

## How China should rule the world

By Martin Wolf



“Reform and opening up” has been China’s mantra for more than three decades. The result has been not only the emergence of a new economic superpower but of one highly integrated into the world economy. A big question, then, is how China should use its influence. It is one I addressed in a speech at this year’s China Development Forum in Beijing. My argument was that **China has achieved greatness and now has responsibility for the global system thrust upon it.**

This colossus is now the world’s largest exporter and second largest importer (after the US), unless the European Union is treated as a single unit. It has the world’s largest trade and current account surpluses and owns a third of world currency reserves. Its flow of savings is the world’s biggest. It is the largest importer of many commodities and the price-setter for many products. China’s influence is, in short, both pervasive and growing. Yet it is also a developing country ruled by the Communist party. This is an unprecedented combination.

China needs to develop its own view of how to use its influence. In doing so, it will have to start from a definition of its national interests and objectives. **China’s overwhelming interest lies, I suggest, in a stable, peaceful and co-operative global political and economic environment.** Only in such a world can China hope to sustain rapid development.

How should China achieve its aim? Broadly, it would be best achieved **via further development of the rules-governed, institutionally based global system.** The obvious alternative would be a hierarchical arrangement, with China at the apex. But such an

approach would, I fear, lead to unmanageable conflicts with the other great powers. With this idea in mind, let us consider trade, payments, finance and resources.

As the world's rising trading power, **China is the natural successor of the US as guardian of the open trading system.** It is important, for this reason, that China abide by all the rules and principles of the system and play an important part in developing it further. China should play a role in bringing the interminable Doha round to some sort of conclusion. It has a rising interest in protecting its own intellectual property and, for this reason, a matching interest in ensuring its own adherence to these rules. China also has **a strong interest in protecting its growing direct investments abroad.** For this reason, it should promote rules on protection of foreign direct investment. Finally, as a global trader, China has a strong interest in ensuring that the regional trade arrangements it creates, or joins, are compatible with the global rules.

As for payments, the immediate issue concerns the challenges created for China and its partners by its huge trade and current account surpluses. Happily, China itself recognises that the outcome has proved domestically destabilising. Chen Demin, China's minister of commerce, has recently stated that the objective now is to "stabilise exports, expand imports and reduce the surplus". Furthermore, he has added: "It is expected that imports will grow faster than exports this year. The share of the trade surplus in GDP may be below 3.1 per cent, lower than in 2010." Indeed, China's trade surpluses, though still huge, are roughly a half of what they were before the crisis (see chart).



China surely recognises that the accumulation of huge official claims on “safe” foreign liabilities must be matched by a corresponding supply. Unfortunately, the demand is now met via destabilising fiscal and external deficits in the US. China could help itself by accelerating liberalisation of capital outflows and increasing exchange rate flexibility.

Furthermore, China needs to develop a strategy for reform of the global monetary system that fits with its interests in managing the interface between its domestic development and global stability. One desirable move would be towards co-ordination of exchange rate management with other export-oriented emerging economies. It is also in China’s interests to secure a pragmatic accommodation with its partners in the discussions within the Group of 20 leading economies. This should focus on indicators of disequilibrium, methods of adjustment and liquidity provision for countries in difficulties.

As for finance, China’s objectives must be: first, to create a domestic system capable of supporting its own economic development; second, to help promote a global system that supports a tolerably stable world economy; and, third, to protect the former from the excesses of the latter. In achieving this difficult reconciliation China’s policies should be guided by the understanding that, in the long run, its financial system will be the hub of

global finance. Yet the transition to full integration will be not only lengthy but also complex and fraught, with full integration of banking particularly dangerous.

Finally, let us look at access to resources. For the first time in its long history, China is dependent on access to imports of industrial raw materials. It is already the world's largest importer of most raw materials. For China, policy in this area is of potentially the highest importance. Its immediate interest is to gain access to the world's resources on favourable terms. It has decided, quite reasonably, to use its cheap capital and labour to secure this end. That is not only in China's own interests but in those of other consumers. Since resources have global prices, any increase in supply is to the benefit of all consumers.

Nevertheless, it would be helpful if a consensus could be reached on the terms of investment and trade in natural resources. One aim should be to ensure that commodity-exporting countries – particularly poor ones, with limited capacity for governance – benefit from foreign investment and exports of natural resources. China will be a central player in securing such agreements. Above all, the world needs to agree that the underlying principle must remain those of free trade in open world markets. Prices need to be set in global competition, with, of course, the possibility of long-term contracts.

As China grows, its impact on the world expands exponentially. It must reconcile the imperatives of its rapid development with the need to take full account of its impact on the world. It will have to develop its own agenda, one that secures its linked objectives of rapid development at home and stability abroad. It will not be easy. China has no alternative.