-risks-of-transport-corridors>.

the source of the largest increase in core contributions to U.S.-led MDBs.<sup>61</sup> At the same time, the United States has the world's strongest private sector. MDBs can link these relative strengths together for a more effective development system.

**Last but not the least, MDBs have enough issue linkages for the United States and China to work together.** MDBs cover very broad development issues under the UN Sustainable Development Goals (SDGs) and provide enough space for the two countries to exchange interests and concerns. The successful 2018 World Bank capital increase package was a case in point. Many differences between the two sides are framed by rhetoric rather than truth. There are no insurmountable obstacles that prevent the two sides from working together through MDBs. No doubt both the Chinese government and the country's businesses are still on a learning curve in terms of their regulatory framework and corporate governance, but President Xi Jinping has made a strong commitment to developing a high-quality BRI. He echoed the importance of high-quality infrastructure for inclusive development at the G20 Osaka Summit concluded at the end of June 2019. China respects the high standards of existing MDBs and hopes to work with them for follow-up implementation.

## *Conclusion*

In sum, MDBs have not been immune from the escalating competition between the world's two largest economies. Both the United States and China are courting MDB support for their global initiatives. MDBs have benefited from this competition and won more resources for development. Now, they need to work together and play a bigger role in combining the two countries' strengths and initiatives and bridging their approaches in delivering development. The two countries should back the MDBs but respect their autonomy for "responsible competition"<sup>62</sup> and refrain from allowing bilateral trade and high-tech sanctions or other restrictions to infect their work.

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61. Scott Morris, "Mapping the Multilateral Concessional Finance Landscape," Center for Global Development, September 10, 2018, <https://www.cgdev.org/blog/mapping-multilateral-concessional-finance-landscape>.

62. Ryan Hass and Mira Rapp-Hooper, "Responsible Competition and the Future of U.S.-China Relations," Brookings Institution, February 6, 2019, <https://www.brookings.edu/blog/order-from-chaos/2019/02/06/responsible-competition-and-the-future-of-u-s-china-relations/>.



# 8 | The United States, China, the Global Financial Safety Net and IMF Resources

## *Scope for Cooperation?*

**BY MARK SOBEL**

The United States and China were founding members of the International Monetary Fund (IMF). The United States has long played a leading role in the Fund, given the U.S. role in creating the institution and as the largest shareholder, but China's role in and ties with the Fund have grown profoundly in recent years. This is a welcome development that should be nurtured.

One key to a stable and vibrant international monetary system (IMS) is for countries to keep their own houses in order. The United States and China are successful economies but both face large challenges. Another key issue facing the IMS relates to the role of the Global Financial Safety Net (GFSN), including the adequacy of IMF resources. As China's economy has surged, another key issue is China's weight in the Fund.

With vision, there could be substantial scope for the United States and China to cooperate on these issues. Frankly, however, there is little reason for optimism on this front at this time.

There is no true global lender of last resort in the sense of an institution capable of providing unlimited liquidity to entities facing strains. The IMF's resources are limited. Thus, to cope with crises and contagion, the world relies upon the GFSN, which is "multi-layered" and, as some have said, "patchy."

What is the GFSN?

- First, sound country fundamentals.
- Second, country-owned reserves. Adequate reserves can be a blessing, and excessive reserves a curse.

- Third, the IMF, whose role can be ex ante (surveillance) or ex post (conditional lending).
- Fourth, regional financing arrangements (RFAs). These also have an ex ante and ex post dimension.
  - Ex ante: Asia has the Asean+3 Macroeconomic Research Office (AMRO) and China is a member. AMRO is still a young organization.
  - Ex post: Asia has the Chiang Mai Initiative Multilateralization (CMIM). The CMIM totals up to \$240 billion. It is untested. The bulk of a country's ability to draw from the CMIM is tied to IMF conditionality.
- A final GFSN layer is swap arrangements.

Against that background, how do the IMF and its resource adequacy fit in? The Fund should continue to play a central role in the GFSN. When the global economy faces crises, countries may come to the Fund in droves, and demands on Fund financing can be large. The Fund must be meaningfully resourced to address such strains. But given constraints on its resources, the Fund must also play a primarily catalytic role through its program conditionality.

The Fund currently has around \$1.4 trillion in resources from quotas, the New Arrangements to Borrow (NAB), and bilateral loans.<sup>63</sup> Both the United States and China are large creditors to the IMF's general resources and the NAB, and China also provides bilateral loans. The NAB can only be tapped when quota resources are run down, and bilateral loans when the NAB is run down.

The IMF has long argued its overall resource totals must be preserved. For several years, the international community agreed that discussions on a new quota increase should conclude in 2019. The United States put an end to such discussions in late 2018.

The IMF is legitimately concerned about its resource envelope for two reasons: (a) in passing the last IMF quota increase, Congress said that the United States should withdraw from the NAB by 2022 unless Congress acted otherwise; and (b) many bilateral lenders have stated that their loans, expiring in 2020, were temporary.

Recently, there were indications that the United States had quietly proposed doubling the NAB while leaving quotas untouched. This would keep the NAB intact and help boost resources. As for bilateral loans, despite asserting that these are temporary, many countries will likely roll them over, at least in part.

Higher quotas are needed, even if only a modest increase. Quota increases take a long time to negotiate and implement and thus must serve the future. The Fund needs to be prepared to play its crisis role.

Quotas also determine voting power in the IMF. China accounts for 6 percent of the Fund's voting power and 16 percent of the global economy. It deserves far more power. But given

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63. There are three layers: first line quota resources of around \$670 billion; the NAB of around \$250 billion; and bilateral loans of around \$440 billion. The IMF's loanable quota resources, which are conservatively estimated, now total \$260 billion; actual total loanable resources from the three pots are \$1 trillion.

the current state of U.S.-China relations, the Trump administration would not want to ask Congress to support a higher Chinese voting share. Plus, any quota negotiations would unleash a donnybrook in the Board.

Thus, the U.S. stance is grossly unfair to China. While the U.S. proposal would at least allow the United States to remain part of the NAB and maintain the IMF resource envelope, it would do nothing to rebalance IMF quotas.

The Fund's relationship with RFAs raises difficult questions. On the conditionality front, when a country falters, who pays? How is conditionality designed? Who is in the lead? How well do parties cooperate?

The IMF should lead on program design. This is the clear message of the Greek epic, in which the Fund and Europe wrangled over growth, primary balance assumptions, and debt. There can be a good case for RFAs to put up more money than the IMF and treat Fund financing and reforms as the catalyst. The RFA must respect the Fund's de facto preferred creditor status. Even if the RFA does not wish to defer completely to the Fund, the Fund and RFA need to show unity. IMF views must remain independent.

So how could the United States and China cooperate to strengthen the GFSN and the IMF's central role?

- A strong IMS requires strong, sustainable, and balanced growth, particularly in its largest members, which bear a special responsibility for its smooth management. China and the United States both face many economic challenges at home. Keeping their houses in order and refraining from protectionism are essential. Instead of finger-pointing, both sides should commit to openness and a level playing field in word and deed.
- Both the United States and China should join together to ensure the IMF has sufficient resource adequacy. The United States should support an IMF quota increase, even if it is only a modest one. Going forward, there is a case for stocking up IMF quotas. The United States should also back beefing up the NAB. China should remain committed to doing its part.
- China's sheer global economic weight means it should clearly be the second-largest shareholder. Even if the United States perceives China as a rival, it should fully back a higher Chinese quota in the IMF in reflection of the realities of the global economy. If the United States is unwilling to see China's share in the Fund rise, it will only give China further reason to drift away from multilateralism.
- Along with U.S. support for a quota increase that ups China's share, China should ensure that there is full transparency around BRI lending and stand ready to do its part to ensure sustainable debt in recipient countries, including reducing debts where needed. Chinese lending in many developing countries is undermining debt sustainability. As a member in good standing at the IMF that supports the Fund's objectives, China must do a much better job on this front.
- China should remain a strong advocate for the CMIM and preserve a large link to the IMF's program design in any lending.

## 9 | China's Leadership Is Central for the Success of WTO Reform

**BY XIANKUN LU**

Within the global trade governance structure shaped after World War II, nothing is more important than the multilateral trading system represented by the World Trade Organization (WTO). With its 164 members accounting for 98 percent of global trade, a comprehensive tri-pillar function (trade negotiations, transparency and notification, and a binding dispute settlement mechanism not seen in any other international organizations) and the full spectrum of its rules covering goods, services, intellectual property, development, environment, and investment, it is hard to imagine that international trade and investment could be as smooth without it, driving the global economy and creating jobs around the world. Most of the time, people take these benefits for granted and tend to forget that, in the absence of the system and its rules, the world would be very different: all countries would suffer, and poorer developing countries would suffer much more.

Having said that, this is not the time for complacency. We recognize, sadly, that the multilateral trading system is now facing an existential crisis, something unprecedented since its establishment in 1947. Since 2008, all of the WTO's major functions have been falling apart piece by piece and, before we realize it, the WTO is already being stretchered into the ICU.

On trade negotiations, the failure of the Doha Round was already obvious in 2015, when WTO members bluntly displayed their sharp differences, with some members “reaffirm[ing] their full commitment to conclude the DDA,” while others did “not reaffirm the Doha mandates” and believed that “new approaches” were needed. The WTO has delivered little in the way of trade agreements except a few patchy achievements, such as the Trade Facilitation Agreement (TFA) and the Information Technology Agreement (ITA) expansion. In other words, the negotiation function of the WTO is not functioning, hence its rule book not being updated since 1995 and its failure to respond to the reality of twenty-first century global trade.

On dispute settlement, the Trump administration has consistently blocked the selection process of new members of the Appellate Body (AB), the “Supreme Court” of the WTO

dispute settlement mechanism, and has reduced the AB members from seven to three, the minimum to adjudicate an appeal after panel reports of a case. If the United States does not change its mind, after December 11 of this year, there will be only one AB member remaining, and this neutral arbitration mechanism will be replaced by bilateral arm-twisting and power games. What will be even worse is that it would further undermine members' interests in negotiating new rules. How useful are new rules if those who violate them are not held accountable?

On transparency and notification, the situation is no better. Take subsidies, for example: a recent background note prepared by the WTO Secretariat (G/SCM/W/546/Rev.10) notes that between 1995 and 2017, the number of members that have failed to make a notification rose sharply.<sup>64</sup> To date, 77 WTO members have not submitted subsidy notifications for 2017, 62 members still have not submitted subsidy notifications for 2015, and 55 members still have not submitted subsidy notifications for 2013. Without proper transparency, it's hard for members not only to supervise the implementation of agreements but also to negotiate new rules, such as on fishery and industrial subsidies, the meaningful results of which will depend a lot on which subsidies members use and what impact they have.

Against this background, there is a strong appeal from the international community for WTO reform. At the 11th Ministerial Conference of the WTO at the end of 2017, ministers recognized that "the system is not perfect and that it is essential to strengthen the commitment to work towards its enhancement."<sup>65</sup> The December 1, 2018 G20 leaders' declaration also underlined that "(t)he system is currently falling short of its objectives and that there is room for improvement. We therefore support the necessary reform of the WTO to improve its functioning."<sup>66</sup>

Among WTO members, China is in the spotlight for the reform of the system. There are multiple reasons for this:

As a major trading power, China's active engagement and meaningful contribution is indispensable for the success of WTO reform. Particularly when the Trump administration is increasingly resorting to unilateralism and protectionism to undermine the system, China's role has become even more important. In its two documents on WTO reform, "China's Position Paper on WTO Reform" of November 2018 and "China's Proposal on WTO Reform" of May 2019, the Chinese government emphasizes its support for the "necessary reform of the WTO, in order to enhance its authority and efficacy."<sup>67,68</sup> On the other hand,

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64. "Notifications Provisions Under the Agreement on Subsidies and Countervailing Measures," World Trade Organization Secretariat, March 29, 2019, [https://docs.wto.org/dol2fe/Pages/FE\\_Search/FE\\_S\\_S009-DP.aspx?language=E&CatalogueIdList=252748,244179,235439,228836,228133,227837,131489,124135,123975,117198&CurrentCatalogueIdIndex=0&FullTextHash=&HasEnglishRecord=True&HasFrenchRecord=True&HasSpanishRecord=True](https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?language=E&CatalogueIdList=252748,244179,235439,228836,228133,227837,131489,124135,123975,117198&CurrentCatalogueIdIndex=0&FullTextHash=&HasEnglishRecord=True&HasFrenchRecord=True&HasSpanishRecord=True).

65. "Remarks by Susana Malcorra, Argentine minister and Chair of MC11," MC11 Closing Ceremony, Eleventh WTO Ministerial Conference, World Trade Organization, December 13, 2017, [https://www.wto.org/english/news\\_e/news17\\_e/malcorra\\_13dec17\\_e.htm](https://www.wto.org/english/news_e/news17_e/malcorra_13dec17_e.htm).

66. "G20 Leaders' Declaration: Building Consensus for Fair and Sustainable Development," G20 Information Centre, University of Toronto, December 1, 2018, <http://www.g20.utoronto.ca/2018/2018-leaders-declaration.html>.

67. "China's Position Paper on WTO Reform," Ministry of Commerce, People's Republic of China, December 20, 2018, <http://english.mofcom.gov.cn/article/newsrelease/counseloroffice/westernasiaandaficareport/201812/20181202818679.shtml>.

68. "China's Proposal on WTO Reform, Communication from China," WTO, May 13, 2019, <https://docs.wto.org/>

the multilateral trading system is also of high importance for China, not only because it has benefited China enormously since China's accession to the WTO in 2001 but also because China's further development and the realization of its "Two Centenary Goals"<sup>69</sup> will need a strong external environment and a sound multilateral trading system. In fact, the ongoing U.S.-China trade tension is the best proof of the potential impact on China if multilateral rules are sidelined. That's why Mr. Wang Shouwen, vice-minister of commerce of China, repeatedly emphasized that a China-U.S. trade deal "must be in conformity with WTO rules."<sup>70</sup>

On the other hand, at least in the eyes of some, China's peculiar development and economic system have also become a challenge. As the Punta del Este Group points out, the general convergence since 1947 took place among countries that are mainly "market economies, had a high per capita income, were liberal democracies, and had some strategic security dependence" with the United States, and, in each and every of these aspects, "the [U.S.] relationship with China is very different" which "poses a central challenge."<sup>71</sup> The trilateral ministerial mechanism among the U.S., EU, and Japanese trade ministers focusing on "non market-oriented policies and practices" is obviously targeting China.<sup>72</sup> In response, China made it clear in its above-mentioned documents on WTO reform that it is "imperative to respect the diversity of development models among members." Therefore, the issue of coexistence of different economic models will be the key. Potential solutions could lie in the delicate balance between China's unique model and the guarantee that it won't distort fair competition.

Another key challenge for China (and the rest of the WTO's membership as well) is its development status and level of contribution. Here the positions are extreme, with the United States on one end trying to deprive some 34 WTO members of their developing country status and the associated "special and differential treatment" (S&D), and China and India on the other end arguing that S&D "is an integral part of the multilateral trading system" and that self-declaration of developing member status is "a fundamental rule in the WTO."<sup>73</sup> While many believe that attempts to negotiate development status, because of its political sensitivity, will not lead to any meaningful results, many more

dol2fe/Pages/FE\_Search/FE\_S\_S009-DP.aspx?CatalogueIdList=254127&CurrentCatalogueIdIndex=0.

69. The two centenary goals are completing the building of a moderately prosperous society in all respects by the CPC's centenary in 2021 and building a prosperous, strong, democratic, culturally advanced, and harmonious country by the centenary of the People's Republic of China in 2049.

70. For example, he made such a position at a press conference June 24, 2019 by Foreign Affairs Ministry of China on G20 summit. See: <https://news.china.com/domestic/945/20190624/36463484.html>.

71. "In defense of multilateralism and the reform of the World Trade Organization," Group of Punta del Este, February 2019, <http://grupopuntadeleste.com/en/wp-content/uploads/2019/06/Manifiesto-PEG-rev-1203-FINAL-FINAL.pdf>.

72. According to the Joint Statement of the Trilateral Meeting of the Trade Ministers of the European Union, Japan, and the United States on January 2019, “The Ministers advanced discussions on their shared objective to address non market-oriented policies and practices of third countries that lead to severe overcapacity” and “[The Ministers] confirmed that market-oriented conditions are fundamental to a fair, mutually advantageous global trading system and that their citizens and businesses operate under market-oriented conditions.” See: [https://eeas.europa.eu/delegations/united-states-america/56329/joint-statement-trilateral-meeting-trade-ministers-european-union-japan-and-united-states\\_en](https://eeas.europa.eu/delegations/united-states-america/56329/joint-statement-trilateral-meeting-trade-ministers-european-union-japan-and-united-states_en).

73. General Council, "The Continued Relevance of Special and Differential Treatment in Favour of Developing Members to promote Development and Ensure Inclusiveness," World Trade Organization, February 26, 2019, [https://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&ved=2ahUKEwjg8\\_6In\\_rkAhVP7J4KH-dc7DSYQFjABegQIBRAC&url=https%3A%2F%2Fdocs.wto.org%2Fdoc2Fol2fe%2Fpages%2F2FDFDocu-ments%2F251619%2Fq%2FWFT%2FGCG%2FW765.pdf&usq=AovVaw2H3eb0LkNwCxaSWbBMd7M](https://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&ved=2ahUKEwjg8_6In_rkAhVP7J4KH-dc7DSYQFjABegQIBRAC&url=https%3A%2F%2Fdocs.wto.org%2Fdoc2Fol2fe%2Fpages%2F2FDFDocu-ments%2F251619%2Fq%2FWFT%2FGCG%2FW765.pdf&usq=AovVaw2H3eb0LkNwCxaSWbBMd7M).

believe that it is essential to avoid the previous “minimalist bargain”<sup>74</sup> to seek exemption of obligations and to manage S&D to bring members “closer together in terms of their shared responsibility.”<sup>75</sup> China, while calling for “continued preservation of the rights of developing members to S&D,” proposes to “encourage developing members to actively assume obligations commensurate with their level of development and economic capability.”<sup>76</sup> It remains to be seen how this will translate into real action in future WTO reform for China and other developing countries.

WTO reform is a very comprehensive process with many issues under discussion. China’s role will be unique because of its power in helping shape the future of the multilateral trading system, as well as some key challenges associated with its development model and status. China’s leadership will be very much defined by how it interacts with other major players, as well as how it applies its power and finds sensible solutions to challenges. One thing is clear: WTO reform will not and should not be only a “China reform.” However, without China reform, there will not be a meaningful WTO reform.

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74. Patrick Low, Hamid Mamdouh, and Evan Rogerson, *Balancing Rights and Obligations in the WTO-A Shared Responsibility* (Stockholm, Sweden: Government Offices of Sweden, 2018), <https://www.swedenabroad.se/globalassets/ambassador/fn-geneve/documents/balancing-rights-and-obligations-in-the-wto.pdf>.

75. Ibid.

76. “China’s Position Paper on WTO Reform (Outline for Reference),” Economic and Commercial Counsellor’s Office of the Embassy of the People’s Republic of China in the Islamic Republic of Iran, November 2018, [ir2.mofcom.gov.cn/article/chinanews/201812/20181202812408.shtml](http://ir2.mofcom.gov.cn/article/chinanews/201812/20181202812408.shtml).



# 10 | The United States and China Should Be Allies on WTO Reform

**BY WILLIAM REINSCH**

Given the current state of U.S.-China relations, it may sound implausible, but both sides should consider that one area where they might constructively work together is in the revitalization of the World Trade Organization (WTO).

In different ways, both countries are major beneficiaries of the WTO and the rules-based system it underlies. The United States was instrumental in creating the organization's antecedents at Bretton Woods in 1944, when Western nations, recognizing that they were going to win the war, set out to create institutions that would prevent a global cataclysm from happening again. They settled on a tripod: the International Monetary Fund (IMF), to deal with currency and exchange rates; the World Bank, to initially promote reconstruction of the war-ruined economies and subsequently to promote global economic development; and what was to be the International Trade Organization (ITO), to lead trade negotiations and promote trade liberalization. The latter was stillborn, ironically because the U.S. Senate did not ratify the treaty establishing it, but the General Agreement on Tariffs and Trade (GATT) became an acceptable, albeit less ambitious, substitute, and when the WTO was created in the Uruguay Round of trade negotiations in 1994, the original Bretton Woods vision was fulfilled.

While the intentions of the world's leaders in 1944, including President Roosevelt, were global and high-minded, it has also turned out that the United States has been a major beneficiary of the institutions that were created because they made a world that worked to U.S. advantage. They enabled the reconstruction of Europe and Japan, creating a network of strong economies and firm allies of the United States opposing the Soviet Union and its satellite states. The trade negotiations concluded under the GATT contributed to that economic strength and provided a convenient path for the United States to become a much larger player in the international trading system than it had been prior to the war. The market opening that occurred because of lower tariffs and new rules played to the strengths of an innovative and competitive producer of both goods and services like the United States. As the world's largest economy throughout this period, the United States had considerable influence over the design of the system and made sure it grew in ways

that helped U.S. exporters and service providers. Today, while the U.S. role as the world's largest economy is being challenged by China, the United States continues to have a leadership role in the WTO and has been one of the most frequent participants in its dispute settlement process as both complainant and respondent.

China, in contrast, arrived at the WTO late in 2001 after extensive negotiations between it and many of the then-current members. This was a significant move for China, which had largely isolated itself from the global economy from its advent as a communist state in 1949 until 1978, when Deng Xiaoping announced a change of policy. Even after that, China has been skeptical of the organization as fundamentally a Western institution created to serve Western, rather than Chinese, interests. Despite these suspicions, however, China has become an active member of the organization and has learned how to use its rules and procedures to its advantage (thanks in significant part to advice from U.S. lawyers), just as many other nations do. And it has clearly benefited from the increased market access that WTO membership provides. China's total trade in 2000, the last year before acceding to the WTO, was \$474 billion; in 2018, it was \$4.1 trillion.<sup>77</sup> And, like the United States, it has become immersed in the dispute settlement process, also as a major complainant and respondent.

In short, both countries have benefited from both the market access and trading system stability brought about by the WTO, and both countries have an interest in seeing that continue.

That has not meant, however, that either of them has been a well-behaved member of the WTO. The United States is currently pursuing a course of action that will likely end up destroying the Appellate Body in the dispute settlement system. It has objected to other WTO rules and practices, it has taken a number of recent actions on tariffs that will likely be found to violate the rules, and there is doubt that the United States at that point will abide by such a decision. China, in turn, has been one of the world's most chronic violators of WTO rules, has not fulfilled all of the obligations it took on when it acceded to the WTO, has failed or been late in making required notifications, and has taken advantage of the special and differential treatment rules by self-declaring itself a developing economy. In other words, it increasingly appears that the WTO is surviving in spite of the United States and China rather than because of the United States and China.

The current state of play and the upcoming Ministerial Conference in Kazakhstan a year from now offers an opportunity for a reset. While many of the U.S. proposals target Chinese actions or policies, most of them identify areas where China is clearly not honoring its accession obligations or where Chinese economists agree the United States has a sound argument. China has been claiming for itself the role of defender of free trade and the trading system, in implicit contrast to the United States, which China regards correctly as veering away from those principles. The run-up to the ministerial would be a good time for China to lend credence to its lofty statements of principle, first by coming into compliance with its own obligations and second by supporting proposals that would make the system function as was originally intended, which in turn would help the organization get back to what it is supposed to do—promote trade liberalization through multilateral negotiations.

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77. "UN Comtrade Database," UN Comtrade, accessed June 28, 2019, <https://comtrade.un.org/>.

The United States for its part should demonstrate that its periodic statements of support for the organization are not just wind but reflect an actual commitment to multilateral rules. The best ways to do that are to accept WTO dispute settlement rulings even if it loses, to enter into serious negotiations on desired rule changes rather than simply restating its position, to launch an effort to restart the flagging negotiations on services and environmental goods, and to work hard to conclude the agreement on fishery subsidies.

Finding common ground on all of these matters is probably a bridge too far, but some of them, particularly regarding future negotiations, certainly ought to be areas where the two countries have common interests. If they can also recognize their mutual interest in the good health of the WTO, then perhaps they can find a way to put aside the other issues that divide them and work together toward that goal.

# 11 | What the Huawei Case Can Teach Us about the U.S.-China Power Game

BY LU CHUANYING AND NICOLAS HUPPENBAUER

*“The broad Pacific Ocean is vast enough to embrace both China and the United States.”*

- President Xi Jinping after meeting with U.S. secretary of state John Kerry on May 17, 2015<sup>78</sup>

*“We’re more likely to achieve our objectives of prosperity and security of our people if we are working together cooperatively, rather than engaged in conflict.”*

- President Barack Obama after meeting with Xi Jinping on June 8, 2013<sup>79</sup>

The latest episode in the unfolding drama between the United States and China was dubbed the “end of global tech” and the beginning of the “next global recession,” with significant collateral damage expected on both sides.<sup>80</sup> What started with mutually increasing tariffs over the last year was followed by a U.S. ban of Chinese 5G providers and finally culminated in temporarily cutting Huawei off from its U.S. suppliers last May by putting it onto the so-called Entity List. This escalation is expected to significantly affect global supply chains and the complex global innovation ecosystem that has evolved over the past decades. Despite some cooling down after talks at the G20 summit in June, there is currently no permanent solution in sight. Since the Huawei dispute reflects the larger power game between the United States and China, the underlying strategic and contingent issues at its core may be difficult to resolve. Mitigating the collateral damage to our societies east and west of the Pacific, however, should be a common goal for any policymaker.

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78. David Brunnstrom, “Despite Tension, Xi Says U.S.-China Relations Are Stable,” Reuters, May 17, 2015, <https://www.reuters.com/article/us-usa-kerry-china/despite-tension-xi-says-u-s-china-relations-are-stable-idUSKBN0O203J20150517>.

79. “Remarks by President Obama and President Xi Jinping of the People’s Republic of China After Bilateral Meeting,” The White House, June 8, 2013, <https://obamawhitehouse.archives.gov/the-press-office/2013/06/08/remarks-president-obama-and-president-xi-jinping-peoples-republic-china->.

80. Charles Rollet, “Huawei Ban Means the End of Global Tech,” Foreign Policy, May 17, 2019, <https://foreignpolicy.com/2019/05/17/huawei-ban-means-the-end-of-global-tech/>; Chad Bray, “Will the Escalating US-China Trade War and Its Catastrophic Aftermath Push the Global Economy into Its Next Recession?” *South China Morning Post*, May 20, 2019, <https://www.scmp.com/business/companies/article/3010878/will-escalating-us-china-trade-war-and-its-catastrophic>.

What might sound like a potential competitive advantage for the United States at first turns out to bring disastrous consequences to the international order, which might eventually hurt the United States even more than China. The United States itself erected the rules-based international order with great effort after World War II, in particular the framework of global intellectual property protection, global supply chains, and the international innovation ecosystems. By means of the U.S. dollar's role as the key currency in the international financial system, the United States serves as the core of the international order and has benefited disproportionately from it. In the high-tech sector, the United States used to emphasize and respect market competition and protect intellectual property rights based on the notion that these are driving factors of economic growth. President Trump's actions to ban Huawei—even to the surprise of the domestic industry—put a hit to the rules-based order and, hence, were damned as short-sighted and potentially causing lasting damage to the national strategic framework of the United States.<sup>81</sup> Although the Trump administration's actions securitizing and politicizing the Huawei case might help to draw the battle lines with China and Huawei more clearly, they first harm the principles of global supply chains and internationally connected innovation ecosystems. The economic consequences of this harm will be borne together by all nations, but because of the United States' former role as the creator and protector of the rules, it is likely that the U.S. national interest will be hurt the most.

Maybe an even more adverse effect of the Huawei sanctions and President Trump's comments is that they undermine the U.S. reputation and attractiveness—or what could be summarized under the title “soft power.” Most obviously, the Huawei dispute significantly affected bilateral U.S.-China relations. Since President Trump took office, bilateral relations have continued to mostly deteriorate due to his aggressive rhetoric toward China. With the latest sanctions, relations have reached their lowest point since normalization in 1979, which they are unlikely to recover from, even if China and the United States manage to finally strike a trade deal and potentially reverse the measures against Huawei.<sup>82</sup> In the eyes of the Chinese public, the recent news emphasized China's need for economic development that is more independent from the West, and the Chinese government's decision to accelerate the development of certain core technologies is welcomed even more. But besides the worsening of the U.S.-China relations, the Huawei ban has also decreased U.S. attractiveness to European and even originally U.S. companies. Forced to “pick a lane,” enterprises might eventually regard the large Chinese market as more dynamic and more attractive than the U.S. market.<sup>83</sup> The real competition and growth follow where the money goes, and in this case, it seems to be China. That China is already developing more and more research capabilities in a number of high-tech fields, slowly catching up to the United States or even surpassing it, only adds to the attractiveness of the Chinese innovation ecosystem.<sup>84</sup> Another aspect is that China boasts

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81. Michael Jacobides, “Donald Trump's Huawei Ban Could Backfire Badly,” *Financial Times*, June 9, 2019, <https://www.ft.com/content/8fc63610-88fe-11e9-b861-54ee436f9768>.

82. Neal Kimberley, “After the Trade War, US-China Relations Will Not Be the Same Again,” *South China Morning Post*, October 2, 2018, <https://www.scmp.com/comment/insight-opinion/united-states/article/2166570/after-trade-war-us-china-relations-will-not-be>.

83. Matthew P. Goodman, “Picking A Lane,” CSIS, *Global Economics Monthly* 7, no. 10 (October 2018), <https://www.csis.org/analysis/picking-lane>.

84. China Power Team, “Is China A Global Leader in Research and Development?” CSIS, *China Power*, January 31, 2018, <https://chinapower.csis.org/china-research-and-development-rnd/>.

the world's largest single market, which not only sufficiently supports the development of the Chinese domestic industry but at the same time also draws global enterprises to China. In the end, the outcome of the U.S.-China dispute depends to a large extent on which country will be more competitive and sustainable on the world stage.

Given the adverse collateral damage of the recent escalations, which might damage the United States even more than China, there are a number of steps that policymakers on both sides should take to de-escalate. The first step should be to listen to those who recognize and appreciate the peaceful competition and cooperation between the two economies that has been thriving over the past forty years. The Chinese and U.S. economies have gradually formed a deeply intertwined and interdependent structure, which, in the transition from the industrial to the information to the artificial intelligence age, could actually continue. Those within the Trump administration who hope to oust China from the global high-tech sector and want to cut ties between the two economies put the globalization of markets and technologies that has developed over the past decades to a serious test. If these systems are stable enough to withstand President Trump's policies, a potentially painful backlash to the U.S. economy might force him to initiate a change of strategy. If, however, the globalized markets and technological systems are torn up in the midst of a U.S.-China trade war, a direct confrontation between the two competing supply chain systems may be inevitable and incite even more insecurity in the current international sphere. As a matter of fact, both the United States and China benefit from the existing world order. But in both countries, a number of people disregard the benefits of these increasingly globalized supply chains and innovation systems while exaggerating the risk of potential conflicts between the two powers.

Secondly, hawkish voices should not substitute rational risk assessments, such as those that European countries are completing to evaluate the risk of allowing Huawei to provide 5G network equipment. We need to realize that the current escalations might have their roots in the growing complexities of emerging technology. As illustrated with 5G technologies, their immersion in our societies today, combined with the inherent insecurity associated with them because they cannot be designed to prevent all potential loopholes, creates anxiety that can lead to mistrust and perceptions of potential threats in the international sphere. In order to deal with this growing complexity and insecurity, it is important that policymakers increase their knowledge of emerging technologies and comprehensively compare the technologies' potential political risks with the economic benefits they might bring.

Thirdly, trust-building mechanisms and platforms for international dialogue in the cyber sphere can help nations mutually understand each other's strategies and policies and work together to create a safer international governance system for new technologies. Although the need for international governance obviously grows more urgent with the proliferation of cyberweapons, there have been surprisingly few tangible results to hedge against the worst attacks. There is a lot of unfulfilled potential for U.S.-China cooperation in international cyber governance, which can be tapped by initiating more cooperative formats and by setting the table for serious negotiations to find more common ground and resolve differences.

The Huawei dispute is one case in point against the backdrop of the larger power game between the United States and China, and it reflects an unfortunate trend toward securitization and economic competition in the bilateral relationship. To avoid further escalation and its potentially disastrous effects on both societies, policymakers need to take a number of steps. In short, we need to realize the complexities that new technologies bring to our global landscape and address them not through escalation but through rational assessments and cool-headed negotiations. Most important of all, policymakers on both sides need to consider the larger threats and misunderstandings that are latent within the Huawei dispute. On the surface, it might appear to be only a technological or economic conflict, but at play are also the peace, development, and stability of the current world order. Realizing how interdependent the two economies are in the high-tech sector, they might be able to recover and then reclaim the gains of the current international system, as proven over again in the past decades. Both sides should now make wise decisions and solve the current crisis.



## 12 | China and the United States

### *Digital Protectionism vs. Digital Free Trade*

**BY NIGEL CORY**

The United States and China have fundamentally different approaches to governance of the digital economy. Over the past two decades, China has worked to isolate itself from the international digital economy through the “Great Firewall of China,” which blocks access to certain digital services such as Google and Facebook and through requirements for the local storage and control of data.<sup>85</sup> In contrast, the United States wants rules that protect the free flow of data and digital goods and services within a broader framework that allows different data governance systems to work together. The divide between the U.S. and Chinese approaches to digital trade policy will make it very difficult for the two countries to work together in World Trade Organization (WTO) e-commerce negotiations.

Digital trade—the cross-border transfer of products, services, and data over the internet—is changing global commerce. Using the internet, businesses and consumers can access digital goods and services—music, software, cloud storage, data analytics services, and the like—which often complement transactions in material markets.<sup>86</sup> Data flows and digital products and services will flow (nearly) seamlessly across borders—unless governments enact artificial barriers like local data storage requirements (known as data localization). Data localization is a barrier to digital trade, as it discriminates between domestic and foreign products, services, and suppliers by forcing firms involved in cross-

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85. Nigel Cory, “Cross-Border Data Flows: Where Are the Barriers, and What Do They Cost?” Information Technology and Innovation Foundation, May 2017, <https://itif.org/publications/2017/05/01/cross-border-data-flows-where-are-barriers-and-what-do-they-cost>; Fredrik Erixon, Brian Hindley, and Hosuk Lee-Makiyama, “Protectionism Online: Internet Censorship and International Trade Law,” European Center for International Political Economy, December 2009, <https://ecipe.org/wp-content/uploads/2014/12/protectionism-online-internet-censorship-and-international-trade-law.pdf>.

86. For example, see: Stephen Ezell and Bret Swanson, “How Cloud Computing Enables Modern Manufacturing,” Information Technology and Innovation Foundation and the American Enterprise Institute, June 2017, <http://www2.itif.org/2017-cloud-computing-enables-manufacturing.pdf>; Daniel Castro and Alan McQuinn, “Cross-Border Data Flows Enable Growth in All Industries” Information Technology and Innovation Foundation, February 2015, <http://www2.itif.org/2015-cross-border-data-flows.pdf>; WTO, *The Future of World Trade: How Digital Technologies Are Transforming Global Commerce* (Geneva: World Trade Organization, 2018), [https://www.wto.org/english/res\\_e/publications\\_e/world\\_trade\\_report18\\_e.pdf](https://www.wto.org/english/res_e/publications_e/world_trade_report18_e.pdf).

border transfers to set up costly local services or pay for third-party providers—or simply prevents them from entering the market.<sup>87</sup>

U.S. trade policy prioritizes the free flow of data and the opportunity digital trade presents. In its 2012 trade agreement with South Korea, the United States enacted commitments on free data flows, which later became stronger, broader, and enforceable through the Trans-Pacific Partnership (TPP) trade agreement, as part of the “Digital Two Dozen” digital trade strategy.<sup>88</sup> Given the withdrawal of the United States from the TPP, the digital trade chapter of the United States–Mexico–Canada Agreement provides an update on U.S. digital trade policy, which has become stronger and more ambitious.<sup>89</sup> U.S. digital trade policy addresses concerns via an “interoperable” data governance framework which seeks to hold firms accountable for managing the data they collect regardless of where they store or process it, as there is no “one-size-fits-all” approach to data privacy.<sup>90</sup> The distributed nature of the internet means that each country’s domestic data governance policies need to be global in scope and interoperable in practice, given that data can flow everywhere.

In contrast to the United States, China treats local data storage as the norm and data flows as the exception, asserting that data privacy and cybersecurity are associated with location and control.<sup>91</sup> Data localization remains a central theme of China’s data governance framework. For example, China’s cybersecurity law requires personal data and “important data”—a vague term encompassing data related to China’s national security, economy, and other public interests—held by key ICT operators to be stored within China. This is in addition to existing data localization measures for health, mapping, and financial data and other data-restrictive policies.<sup>92</sup>

Against this backdrop, China has made few substantive commitments on digital

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87. National treatment is a basic legal principle at the World Trade Organization, whereby members have agreed that: “Members shall accord to services and service suppliers of any other Member . . . treatment no less favourable than that it accords to its own like services and service suppliers.” From “Principles of the Trading System,” World Trade Organization, accessed August 5, 2019, [https://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/fact2\\_e.htm](https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm).

88. “Digital 2 Dozen,” United States Trade Representative, accessed March 21, 2019, <https://ustr.gov/sites/default/files/Digital-2-Dozen-Final.pdf>.

89. For example, see: Nigel Cory and Stephen Ezell, “Investigation No. TPA 105 003, United States-Mexico-Canada Agreement: Likely Impact on the U.S. Economy and on Specific Industry Sectors (Post-Hearing Submission),” Information Technology and Innovation Foundation, December 17, 2018, [http://www2.itif.org/2018-USM-CA\\_filing.pdf](http://www2.itif.org/2018-USM-CA_filing.pdf).

90. For a discussion of these issues, see: Nigel Cory, Robert Atkinson, and Daniel Castro, “Principles and Policies for ‘Data Free Flow With Trust,’” Information Technology and Innovation Foundation, May 27, 2019, <https://itif.org/publications/2019/05/27/principles-and-policies-data-free-flow-trust>.

91. Office of the United States Trade Representative, *2018 National Trade Estimate Report on Foreign Trade Barriers* (Washington, DC: 2018), <https://ustr.gov/sites/default/files/files/Press/Reports/2018%20National%20Trade%20Estimate%20Report.pdf>.

92. Nigel Cory, “Cross-Border Data Flows”; Nigel Cory, “The Ten Worst Digital Protectionism and Innovation Mercantilist Policies of 2018,” Information Technology and Innovation Foundation, January 28, 2019, <https://itif.org/publications/2019/01/28/ten-worst-digital-protectionism-and-innovation-mercantilist-policies-2018>; Nigel Cory, “The Worst Innovation Mercantilist Policies of 2017,” Information Technology and Innovation Foundation, January 22, 2019, <https://itif.org/publications/2018/01/22/worst-innovation-mercantilist-policies-2017>; Robert Atkinson and Nigel Cory, “Comments: Circular of the State Internet Information Office on the Public Consultation on the Measures for the Assessment of Personal Information and Important Data Exit Security,” Information and Technology and Innovation Foundation, May 11, 2017, <http://www2.itif.org/2017-china-handling-data.pdf>; Martina F. Ferracane and Erik van der Marel, “Patterns of Trade Restrictiveness in Online Platforms: A First Look,” European Center for International Political Economy, January 2019, <https://ecipe.org/publications/patterns-of-trade-restrictiveness/>.

governance in its trade agreements, especially on data flows.<sup>93</sup> Nor has it signed on to other interoperable data transfer mechanisms, such as the Asia-Pacific Economic Cooperation (APEC) Cross-Border Privacy Regime.<sup>94</sup> China has taken a narrow, traditional view of e-commerce as physical goods bought via digital platforms that need to be shipped overseas and passed through customs clearance into foreign markets. Ever since the WTO e-commerce agenda began in 1998, China's engagement in relevant trade disputes, submissions, and statements has reflected this narrow view of e-commerce.<sup>95</sup>

At the heart of the matter is that China sees data governance as central to state/party and "cyber" sovereignty and therefore non-negotiable in the context of trade.<sup>96</sup> However, the impact of these policies is trade-restricting and anti-competitive, as local tech firms—shielded from foreign competition—use China's large domestic digital economy to grow before expanding into global markets (where China's government expects them to be able to enter and compete). President Xi Jinping has made this non-reciprocal goal clear in speeches about his goal of China becoming a "cyber superpower" free from foreign technology.<sup>97</sup>

This puts China on a very different course from the many other countries engaging at the WTO who want rules that maximize the flow of data as part of an open, competition-enabling, and rules-based global digital economy. The 11 Asia-Pacific members of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) have enacted rules that protect data flows and promote interoperability. Brazil agreed to CPTPP-like rules in its trade agreement with Chile. While the European Union's approach differs from that of the United States, it too recognizes the value of protecting data flows for digital trade and opposing data localization.<sup>98</sup>

These countries have started putting in place the building blocks for a broader global digital trading framework that accounts for privacy and other interests. Accounting for such shared interests, but differential approaches, is not unique to digital trade, given phytosanitary issues for agricultural goods or safety standards for cars. Crafting the

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93. "Electronic Commerce," WTO, accessed March 21, 2019, [https://www.wto.org/english/tratop\\_e/ecom\\_e/ecom\\_e.htm](https://www.wto.org/english/tratop_e/ecom_e/ecom_e.htm).

94. Nigel Cory, "Why China Should Be Disqualified from Participating in WTO Negotiations on Digital Trade Rules," Information and Technology and Innovation Foundation, May 9, 2019, <https://itif.org/publications/2019/05/09/why-china-should-be-disqualified-participating-wto-negotiations-digital>.

95. For example, in two WTO dispute cases, China has tried to deny that the digital delivery of goods and services and data flows are central to modern trade: in 2009, in the WTO dispute case "China—Publications and Audiovisual Products," and in 2012, in the WTO dispute case "China—Electronic Payments." Also see: "Statement at the 7th Meeting of the Joint Statement on Electronic Commerce Initiative," China's Permanent Mission to the World Trade Organization, Ministry of Commerce website, accessed March 8, 2019, <http://wto2.mofcom.gov.cn/article/chinaviewpoints/201811/20181102804449.shtml>.

96. Jun Mai, "Xi Jinping Renews 'Cyber Sovereignty' Call at China's Top Meeting of Internet Minds," South China Morning Post, December 3, 2017, <https://www.scmp.com/news/china/policies-politics/article/2122683/xi-jin-ping-renews-cyber-sovereignty-call-chinas-top>; Nigel Cory, "Why China Should Be Disqualified from Participating in WTO Negotiations on Digital Trade Rules."

97. Sam Sacks, "Beijing Wants to Rewrite the Rules of the Internet," *The Atlantic*, June 18, 2018, <https://www.theatlantic.com/international/archive/2018/06/zte-huawei-china-trump-trade-cyber/563033/>.

98. The European Union does at times struggle to articulate and advocate a common and consistent approach to the interrelated issues of privacy, digital trade, and data localization. The EU submission opposing data localization in India is a good example of it weighing in on the issue: "Submission on Draft Personal Data Protection Bill of India 2018 by the Directorate-General for Justice & Consumers to the Ministry of Electronics and Information Technology (MeitY)," Delegation of the European Union to India and Bhutan, November 19, 2018, [https://eeas.europa.eu/delegations/india/53963/submission-draft-personal-data-protection-bill-india-2018-directorate-general-justice\\_en](https://eeas.europa.eu/delegations/india/53963/submission-draft-personal-data-protection-bill-india-2018-directorate-general-justice_en).

equilibrium will depend on international cooperation and rules that maximize the benefits from digital trade and data flows while allowing necessary, proportionate, and minimally trade-distorting regulations.

Seventy-six countries recently started e-commerce negotiations at the WTO.<sup>99</sup> China was an unexpected, late addition to negotiations, but it will struggle for a place, as free data flows are integral.<sup>100</sup> As WTO Director General Roberto Azevedo noted, in the context of these negotiations, countries have only two options: to participate and help make the rules or to stand back and accept the rules as given.<sup>101</sup> In an ideal world, China would take this to heart and change its approach.

Setting up a joint “cross-border data flows and digital trade task force” with the United States would be a step in the right direction, as it would create a vehicle for exploring whether there are other ways to address legitimate policy concerns while still allowing data flows and digital free trade. The European Union and CPTPP membership bloc could establish similar task forces to discuss the full scope of issues and perspectives. Without these types of initiatives and accompanying domestic reforms, China will likely be marginalized at global discussions on efforts to set rules for an open, rules-based global digital economy.

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99. Leika Kihara, “China and U.S. among 76 WTO Members Pushing for New E-Commerce Rules,” Reuters, January 25, 2019, <https://www.reuters.com/article/us-davos-meeting-ecommerce/china-and-u-s-among-76-wto-members-pushing-for-new-e-commerce-rules-idUSKCN1PJ0UK>.

100. “USTR Robert Lighthizer on the Joint Statement on Electronic Commerce,” USTR, press release, January 25, 2019, <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/january/ustr-robert-lighthizer-joint>.

101. Deborah Elms, “Making E-commerce and Digital Trade Work for Smaller Firms,” Asian Trade Center, April 3, 2019, <http://www.asiantradecentre.org/talkingtrade/making-e-commerce-and-digital-trade-work-for-smaller-firms>.

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Dr. Ye Yu is an associate professor at the Institute for World Economy Studies at the Shanghai Institutes for International Studies (SIIS). Her research focuses on the role of China in global economic governance, with a focus on the system of multilateral development banks in recent years. She has undertaken numerous projects commissioned by the National Social Science Foundation of China, the Ministry of Finance, and the Ministry of Foreign Affairs, among others, and publishes academic articles regularly. She is the author of the monograph *International Law Regulation of Oil Trade and Investment*. She received her PhD in international economic law from Fudan University and has been a



visiting scholar at a variety of international institutions, such as Yale University, CSIS, and the Lowy Institute for International Policy.

### **Lu Chuanying**

*Director of the Center for Cyberspace Governance, SIIS*

Dr. Lu Chuanying is director of the Center for Cyberspace Governance and a senior research fellow at the Shanghai Institutes for International Studies (2009-present). He was previously a visiting fellow at the Center for Strategic and International Studies (United States) and Oxford University (United Kingdom). Dr. Lu specializes in cyberspace governance and cybersecurity. He is also the editor-in-chief of *Information Security and Communication Privacy*. He is also a member of the China-EU Digital Economy and Cybersecurity working group. He has published articles on issues related to cyberspace in journals and newspapers including *Cyberspace Governance* and *Cyber Security*.

### **Nicolas Huppenbauer**

*Visiting Fellow, SIIS*

Nicolas Huppenbauer is currently a visiting research fellow at the Shanghai Institutes for International Studies (SIIS) and a graduate student at the Technical University of Munich (TUM). At SIIS, he works at the Cyberspace International Governance Research Center to explore current issues in domestic and international cyber policy, focusing on China and the European Union. More broadly, his research interests revolve around the global and regional politics of science and technology, including security studies, technology governance, innovation policy, and regional innovation cultures, combining interdisciplinary research methodologies.

## **From CSIS**

### **Nigel Cory**

*Associate Director of Trade Policy, Information Technology and Innovation Foundation*

Nigel Cory is an associate director covering trade policy at the Information Technology and Innovation Foundation. He previously worked as a researcher at the Sumitro Chair for Southeast Asia Studies at the Center for Strategic and International Studies. Prior to that, he worked for eight years in Australia's Department of Foreign Affairs and Trade, which included positions working on G20 global economic and trade issues and the Doha Development Round. Cory also had diplomatic postings to Malaysia, where he worked on bilateral and regional trade, economic, and security issues, and Afghanistan, where he was the deputy director of a joint U.S.-Australia provincial reconstruction team.

### **Matthew P. Goodman**

*Senior Vice President and Simon Chair in Political Economy, CSIS*

Matthew P. Goodman is senior vice president and holds the Simon Chair in Political Economy at the Center for Strategic International Studies. Matthew Goodman served as director for international economics on the National Security Council staff, helping the president prepare for G20 and G8 summits. He was also White House coordinator for Asia-Pacific Economic Cooperation (APEC) and the East Asia Summit. Prior to the White House,



Goodman was senior adviser to the undersecretary for economic, energy, and agricultural affairs at the U.S. Department of State.

Matthew Goodman has extensive experience in both the public and private sectors. Before joining the Obama administration in 2009, he worked for five years at Albright Stonebridge Group, a global business advisory firm based in Washington, D.C., where he was managing director for Asia. From 2002 to 2004, he served at the White House as director for Asian economic affairs on the National Security Council staff. Prior to that, he spent five years at Goldman, Sachs & Co., heading the investment bank's government affairs operations in Tokyo and London. From 1988 to 1997, he worked as an international economist at the U.S. Treasury Department, including five years as financial attaché at the U.S. embassy in Tokyo. He is a life member of the Council on Foreign Relations and is chairman emeritus of the board of trustees of the Japan-America Society of Washington, D.C.

### **John J. Hamre**

*President and CEO, CSIS*

John Hamre was elected president and CEO of CSIS in January 2000. Before joining CSIS, he served as the 26th U.S. deputy secretary of defense. Prior to holding that post, he was the under secretary of defense (comptroller) from 1993 to 1997. As comptroller, Dr. Hamre was the principal assistant to the secretary of defense for the preparation, presentation, and execution of the defense budget and management improvement programs. In 2007, Secretary of Defense Robert Gates appointed Dr. Hamre to serve as chairman of the Defense Policy Board, and he served in that capacity for four secretaries of defense.

Before serving in the Department of Defense, Dr. Hamre worked for 10 years as a professional staff member of the Senate Armed Services Committee. During that time, he was primarily responsible for the oversight and evaluation of procurement, research, and development programs, defense budget issues, and relations with the Senate Appropriations Committee. From 1978 to 1984, Dr. Hamre served in the Congressional Budget Office, where he became its deputy assistant director for national security and international affairs. In that position, he oversaw analysis and other support for committees in both the House of Representatives and the Senate.

### **Peter Raymond**

*Senior Associate (Non-resident) for the Reconnecting Asia Project and Simon Chair in Political Economy, CSIS*

Peter Raymond is a senior associate with the Simon Chair in Political Economy and the Reconnecting Asia Project at the Center for Strategic and International Studies (CSIS). He brings a 30-year career of service at the intersection of the public and private sectors, of infrastructure and financial services, globally. Prior to joining CSIS, he served as global advisory leader of PwC's Capital Projects & Infrastructure (CP&I) practice. With nearly two thousand staff and partners globally, the practice advises on some \$100 billion in capital projects annually with clients in the utilities, transportation, oil and gas, manufacturing, engineering and construction, and technology and telecommunications sectors, as well as investors, financial institutions, multilateral banks, and government entities. Peter also served as PwC's advisory partner for the Asian Infrastructure

Investment Bank (AIIB) and senior relationship partner for the World Bank Group. He has lived and worked in China, where he also served as COO of PwC's Consulting Business, Poland, Hungary, Russia, and Thailand.

In the United States, Peter conceived and built PwC's Public Sector Financial Services practice and led the firm's support to the U.S. government during the financial crisis, including its work on TARP and numerous other crisis response programs. He was recognized as a Top 25 Consultant by Consulting Magazine in 2010 for these efforts. In the 1990s, Peter advised on the Asian Financial Crisis, moving to Thailand and leading efforts to reform the industrial and infrastructure sectors of the economy. In the early-1990s, Peter advised on the opening of the economies in Central and Eastern Europe, living in Poland, Hungary, and Russia.

### **William Reinsch**

*Senior Adviser and Scholl Chair in International Business, CSIS*

William Reinsch holds the Scholl Chair in International Business at the Center for Strategic and International Studies and is a senior adviser at Kelley, Drye & Warren LLP. Previously, he served for 15 years as president of the National Foreign Trade Council, where he led efforts in favor of open markets, in support of the Export-Import Bank and the Overseas Private Investment Corporation, against unilateral sanctions, and in support of sound international tax policy, among many issues. From 2001 to 2016, he concurrently served as a member of the U.S.-China Economic and Security Review Commission. He is also an adjunct assistant professor at the University of Maryland School of Public Policy, teaching courses in globalization, trade policy, and politics. Reinsch also served as the under secretary of commerce for export administration during the Clinton administration. Prior to that, he spent 20 years on Capitol Hill, most of them as senior legislative assistant to the late Senator John Heinz (R-PA) and subsequently to Senator John D. Rockefeller IV (D-WV).

### **Stephanie Segal**

*Senior Fellow of the Simon Chair in Political Economy, CSIS*

Stephanie Segal is deputy director and senior fellow of the CSIS Simon Chair in Political Economy. Previously, she served as co-director of the East Asia Office at the U.S. Department of the Treasury. Prior to the Department of Treasury, she was senior economist at the International Monetary Fund (IMF), where she covered a range of emerging market and advanced country economies. Earlier in her career, Ms. Segal served as an economist in the Western Hemisphere, Southeast Asia, and International Monetary Policy offices at the Department of Treasury; as an adviser to the U.S. director at the IMF; and as an analyst and then associate in Mergers & Acquisitions at J.P. Morgan in New York.

### **Mark Sobel**

*U.S. Chairman, OMFIF*

Mark Sobel is U.S. chairman at the Official Monetary and Financial Institutions Forum (OMFIF). Mark is a veteran U.S. Treasury official who was at the forefront of international financial diplomacy for two decades. Mark, who represented the United States on the International Monetary Fund executive board up to April 2018, has had a 40-year

Department of Treasury career with extensive around-the-world engagement. He works with OMFIF in dealings with private and public sector organizations, speaks regularly on international and U.S. policy, and provides OMFIF members with insight and analysis.

Mark was Department of Treasury deputy assistant secretary for international monetary and financial policy between 2000 and early 2015. He helped lead Department of Treasury preparations for G7 and G20 finance minister and central bank governor meetings, formulated U.S. positions at the IMF, and coordinated Department of Treasury and regulatory agencies' work in the Financial Stability Board. Mark founded the U.S.-EU Financial Market Regulatory Dialogue and chaired an international group of private and official sovereign debt experts that developed enhanced collective action clauses for sovereign debt restructuring. He managed the \$100 billion-plus Department of Treasury Exchange Stabilization Fund and played a key role in U.S. foreign exchange policy, including coordinating the Department of Treasury's semi-annual foreign exchange report on China and other countries.



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