



Expanding the G8: should China join?

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Executive Summary

As the centre of gravity in the world's economy continues to move east, it appears increasingly anachronistic that the only Asian country represented at the G8 table is Japan, by all accounts a stagnating economic and political power in the world. The time is approaching for China to be invited to be a full member of the G8, and for the new G9 or G10 (if India is included) to focus on its central objective: to preside over and guide the world's economy.

China's rise in the world economy has echoes of historical episodes such as the industrial revolution, or the Meiji Restoration in Japan, in terms of its scope for disruption and impact on the global economic (and political) order. Since the Second World War, countries such as Japan and Korea achieved economic miracles but the relatively small size of their populations meant that the global impact, though noticeable in many sectors, was still relatively muted. Beijing plans to complete its modernisation programme by the middle of the 21st century, a process that has the potential to create seismic shifts in the world economy. To manage this phenomenon, China needs to be an integral part of global economic governance structures.

This pamphlet makes the case for China to be invited to join the G7 group of finance ministers and central bankers (the financial G7), while G8 membership should be offered on the basis of discernible movement towards liberal democratic norms and universal conceptions of human rights.

China is a central feature of the global economy in ways that have altered long-term economic relationships and have created new and dangerous global co-dependencies that is not being addressed comprehensively in any forum. These new imbalances are being felt in a wide range of sectors across the G8 economies, and are finding their expression in simmering trade quarrels and threats of protectionism.

With the increased role in global governance of the private sector, NGOs and non-state groups, no one organisation or system will solely preside over global governance in the 21st century. Some discussions can be handled outside the G7/G8 process, but in other cases where rapid response or high level decision making is critical, there are few substitutes to the G8. As the 'informal steering committee' for the major multilateral financial institutions and the world economy, the financial G7 has the power to deliver optimal cooperative outcomes. The most important instances of international economic cooperation in the last quarter century – most notably the Plaza and Louvre accords of the 1980s – occurred under the aegis of the then G7 group of the world's leading economic powers. The world economy is now ripe for similar agreements to contain some of the severe imbalances plaguing it.

China has been present at many of the outreach sessions as well as meetings of the finance ministers of the G7. Virtually all the G8 countries in the past six years have floated the idea of incorporating China in the club in some capacity if not as a full member. At the Gleneagles Summit on 6-8 July in 2005, Prime Minister Tony Blair called for the enlargement of the G8 to include India and China, although he acknowledged that there would be resistance from within the club.

The biggest opposition will come from the United States and, to a lesser extent, Japan on the basis that China does not share the political values – namely open, democratic societies – that were enshrined in the original statement at Rambouillet on the founding of the G6 in 1975. But in the United States there has been a slight perceptible shift in policy towards China from calling for the 'containment' of China to urging it to become a 'responsible stakeholder' in the world economy.

The perspective of the Middle Kingdom towards the G8 has shifted in recent years. Recently, under the presidency of Hu Jintao, there has been a perceptible change towards the G8. Joining such an exclusive forum would give China global status, signalling that it has 'arrived' on the world stage.

In the meantime, China is rapidly expanding its (economic) sphere of influence in Asia in ways that will ultimately have great influence on how multilateral institutions such as the International Monetary Fund (IMF), World Bank and World Trade Organisation (WTO) as well as the G8 operate. New regional formations such as the East Asian Community which were inaugurated recently, are for the first time excluding the United States. Across Asia, the beginning of this millennium is witnessing an economically battered continent repair itself rapidly and join hands in a series of bilateral and regional economic alliances that have major but only yet thinly grasped implications for the G8; an Asian economic bloc that would have the financial and economic clout to match the United States or European Union. It is critical for the G8 to engage with this process early on, in order to ensure the smooth functioning of the global economy.

The resistance anticipated by Tony Blair to China's incorporation in the club is clearly based on the lack of a clear road map towards a more participatory political system, China's poor record on human rights, and virtual absence of the rule of law. While political reform is taking place in China, it is now as it was in the 1980s, focussed on strengthening the party to deliver economic reforms and so also its monopoly on power. There is no denying the slow and deliberate nature of change in the Chinese system. The political model that China appears to be moving towards is a form of societal co-optation or corporatism, analogous to political systems in other 'soft' authoritarian states in East Asia.

In the final analysis, it would be very difficult for the G8 to incorporate China in the near term into its ranks without a fundamental redefinition of its membership credentials. When the G6 was founded in 1975, the Communiqué Declaration of Rambouillet stated that 'we came together because of shared beliefs and shared responsibilities. We are each responsible for the government of an open, democratic society, dedicated to individual liberty and social advancement.'

Paradoxically, while the G8 is of great symbolic importance, it is the G7 group of finance ministers and central bankers that wields influence over the global economy. Without early incorporation of China into the G7 finance group as a way-station to the G8, this powerful forum could

find itself increasingly irrelevant in the economic landscape of the 21st century. The world would find itself in a perilous place with no forum to adequately govern an ever more interlinked and complex global economy.

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Introduction

As the centre of gravity in the world's economy once again shifts east, it appears increasingly anachronistic that the only Asian country represented at the G8 table is Japan, by all accounts a stagnating economic and political power in the world. The time is approaching for China to be invited to be a full member of the G8, and for the new G9 or G10 (if India is included) to focus on its central objective: to preside over and guide the world's economy.

China's rise in the world economy has echoes of historical episodes such as the industrial revolution, or the Meiji Restoration in Japan, in terms of its scope for disruption and impact on the global economic (and political) order. Since the Second World War, countries such as Japan and Korea achieved economic miracles but the relatively small size of their populations meant that the global impact, though noticeable in many sectors, was still relatively muted. Beijing plans to complete its modernisation programme by the middle of the 21st century, a process has the potential to create seismic shifts in the world economy. To manage this phenomenon, China needs to be an integral part of global economic governance structures.

In its history, the current G8 has been most successful and effective in dealing with major world financial imbalances; indeed it was founded soon after the Bretton Woods crisis and the first oil shock of the early 1970s to deal with global economic dislocations. Since then it has become a broader forum for foreign affairs, although the economic dimension was upgraded once again in the mid-1980s mostly notably with the Plaza and Louvre agreements. The most important instances of international economic cooperation in the last quarter century took place under the aegis of the then G7 group of the world's leading economic powers. In recent years the club has increasingly discussed issues outside its immediate influence – for instance, oil prices and Asian currencies – reflecting the extent to which it now shares the economic centre stage with other, emerging economies. The G8 needs to acknowledge and accommodate these rapid shifts in world economic power if it is to find collective solutions to challenges facing the world and stay relevant as a global institution.

This pamphlet makes the case for China to be invited to join the G7 group of finance ministers and central bankers, while G8 membership should be offered on the basis of discernible movement towards liberal democratic norms and universal conceptions of human rights.

As the 'informal steering committee' for the major multilateral financial institutions and the world economy, the financial G7 has the power to deliver optimal cooperative outcomes. There are four reasons why the G7/G8 should not delay inviting China to join the G7 group of finance ministers.

First, China's weight in the world as the fourth largest economy and degree of economic integration with the G8 imply that it must be included in any forum for global economic governance. Institutions for managing the world's economy are widely believed to be in need of reformation and repair. Some of the larger emerging markets, most significantly China, need to have a voice in any new system that is instituted for it to have credibility.

Second, China is now a central feature of the global economy in ways that have altered long-term economic relationships and have created a new and dangerous global co-dependency not being addressed comprehensively in any forum. This applies as much to exchange rates as it does to production and trade. Added to concerns about China's growing foreign reserves is the threat of a trade war: Sino-American and Sino-European trade quarrels are continually simmering. Protectionist sentiment has been steadily growing particularly in the United States, and Congress is ready to slap punitive tariffs on China. A trade war would be less likely between members of the G8 or an expanded G9.

What is more, is that economic friction with China is couched in explanations – in policy and political circles – that do not adequately take into account the structural impacts of China's rise. Trade deficits and currencies wax and wane in line with economic cycles, but there is gathering evidence that at least a part of the deficits and currency misalignments are the result of long term, structural shifts as the Chinese economy continues to morph. Without high level, cooperative

discussions on how to address these new challenges, disruption and discord will continue to grow.

Third, regional and trading arrangements are taking root across Asia, with China occupying a key role in these formations. The economic size of any Asian bloc that eventually emerges will have the financial clout to match the influence of the United States or European Union. For the global economy to function smoothly, it is crucial that the major elements of this nascent bloc are included in the meetings of the financial G7.

Fourth, there is real scope for collaboration between China and the G8 as it is constituted today on issues of international development. China's role as a donor – or more appropriately – as a lender in Africa is garnering increased attention. While most analyses focus on the potential for conflict in Africa, there is also scope for genuine cooperation by pooling funds and ideas, especially on themes of poverty reduction on which China has much to offer.

It is a cliché to say that membership of a club comes with rights and responsibilities. But this truism applies as much to existing members of the G8 as it does to China, who will find themselves faced with new ideas and concepts of how to manage the world economy. China has pursued its own home grown model of development which conflicts in key ways with mainstream economic ideas. As the quotas, voting power and representation of emerging economies such as China in the IMF rises, so will pressures for policy ideas, conditionality and alternative concepts for the use of Fund resources.

With the increased role of the private sector, NGOs and non-state groups in global governance, no one organisation or system will solely preside over global governance in the 21st century. Some of the themes outlined above can be handled outside the G7/G8 process, but in other cases where rapid response or high level decision making is critical, there are few substitutes to the G8.

Since the wave of economic crises that swept Asia in 1997, policymakers in the West and Asia have spoken about the need to reform institutions of global economic governance and put in place a

new financial architecture. Notably, the G8 in Birmingham in 1998 pledged to reform the global financial architecture but came up with few new initiatives. No consensus has yet emerged that would take into account the need for more efficiency and more democracy in the structure. The issue has been hotly debated and discussed, and while a number of proposals have been mooted: from a G3 to a G22; from networks of experts to a global democracy;¹ one theme remains constant and that is a need to incorporate at least the larger emerging economies, if not greater representation for Africa and the oil producing countries. The time has come for the world's governance institutions to reflect new power centres.

Up to a point, this is already happening. China has been present at many of the outreach sessions as well as meetings of the finance ministers of the G7. Virtually all the G8 countries in the past six years have floated the idea of incorporating China in the club in some capacity if not as a full member. The idea was first advanced by German Chancellor Gerhard Schroeder in 1999, and was looked upon favourably by the Canadians and the British. At the Gleneagles Summit on 6-8 July this year, Prime Minister Tony Blair called for the enlargement of the G8 to include India and China, although he acknowledged that there would be resistance from within the club.

The biggest opposition will come from the United States and, to a lesser extent, Japan on the basis that China does not share the political values – namely open, democratic societies – that were enshrined in the original statement at Rambouillet on the founding of the G6 in 1976. There has been a slight discernible change in nuance in the past months in Washington from the containment of China to calling on it to be a 'responsible stakeholder' in the world economy – the new line from Deputy Secretary of State Robert Zoellick – but there is little clarification on what this implies for policy.

For the United States, in both Congress and the Bush administration, America's economic interests have become increasingly conflated with

¹ For a review of the possibilities, see Ngaire Woods, 'Who should govern the world economy: the challenges of globalisation and governance', *Renewal*, Vol 9, No.2/3, 2001.

its national security interests. What is interesting is that the same appears to be increasingly true of China, with statements made by Chinese leaders pointing to the need for economic progress and 'comprehensive national strength'. In this sense, both are mirror images of the other and they contain the seeds of conflict – in this case, economic – if there is weak coordination and cooperation.

The perspective of the Middle Kingdom towards the G8 has shifted in recent years. At first, the Chinese leadership was lukewarm about the prospect of joining the G8, believing that joining it would not serve their national interests. It viewed the United Nations as the only international organisation with legitimacy.² But recently, under the presidency of Hu Jintao, there has been a perceptible change towards the G8. The Chinese leadership has been responding positively to invitations to G8 meetings, even privately expressing disappointment that it was not invited to the United States in 2004. Joining such an exclusive forum would give China global status, signalling that it has 'arrived' on the world stage.

Following the argument of Chinese scholar Wang Jisi in the October 2005 issue of *Foreign Affairs*,³ it is a mistake to view China's relations with other major powers as a zero sum game. In particular, the Chinese and US economies are strongly intertwined and while each may act to serve its own best interests, in the process they end up advancing the other's interests. They have enormous stakes in continued stability and growth in each other's economies. Collectively, the tide of their rising growth lifts all boats. Conversely, any sharp reversals in fortune will reverberate across the G8. In order to ensure a favourable situation, regular high-level, face-to-face contacts and coordinated action in a new G8 group of finance ministers is essential.

In the meantime, China is rapidly expanding its (economic) sphere of influence in Asia in ways that will ultimately have an important influence on how multilateral institutions such as the International

² Yu Yongding, 'G20 and China: A Chinese Perspective', *China & World Economy*, Vol.13, No.1, 2005, pp.3-14.

³ Wang Jisi, 'China's Search for Stability with America', *Foreign Affairs*, September/October 2005.

Monetary Fund (IMF), World Bank and World Trade Organisation (WTO) as well as the G8 operate. New regional formations such as the East Asian Community which were inaugurated recently, are for the first time excluding the United States. Across Asia, the beginning of this millennium is witnessing an economically battered continent repair itself rapidly and join hands in a series of bilateral and regional economic alliances that have major but only yet thinly grasped implications for the G8.

The resistance anticipated by Tony Blair to China's incorporation in the club is clearly based on the lack of a clear road map towards a more participatory political system, China's poor record on human rights, and virtual absence of the rule of law. China is not yet sufficiently aligned with US Secretary of State Condoleezza Rice's definition of the G8 ('a group of democracies...fully committed to free market principles, free trade, rule of law'), for it to be unanimously offered a place at the table. These considerations make the G8 queasy about allowing China into the club. How can large Western or Asian democracies 'engage' meaningfully with a country that does not share the same belief system or worldview?

While the initial focus of the then G7 was on coordinating macroeconomic policies, the leaders of the countries who were all Cold War allies, began to discuss security and regional political issues in the late 1970s and 1980s. Post Cold War, this political foundation for coordination has faded and in its place no new political consensus has emerged. The only glue that binds members of the G8 today is the shared political value of liberal democracy. But this is no trivial matter: the quality of relations between liberal states is of a fundamentally different nature than that between pluralist and non-democratic entities. For informal or formal agreements between nations to be binding, a high degree of political consensus is critical for meaningful collective global governance.

From the Chinese perspective, having witnessed the effects of shock therapy and the fate of the Gorbachev reforms in the former Soviet Union, it opted for incremental restructuring ('crossing the river by feeling for the stones underfoot'). The consequence is that China represents the only historical anomaly of a communist state that has

combined fundamental economic transformation with a glacial pace of political reform.

A common assumption and a major premise of 'engagement' with China has nevertheless been that the forces of economic reform and globalisation would spawn the growth of the middle class and redistribute power within the party, allowing new political forces to prevail. Many of the reforms taking place – financial sector, SOE reform, social security – are being implemented by technocrats; these changes in institutions in China are to some extent driving a wedge between party and state. The expectation in the West is that over time, this technocratic element will gain the upper hand and steer the Chinese polity towards democratic reforms.

But an automatic translation to democratic politics does not follow – in other late developers such as South Korea and Taiwan, authoritarian regimes remained entrenched during the years of booming economic growth and a growing middle class. It seems dangerously naïve to expect that a growing middle class will lead to a smooth and desirable transition to a more pluralist political system. Eventually, there will be pressures for change but that may be decades away.

The communist party is reforming as the Chinese leadership has come to acknowledge the existence of a rising middle class, and now looks for ways to incorporate it into the political system. But political reform in China today, as it was in the 1980s, is focussed on strengthening the party to deliver the economic reforms and also to strengthen the party's monopoly on power.

What should be noted however is the quality of the new leadership in China. This 'fourth generation', which took over in 2002 are in significant ways different from the previous generation: they are younger, well educated (the vast majority of the new Politburo have university degrees), and they are civilian. They are technocrats who have been put in place to oversee China's modernisation.

But there is no denying the slow and deliberate nature of change in the Chinese system. The political model that China appears to be moving

towards is a form of societal co-optation or corporatism, analogous to political systems in other 'soft' authoritarian states in East Asia.

In the final analysis, it would be very difficult for the G8 to incorporate China in the near term into its ranks without a fundamental redefinition of its membership credentials. When the G6 was founded in 1975, the Communiqué Declaration of Rambouillet stated that 'we came together because of shared beliefs and shared responsibilities. We are each responsible for the government of an open, democratic society, dedicated to individual liberty and social advancement.'

Paradoxically, while the G8 is of great symbolic importance, it is the G7 group of finance ministers and central bankers that wields influence over the global economy. Without early incorporation of China into the G7 finance group as a way-station to the G8, this powerful forum could find itself increasingly irrelevant in the economic landscape of the 21st century. The world would find itself in a perilous place with no forum in place to adequately govern an increasingly interlinked and complex global economy.

The Economic Imperative

Having grown at nine per cent a year for a quarter of a century, China's remarkable economic performance has been the envy of the world, but what is not yet fully apparent is how its rise is transforming fundamental global economic relationships. These new interlinkages have made China an indispensable element in any forum that claims to govern the world economy. Accelerated globalisation in the past decade has complicated the challenge of isolating China's impact on the world economy, and to detach cyclical and structural elements of the impact of China's rise. The section below discusses some of these elements.

China Rising: The Beginning of a Long Innings?

It hardly bears repeating that China is now an economic power. It is the sixth-largest economy (at market exchange rates) and the fourth-largest trader in the world. (If recent upward revisions of the order of

US\$300 billion are proved to be accurate, China is the fourth largest economy in the world).⁴ It has become a significant player in international finance, with more foreign exchange reserves than any country besides Japan, and also a major creditor to the United States – around three quarter of the People’s Republic of China’s (PRC) foreign exchange reserves are believed to be held in US dollars. While other emerging economies – India, Brazil and South Africa – are growing fast, China is the most interlinked in the global economy, thanks to its free trade offensive. The PRC’s exports and imports have grown at an average rate of 15 per cent annually since 1979, compared with a global average of seven per cent.⁵

China has taken over from Japan and South Korea as the world’s ‘super-accumulator’, investing almost a third of its GDP. In turn, this has meant that it has become a significant contributor to global growth: in the period 2001 to 2003, it contributed nearly a quarter of world GDP growth.⁶ Or, to quote another staggering statistic, China’s share of world GDP has risen from five to fourteen per cent over a twenty-five year period.⁷

Contrary to popular perceptions, the China story has not yet begun in earnest – its growth path has in fact been more gradual than that of previous cases of countries (most notably in East Asia) that have caught up with their industrialised counterparts. China’s exports to date have grown at a slower pace than historical experience suggests would occur when countries are beginning their rapid climb – for instance, the Asian growth episodes of the 1970s and 1980s. As an indication, China accounts for 12 per cent of imports into the United States, little more than half the 22 per cent share of imports from Japan in 1986, when Japan was at the peak of its industrial success. China’s per capita income is still lower than it was in other East Asian countries during their take-off period, suggesting that there is plenty of room to catch up.

⁴ ‘China to up GDP estimate by 20%’, *Financial Times*, 14 December, 2005.

⁵ ‘China’s Growth and Integration into the World Economy: Prospects and Challenges’, *IMF Occasional Paper No. 232*, International Monetary Fund, 2004.

⁶ This is based on purchasing power parity calculations of GDP.

⁷ Andrew Glyn, ‘Imbalances of the Global Economy’, *New Left Review*, 34, July/August 2005.

The big difference between the earlier episodes and China is its sheer size. Given the PRC’s vast population and still relatively low per capita income, millions can be drawn from farms into factories – estimates range from 150m to 300m – implying that the spectacular growth rates are likely to continue for many more years, barring sudden shocks or reversals.

Eventually, according to the IMF, ‘China’s emergence will represent a larger shock to world factor endowments and to the global economy than previous integration episodes [Japanese, East Asian and Southeast Asian integration into the world economy], potentially implying a major impact on certain regions and sectors’.⁸

But we should be careful not to make a straight-line extrapolation – there is plenty that can sap China’s economic dynamism. The economy faces a multitude of problems, most notably labour protests by disenfranchised workers in state-owned enterprises as well as farmer protests which are making the Chinese government increasingly jittery. The government’s own figures indicate that there were over 70,000 riots or public disturbances in 2004. Given the brittle nature of China’s political regime and its lower capacity to absorb shocks, an economic downturn could create political convulsions and a temporary economic jolt. Labour could be the powder keg that blows everything apart. China’s economic story is also vulnerable to the demographics that are rapidly turning against it – in a decade, China’s population will begin to age and with that will come a whole new set of challenges – from providing pensions, to macroeconomic management. And likewise, the industrialised countries will have to contend with rising labour costs and product prices.

The Chinese leadership is putting some brakes on the red-hot-growth-at-all-costs model. ‘Sustainable development’, ‘scientific concept of development’ and ‘harmonious society’ are the new catchphrase in policy circles in China, emphasised in the 11th Five Year Plan. These new concepts are intended to pay attention to the environmental costs of China’s growth, and the problem of rural-urban inequality. But

⁸ IMF World Economic Outlook, April 2004.

although this new focus may moderate growth rates a bit, the Plan does not urge planners to detract from the ultimate objective of high growth rates.

China's Impact on the G8

In most accounts of China's rise, it is seen as a low wage supplier of consumer goods to the world, the phenomenon being a double-edged sword: raising standards of living in the West, but creating pockets of unemployment in the process. Western governments have responded with doses of protectionism and a longer-term focus on skill development, innovation and R&D.

But beyond that, there is little substantive discussion of how China's growth trajectory is transforming relations in the global economy. It is worth focusing then, on the dimensions of this challenge and in what ways China's re-entry into the world economy is producing a new geometry. There are five major impacts: first, the impact on the price of labour and trade; second, the development of an Asian economic bloc, magnifying its impact on the world; third, the impact on energy prices and the environment; fourth, the effects on growth and poverty, particularly the Millennium Development Goals; and fifth, large-scale international financial flows which have the potential to be destabilising.

(i) Relative price of labour and trade flows

This is probably the most evident and acknowledged impact of China's economic influence. Research indicates that China's integration (as well as India and the former Soviet Union) into the world has doubled the global labour force over the past twenty years, from an estimated 3.3 billion to 6 billion.⁹ Because of the vast potential for factories to continue sucking in surplus agricultural labour, as well as increasingly fragmented production processes and supply chains, there is powerful downward pressure on the wages of unskilled labour. This has combined with China's openness in terms of trade and investment, to transform China into the 'workshop of the world'. The result has been some shift in production platforms around the world with growing

⁹ Richard Freeman, 'What really ails Europe (and America): The Doubling of the Global Workforce', *The Globalist*, 3 June 2005.

import penetration. China has also displaced market share from other developing countries around the world.

The obvious consequence is the growing risk of protectionism and trade wars. But even as the US and EU focus on textiles and perhaps next, steel, the 'bra wars' between the US and China, and the EU and China have concealed a much more significant looming economic conflict between the two sides. China is now rapidly climbing up the value chain encompassing high technology trade. While there are difficulties in calculating the precise value added in China, economists now increasingly suspect that at least a part of the global economic imbalances in the world today are structural, and here to stay.¹⁰

This fear is being articulated in the United States, most recently by the US-China Commission:

We are concerned not only about the size of our bilateral deficit, but also its composition. Across the economic spectrum, China is rapidly becoming a world-class competitor. Last year, the United States had a deficit of \$36 billion in Advanced Technology Products with China, an increase of 500 percent since 2001. China is pursuing the development of its nanotechnology, biotechnology, and opto-electronics sectors. As our trade balance continues to worsen and trading and sourcing patterns change, the imbalances become structural and increasingly difficult to address.

Chinese foreign trade experts claim that at least some of this can be addressed by removing restrictions on high tech dual-use imports from America. But nevertheless, there are growing signs of a structural trade deficit with China in high value goods, a worrying trend for the western countries.

¹⁰ Catherine Mann of the Institute of International Economics points out that from a surplus of US\$50 billion in 1997, the balance of trade in capital goods in the United States is now in deficit of about the same amount. One reason could be 'a permanent change in the international supply chain for the production of capital goods, perhaps to centre on China'. See 'Breaking Up is Hard To Do: Global Co-Dependency, Collective Action, and the Challenges of Global Adjustment', *Institute of International Economics*, January 2005.

In its new Economic Survey of China released recently, the OECD expects China to surpass the United States and Germany to become the world's largest exporter by the end of the decade, accounting for ten per cent of world trade by 2010 compared with six per cent at present.¹¹ Much of these gains are expected to come from higher value items, not cheap consumer goods. Beijing has repeatedly stated its intention to create national world champions and industrial giants by focusing on innovation and science and technology. These plans have not necessarily materialised as anticipated, but they have set in motion production strategies that compete directly with western producers.

As a result of these structural shifts in world trading patterns, the potential for trade frictions and damage to the global trading system is enormous at a time when China and other emerging countries are rapidly integrating their economies into the world. Sino-American and Sino-European trade quarrels are continually simmering. Protectionist sentiment has been steadily growing particularly in the United States, and Congress is ready to slap punitive tariffs on China. A trade war would be less likely between members of the G8 or an expanded G9.

(ii) Asian regionalism

The Asian crisis of the late 1990s marked a significant watershed in intra-Asian relations. It became clear to Asians that the traditional trade-groupings that existed in the region could do little to stem the financial panic. Since then, regional trade and financial arrangements have been given high priority on political agendas. These developments are significant, not only for Asia, but also for the United States which is gradually being excluded from these new groupings. The G8 should pay heed because the combined economic clout in the region is large enough to render the major multilateral arrangements – The World Bank, IMF and the G7/G8 process – increasingly irrelevant to the region.

For almost a decade, China has been the locomotive of Asian growth, both due to its high domestic demand and growing economy, and also because of increasing vertical integration and specialisation in the

¹¹ Economic Survey of China 2005, *Organisation for Economic Co-operation and Development*.

region. Up until the 1990s, countries in the region appeared to prefer to discuss collective issues through the Asia Pacific Economic Cooperation (APEC), with the United States in dominant mode. But this situation changed in the late 1990s as a result of great dissatisfaction in Asia with the manner in which their economic difficulties were handled by the global institutions. The widespread belief at the time was that the global response precipitated the real crisis which could have been stemmed at a much earlier stage. APEC has also been perceived as a failure. Asian governments since then began to look at their own economic power and potential collectively, to stimulate growth, prevent financial crises and create new regional institutions which they could control more effectively.

A rash of free trade areas is now at various stages of negotiation involving different formulations between China, Japan and Korea, and China and ASEAN. China is playing a leading role in these formulations: just as with the EU and the United States, free trade areas are as much an economic policy tool as a foreign policy tool. Its 'peaceful rise' thesis applies as much to West as to its immediate neighbours which are gradually being persuaded of the Middle Kingdom's economic charms (and clout). China hopes that over time an 'ASEAN plus three' framework could be evolved which would include the ten ASEAN countries, plus China, Japan and South Korea. The final goal is to construct an East Asian Cooperation Entity.

China's regional ambitions do not only extend to trade – its policymakers have often indicated that it prefers regional arrangements to a global financial architecture. The economic debacles in Asia emphasised the importance of financial flows in the global economy. The launch of the euro encouraged Asians to think of an eventual Asian Currency Unit, an imitation of the European Currency Unit which was the precursor to the euro. A proposal for an Asian Monetary Fund was first mooted by Japan in the late 1990s and rebuffed by both the US and China chiefly for political reasons, but China has now warmed to the idea of an AMF. What does exist at present is the Chiang Mai Initiative, a regional financing arrangement with a sizeable fund that could be the precursor to an AMF. The idea has found favour in policy circles in Asia and even in the United States government.

It has been estimated that 'such a grouping would account for 20 per cent of global output – using market exchange rates. It would comprise close to 20 per cent of world trade. Its members would hold well over 50 per cent of international monetary reserves. It would be a major economic power on a par with the European Union and the United States (or a Free Trade of the Americas)'.¹² The Director of the Washington-based Institute for International Economics claims that these ambitions 'could alter international financial, trade, and economic architecture more fundamentally than any of the current deliberations in the International Monetary Fund, The World Trade Organisation and the G7'.

For the most part, these developments have received scant attention in the West – they are widely viewed as regional issues that have little resonance for policy in the rest of the G8 except Japan. Not much effort has gone into understanding what such a combined economic force might imply for the rest of the world. To a point this may be due to scepticism that any arrangement between Asia's great-power rivals, China and Japan, can be significant until there is a meaningful thaw in their political interaction.

Eventually, assuming that regional integration proceeds at a brisk pace, an Asian economic bloc would have significant implications for the rest of the world. These could be positive or negative – they could enhance trade with the rest of the world, or divert trade away from it towards the bloc. It raises questions about the future of international organisations such as the IMF in a three bloc world (of an East Asian Economic Community, the European Union and the proposed Free Trade Area of the Americas). Should the IMF promote regional offshoots, or should it increase Asia's, and particularly China's, role and quotas and seats on the IMF's Executive Board? Will the IMF increasingly become irrelevant, and if so, what arrangement will replace it? Will an East Asian community attempt to change the 'rules' governing globalisation, and limit – at least in the financial domain – free flows of capital? These questions need to be addressed by the G8 structure if it is to maximise the benefits of these new groupings.

¹² C. Fred Bergsten, 'Embedding Pacific Asia in the Asia Pacific: The Global Impact of an East Asian Community', Institute for International Economics, 2 September 2005.

The upcoming East Asian Summit in Malaysia expected to culminate in an East Asian Community is being taken very seriously in China. The summit includes the ASEAN countries plus China, Japan, Korea as well as Australia, New Zealand and India. This is the first time that regional arrangements are actively excluding the US. There are as yet no binding multilateral alliances in Asia but we cannot assume these will not be forthcoming. The impact of these new developments will be far reaching for the world economy, geopolitics and regional security.

Again, we need to be realistic about the political prospects for an Asia-wide economic arrangement. The fraught relations between China and Japan would need to be resolved before further integration can proceed. There is also the question of which nation plays the dominant leadership role in Asia. Authoritarian and anti-democratic China is not necessarily the natural leader of Asia but neither is an economically mature but struggling Japan. These politics were played out in the run up to the East Asian Summit in December 2005, with both countries vying for the leadership role.

It is not yet clear whether a three bloc world will emerge or whether there will be an overlapping and messy structure of bilateral trade deals and multi-country free trade areas. Politically speaking, the US government has been loath to encourage regional groupings but the current Bush administration has a much more lax approach towards non-global (bilateral, regional) arrangements. On the other hand, from the Asian perspective, countries such as Korea, Singapore and perhaps Japan may be reluctant to allow rapid regional integration without the active involvement of the United States.

The key point is that the G8 will need to formulate a clear framework and set of policies vis-à-vis regional trading arrangements and their place in the global economic order, particularly as regards the Asian economic bloc.

(iii) Financial flows

Technological changes and liberalisation have meant that by the beginning of the new millennium, world capital markets exceeded global GDP by a staggering US\$300 trillion. Greater integration of

financial markets around the world and rapid technological changes have permanently altered some of the core concepts governing relations between developed and developing countries. These held that trade linkages were the key mode of transmission between the two worlds. But increasingly financial linkages are far more important in the high octane world of global finance.

The result of these changes has been that China and the United States have become central elements in the major imbalances plaguing the world economy today, which have been the source of numerous dire warnings from organisations such as the IMF and Bank of International Settlements (BIS). The imbalance of saving and spending between the two countries is rooted in both countries' domestic policies. Thanks to its cheap currency policy China has been a key purchaser of US debt in recent years, enabling Washington to recklessly run up budget deficits without raising interest rates. US external deficits (at nearly seven per cent of GDP) have now gone beyond the point (four to five per cent) where economists, based on research on such imbalances in industrialised countries, would have expected there to be a natural reversion of course. The result, according to some economists, is the biggest bubble in human history. Only joint international action can avert a global disaster than could manifest itself in widespread recession and trade protectionism.

An added consideration is that old policy solutions in G8 countries appear to be yielding perverse results. Tried and tested methods are not working as expected due to the entry of China in the global system. The result of China's integration into the world economy and the flood of cheap goods to the West may have altered the link, for instance, between inflation and interest rates.¹³ The manifestation of this is seen in daily aspects of business and consumer life in western nations from house prices to growing private sector debt.

These new inter-linkages mean that finding a system to maintain open trading systems, while preventing destabilising flows of money, putting in place a crisis prevention mechanism and a damage limitation scheme must lie at the top of any forum of global economic

¹³ 'Traffic lights on the blink?', *The Economist*, 20 August 2005.

governance. Such a structure must include large emerging economies such as China to be effective.

(iv) Energy needs and environmental consequences

The PRC has been a net oil importer since 1993 and was the world's second largest consumer of petroleum products in 2004, having surpassed Japan for the first time in 2003. China accounts for less than ten per cent of global oil consumption, well below America's demand at 40 per cent, but the source of around one third of world oil demand growth over the past four years, Chinese oil demand is a key factor in oil markets.

While it is received wisdom in the West that Chinese growth is behind the steep rise in oil prices, Chinese analysts differ on this point. They have accused western nations, particularly the United States of pushing up prices through hoarding oil reserves. Their argument is that oil prices suffer from a sizeable 'terror premium' and 'speculation premium', neither of which originate in China's policies.¹⁴

The steep climb in oil prices could eventually have dramatic implications for economic growth around the world. The Chinese economy is much more dependent on heavy industry than the United States, so some mechanism will need to be agreed on to limit oil price rises.

Apart from oil prices, there are clear implications for the future of energy security and for potential conflict. China is rapidly expanding its ties with resource-rich states across the world in Africa, Latin America and the Middle East which often takes it into areas which are traditionally considered as American spheres of influence.

In keeping with one of the elements of the Founding Declaration of the G6 at Rambouillet in 1975, 'we shall spare no effort in order to ensure more balanced conditions and a harmonious and steady development in the world energy market', all sides should enter into a joint dialogue on this key issue. There is more potential for cooperation than might seem to be the case: for instance, creating joint reserves or oil pools.

¹⁴ 'Is China to blame for the rise in oil prices?', *China Daily*, 27 October 2005.

China's rapid growth is also making it a major polluter both at home and abroad. China is the world's biggest producer and consumer of ozone-depleting gases. Environmental experts in California predict that China could eventually account for roughly a third of the state's air pollution.¹⁵ One commentator has calculated that 'if China's 1.4 billion people were to sustain their current growth point and at some point catch up with today's US level of per capita income, and were to use similar technologies, the country's use of commercial energy and emissions of carbon dioxide would be one fifth greater than those of the entire world today'.¹⁶ Clearly, China's environmental problems, perhaps more than any other country, impact the entire world.

(v) Achievement of MDGs

Just as China's blistering growth is beginning to have perceptible impacts on the G8, it also has significant and conflicting implications for growth in developing countries, and ultimately for the achievement of the Millennium Development Goals. There is some evidence that its export-led development has displaced such activity in other countries in Asia and Africa that have also sought to produce labour intensive manufactures and compete in international markets. On the other hand, Chinese foreign investment overseas has the potential to be a positive influence on other developing countries. China is also gradually becoming an international donor, or more accurately, a provider of low-interest loans to poorer countries which make it a player on the international development scene. How the G8 engages China in this arena will influence whether they work at cross-purposes or as a combined force.

Governing the International Economy

The points made above highlight the clear need to incorporate China into any system that governs the global economy. But what would such a structure of such governance look like, and to what purpose would it be put? Through the second half of the twentieth century,

¹⁵ Jim Yardley, 'China's Next Big Boom Could be the Foul Air', *The New York Times*, 30 October 2005.

¹⁶ Peter Nolan, 'China at the Crossroads', p.29.

there was a fair degree of consensus among the major world powers about the form and scope of global economic governance, but two features of international development have weakened collective agreement on this issue: first, the rapid integration of the world's economies in the closing phase of the last century that has outpaced the ability of national governments to adequately regulate and provide a framework for global markets; and second, the increased clamour from emergent economies and non-state actors (such as civil society and NGO groups) for more representation and democracy in today's networked world. The key conundrum is how to achieve the 'impossible trinity of integration, regulation and sovereignty'.¹⁷

The Need for a New World Economic Order

'Everybody who is anybody has opined on the matter. President Clinton wants to "adapt the international financial architecture to the 21st century"; Tony Blair, Britain's prime minister, wants "a new Bretton Woods for the new millennium"; Alan Greenspan, head of America's central bank and a man not given to hyperbole, has called this once-boring subject "a cage-rattler". He, too, wants to change the "patchwork of arrangements" governing global finance".¹⁸

One reason why global economic governance has become such a recurring theme in international affairs is because it goes to the heart of debates on globalisation and its bearing on the boundary between states and markets. The integration of national economies has outpaced any development of a global polity, leaving open the question of who should govern the global economy and how should it be governed.

In 1944, the major Allied nations created a new financial architecture to revive the world economy at Bretton Woods. The key feature of this arrangement was a system of fixed exchange rates. But this system collapsed in the 1970s when pre-determined exchange rates were dismantled and the gold standard finally abandoned in entirety, although its institutions, the World Bank and IMF, have survived. Critics and criticisms of these organisations have grown, and it has

¹⁷ Global Finance Survey, *The Economist*, 30 January 1999.

¹⁸ Ibid.

become apparent that they are in dire need of reform both in terms of their structures and policy remit. With the demise of the Bretton Woods system, the G7 acquired real power but used it only intermittently.

Heightened global economic and financial inter-linkages since the 1990s have created new policy challenges particularly at times of crisis and contagion, for instance, during the wave of financial crises in the 1990s originating in Mexico, Russia and Thailand. While each of these crises was addressed on their own terms by multilateral institutions and the US Treasury, they generated widespread discussions among economists and policymakers on the need for a new global financial architecture and what form such institutions might take.

But some of the fast growing economies have only a very weak voice in the multilateral institutions. Institutions of global economic governance are increasingly accused of being unaccountable and unrepresentative in terms of constituencies both within nations and between nations. Proposals to include a wider representation have included the idea of an Economic and Social Security Council that would preside over and monitor institutions such as the IMF, World Bank, and WTO.

In many ways, revamping the global financial system is a much bigger challenge than reforming the global trading system. Trade is still a function of domestic economic policy whereas finance is virtual, borderless, and decentralised (or more specifically, centred on global financial hubs in the US, Europe, Asia). But history shows us that the breakdown of trade and commencement of war in Europe in the first half of the 20th century was preceded by a breakdown of the international monetary order.

After the series of emerging market crises in the 1990s, the G8 promised to proceed with redesigning global finance in 1998 but since then has been unable to provide appropriate leadership. It is unlikely that any durable architecture can transpire without large emerging economies – that are increasingly shifting the balance in the world economy – playing a meaningful role in the formation of the new structures. It is becoming increasingly apparent that solutions for

reforming the international financial architecture cannot exclude important emerging markets such as China, Brazil, India or South Africa.

China and Global Economic Governance

China's integration into the world adds a new dimension to the short and long term health of the global economy. Through its large and growing savings, its potential role in a reformed IMF, and its role in developing countries China's influence will be an integral part of any new arrangement that will emerge.

A political solution to an economic problem

The biggest threat the world economy faces today concerns the global imbalances of savings and investment. Industrial country share of global savings has been dropping steadily since the 1970s, accompanied by a rise in emerging markets, but this gap has become more pronounced since 1997. Particularly notable is the sharp rise in savings in China since 2000 – 'the paradox of thrift' – to nearly 50 per cent of GDP (from around 40 per cent in the 1990s). It appears to be the consequence of job insecurity and retrenchment, but also, weak financial intermediation because of the deplorable state of the banking sector. This has meant that savings are one of the few ways to finance higher investment. Many Chinese economists believe that improving the mechanism for coordinating savings and investment will reduce excess savings.

These skewed (and counterintuitive)¹⁹ trends find their manifestation in large current account deficits in the United States matched by equally large surpluses in China. Through its accumulation and vast arsenal of foreign reserves, now at US\$800 billion, China has become a significant funder of the US fiscal deficit. The US dollar has made an adjustment vis-à-vis the Euro zone, but for Asian currencies, given the limits to currency market forces, more coordinated action is urgently required. Tinkering at the edges, with textile quotas for instance, will barely make a dent in this situation.

¹⁹ Economic theory and historical patterns suggest that capital always flows from rich to poor countries. The current pattern represents an anomaly.

Economists now claim that a new *de facto* Bretton Woods system has emerged, with United States at the centre of it, and Asian countries most notably China at the periphery, but with no formal arrangements, agreements or institutions to police or manage it.²⁰ In contrast, in the 1980s when major imbalances built up, the countries involved – in this case Japan and the United States – were able to reach agreements such as the Plaza (1985) and Louvre (1987) accords signed by finance ministers of the then G5 and G6 respectively.

What is interesting in the period from 1997 onwards, is that US deficits are matched by surpluses in oil producing economies as well as emerging markets such as China, as opposed to a few countries in the industrialised world (Japan and Europe) as was the situation in the 1980s. There could be no more graphic illustration of the changing global economy, a problem that will require entrenched positions to be broken up in a number of countries that are now not members of the G8, most notably China.

But what has actually happened is that in July 2005, China ended the 'will they, won't they' speculation with a fudge designed to ruffle feathers across the Pacific. China moved to stave off the Schumer-Graham sponsored China Currency Act in US Congress which would have branded China a currency manipulator.²¹ As globalisation has begun to affect the ordinary American, so Congress has become more prone to populist influences on international economic policy. No one expects the mini-revaluation of the renminbi (two per cent) to make any real difference to the global imbalances, unless the wider problem is addressed in a coordinated manner. No observer is sanguine about the situation as it stands at present

China is loath to be seen to be responding to American pressure on the issue. In October 2005, Jin Renquing, China's finance minister commented that 'using revaluation of the renminbi to resolve global

²⁰ Michael P. Dooley, David Folkerts-Landau, and Peter Garber, 'An Essay on the Revived Bretton Woods System', NBER Working Paper 9971, Cambridge, MA, National Bureau of Economic Research, September 2003.

²¹ The Act proposed a 27.5 per cent revaluation of the yuan.

imbalances, particularly the imbalances of certain countries, is impossible and also unnecessary'.

There has nonetheless been a subtle shift in US policy more recently as the 'good cop' – the US Treasury – has changed gear by broadening the agenda beyond the yuan to focus on the main underlying causes of China's growing current account surplus, focusing on its exceptionally high savings rate. But it is not clear to what extent this new policy is working. In its November 2005 report to Congress the US-China Economic and Security Review Commission stated that, 'in the absence of a coherent articulation of US policy toward China by the Administration, Congress is filling the vacuum'.²² A politically damaged White House is unlikely to be able to fend off the growing demands for trade retaliation for much longer. The pressure for consensual, coordinated global action is growing by the day. Neither is it clear to what extent a politically weakened White House can stave off demands for tough punitive legislation especially on Chinese trade and currency policy.

In the longer run, one of the big issues regarding consensus within an expanded G9 or G10 would be one of worldview or belief systems. This is where including China will provide the biggest challenge. This is not about some simple binary distinction between authoritarian and democratic rule, but about assumptions underpinning globalisation and indeed how the process should be governed.

A big challenge is that China's interests are diametrically opposed to those of the G8 in many key respects. Although it is the new growth locomotive, in terms of international history it is probably more appropriate to compare it with the Meiji period in Japan in the 19th century or Britain in the 18th and 19th centuries. China sits uncomfortably between the developed and developing worlds; for the purposes of its own development its officials believe it should be given leeway to have an undervalued currency, weak intellectual property

²² Report to Congress of the US-China Economic and Security Review Commission, November 2005, www.uscc.gov/annual_report/2005.

rules, or relatively lax environmental standards. These differences need to be negotiated, rather than sidestepped.

Washington Consensus or Beijing Consensus

If and when China is incorporated into the G7 core group of finance ministers or the G8, its quota in the IMF is likely to rise significantly. Quotas in the Fund determine a country's voting power, and are calculated according to a combination of a country's GDP, international reserves and external payments.²³ In reality, the formula has rarely been mechanically applied, giving a disproportionately large voice to the United States and Europe. Influential voices, including those in the Executive Board of the IMF, have called for quotas to be calculated on a purchasing power parity (PPP) basis and if such a calculation were applied to China, its quota would rise by over 50 per cent.

As the quotas, voting power and representation of emerging economies such as China in the IMF rises, so will pressures for policy ideas, conditionality and alternative concepts for the use of Fund resources. This generates the potential for contention with established voices in the major multilateral institutions.

A decade ago, such conflicts of ideas arose out of Japan's growing influence in the IMF which by 1992 had become the second largest shareholder in the organisation after the United States. Along with this came pressures from Japan to incorporate more interventionist, state-led models of development than the structural adjustment models preferred in mainstream thinking. The divergence of views resulted in an internal political struggle within the World Bank and in the high profile report 'The East Asian Miracle',²⁴ from which the dominant paradigm emerged intact with few concessions to the Japanese.

²³ The formulas for calculation of quotas in the IMF are explained in 'Financial Organisation and Operations of the IMF', No.45, Sixth Edition, International Monetary Fund 2001. Quota formulas have evolved since the original Bretton Woods formulation in 1944 but there is a significant difference in actual and calculated quota shares for most countries.

²⁴ For a detailed account of the discord, see Robert Wade, 'Japan, The World Bank, and the Art of Paradigm Maintenance: The East Asian Miracle in Political Perspective', *New Left Review*, 217, May/June 1996.

As China's influence in multilateral institutions increases, so too is it likely that Chinese ideas will jostle for recognition and incorporation in global governance. But what are these ideas? As a paradigm, the idea of the Beijing Consensus (BJC) is in its infancy.²⁵ This influential tract about Beijing's new blueprint for growth and power suggests that the new Consensus contains 'a development model where sustainability and equality become first considerations, not luxuries'. It tells us about ideas and outcomes, but little about the route to the final stage.

In that sense, the BJC is not yet an established paradigm. The Chinese development strategy has been based in large part on incremental change, on trial and error, rather than a grand strategy that so many *post hoc* narratives on the Chinese economy would suggest. It is only defined with reference to the Washington Consensus – a 'what *not* to do' guide some would argue – rather than a model with neat prescriptions that can be easily emulated by countries around the world. Chinese economists are careful to explain that there is no fixed economic 'model' that can be copied by smaller economies, but that the strategy is based on the idea of policy space and innovations built on historic institutions in China.

Over a period of time, nevertheless, such ideas could find their way into systemic thinking and policies. To date though, China has kept a low profile in multilateral institutions such as the World Bank, IMF and WTO. As suggested by one commentator, China is a 'system maintainer' rather than a 'system transformer'.²⁶ Although it joined the G20, which stood up to the United States and the European Union at the Cancun Ministerial of the WTO in 2003, the initiative largely came from Brazil and India. Mao once proclaimed that 'China would forever belong to the third world', but that emotional attachment may be shifting somewhat. To date though, China has not staked a position in developed or developing country categories, instead opting to serve as a bridge between the two, in the process leveraging the best possible

²⁵ Joshua Cooper Ramo, 'The Beijing Consensus', May 2004, The Foreign Policy Centre.

²⁶ Elizabeth Economy, Michel Oksenberg, 'China joins the World: Progress and Prospects', *Council on Foreign Relations*, 1999.

set of outcomes for its own development. This will, of course, alter as China's involvement and its internal consultative process deepens.

Expanding the G8: the inclusion of China

G9 or G20?

The Value of G9

Perhaps the most meaningful statement that can be made of the G7/G8 is that it has endured for over three decades, through the Cold War and its demise. There have been some high watermarks, but in recent years summits have been marked by pomp and communiqués.

Its origins can be traced back to 1975, when the Bretton Woods system broke down and the world was faced with the first oil price shock. While the initial focus was on coordinating macroeconomic policies, the leaders of the countries who were all Cold War allies, began to discuss security and regional political issues in the late 1970s and 1980s. The most dramatic instances of collaboration in the economic arena were the 1985 and 1987 Louvre accords discussed earlier in this pamphlet. At the time, they pulled the world back from the brink of economic disaster. More recently, the G7 was pivotal in the conclusion of the Uruguay Round and formation of the WTO.

While the actual summit of G8 leaders is marked by spectacle, the meetings of the G7 group of finance minister carries real weight in no small part because they are the controlling shareholders of multilateral bodies. The genesis of most major economic initiatives can often be traced to discussions between the G7 of Finance Ministers before they find their way into policy prescriptions or action by multilateral organisations. The big advantage of the G7 over official institutions is its spontaneity, flexibility and ability to avoid lengthy bureaucratic discussions or obstacles.

There have been a number of suggestions from commentators that would give the G7 process institutional structure and momentum. Ideas have included the formation of a G7 Secretariat and Council of Ministers composed of foreign and treasury ministers to institutionalise

the process and give it weight on an ongoing basis.²⁷ Perhaps the summits, which have for the most part turned into media circuses, could be done away with altogether.

The G8 has found it most difficult to make headway on issues where it requires the cooperation of non-member states: for instance, in 1998 the G8 stated its aim to 'reform the global financial architecture', but few new initiatives have been forthcoming. Similarly, trade talks have stalled on north-south differences.

This is why the case for incorporating China and other large emerging economies is particularly strong. The risk is of course, that expansion of the G8 will make it more difficult to arrive at a collective stance on some topics. Sensitivities and rigid stances can also make it harder to achieve consensus or even openly discuss issues. It is, for instance, believed that China's attendance at Gleneagles was made easier by assurances from the British that the currency issue would not be raised. If the G8 is to float genuinely new and important initiatives, thorny issues will need to be tackled upfront.

Is G20 the way forward?

The G20, consisting of the then G7 as well as large emerging economies, was initiated in 1999 to deepen the discussions on the world economy. Discussions with Chinese economists suggest that they view the G20 as the optimal basis for the future of global economic governance. To date, however, it is not clear at all that the G20 has floated any new initiatives or ideas since its inception. Its most significant limitation appears to be that it lacks a power structure – unlike the G7.

One problem with having a greater number of countries is that consensus in large groups may be difficult to come by, and could result in splintering into antagonistic groups or camps. Indeed, there may be

²⁷ John Ikenberry, 'Salvaging the G7', *Foreign Affairs*, vol. 72 (Spring), 1993, pp. 132-139.

a real trade-off between having efficient and effective multilateral institutions, and global democracy.

The G8 Perspective on China

In the words of one commentator:

In the aftermath of previous dramatic upheavals in the international system – the Napoleonic wars and the two world wars – statesmen were forced to confront issues of global architecture. As before, the imperative is not simply to design institutions to prevent war or manage exchange rates but to find ways to harness the collective power of the major states to address broader global problems. If the claims of liberal democratic exceptionalism means anything, it is that these nations are embedded in a larger system of relations that links them all...In a profound sense they form a civilisation.²⁸

Virtually all the G8 countries in the past six years have floated the idea of incorporating China in the club in some capacity if not as a full member. The idea was first advanced by German Chancellor Gerhard Schroeder in 1999, and was looked upon favourably by the Canadians and the British. Former US President Clinton was reported to be amenable to the suggestion, although the Bush administration is not ready to make such overtures yet. Japan has been much more cautious. At the Gleneagles Summit on 6-8 July this year, Prime Minister Tony Blair called for the enlargement of the G8 to include India and China, although he acknowledged that there would be opposition from within the club.

As is well known, the G8 is an informal club that is not governed by rules or regulations, or bound by a formal charter. If US Secretary of State Condoleezza Rice's recent description of the G8 as 'a group of democracies...fully committed to free market principles, free trade, rule of law' encapsulates its basic tenets, then China barely scores on one of the points. China's entry to the G8 would present a much greater challenge to the club even than Russia (which became a fully participating member in 2002): it has not yet made the transition to democracy, and the development of the rule of law is still in its early stages.

²⁸ Ibid.

G8 enthusiasm for incorporating China has been based mostly on its growing economic prowess. It is widely recognised that its value system and political configuration can be a stumbling block to full membership.

Clash of civilizations?

In his writings on foreign policy in the 21st century, senior British diplomat Robert Cooper distinguishes between 'post-modern' states, traditional 'modern' states and 'pre-modern' fragile and failing states.²⁹ He puts China (and India) in the second category – countries that are not yet able to play a decisive role in shaping the process of globalisation – where national efforts are still directed towards concerns of sovereignty.

But these national efforts increasingly, in today's globalised age, make the actions of 'modern' states globally relevant. While invasion and occupation of lawless states may be justified in Cooper's new world, the G8 will need to craft an appropriate form of engagement with these newly emergent powers.

As mentioned earlier, China has been a 'system maintainer' when it comes to its role in international organisations. But what is becoming increasingly apparent is that the PRC operates internationally outside the system, on its own terms of engagement.

As an example, one area that is receiving increased international attention is China's efforts to woo African countries, from the Horn to the Great Lakes. Trade growth has jumped this century, doubling in the past five years so that by the end of 2005 China was expected to become Africa's third biggest trading partner, ahead of the United Kingdom. Most of this consists of export of Chinese-made manufactures, but alongside this involvement comes all manner of technical assistance and aid. Special strategic relationships – with Sudan for instance – are buttressed by arms sales from China. On the other side of the coin are China's colossal energy needs, which bring the oil-rich countries of Africa – Angola, Nigeria and Sudan – directly in

²⁹ Mark Leonard (ed.), 'Re-ordering the World', March 2002, The Foreign Policy Centre.

Beijing's sights. The US Department of Energy forecasts that China will import nearly half its oil requirements by the end of this decade, which will cement these relationships even further.

For Western nations attempting to 'reform' Africa and instill the continent with good governance, this involvement has the potential to derail efforts to bring corrupt dictators and human rights violators to book. China's response to the renewed efforts of the West – as exemplified by the formation of NEPAD³⁰ – has been one of support, particularly in avenues for sustainable development; *but*, their energies have been directed through the China Africa Cooperation Forum thereby bypassing all the prickly issues about human rights, free press and the rule of law.

China's Perspective

China's stance is changing

At first, the Chinese leadership was lukewarm about the prospect of joining the G8, believing that joining it would not serve their national interests. It viewed the United Nations as the only international organisation with legitimacy.³¹ But recently, under the presidency of Hu Jintao, there has been a perceptible change towards the G8. The Chinese leadership has been responding positively to invitations to G8 meetings, even privately expressing disappointment that it was not invited to the United States in 2004. Joining such an exclusive forum would give China global status, signalling that it has 'arrived' on the world stage.

More broadly, China has demonstrably embraced the institutions of post-war embedded liberalism³², namely the IMF, World Bank and

³⁰ New Partnership for Africa's Development, NEPAD. The NEPAD strategic framework document arises from a mandate given to the five initiating Heads of State (Algeria, Egypt, Nigeria, Senegal, South Africa) by the Organisation of African Unity (OAU) to develop an integrated socio-economic development framework for Africa.

³¹ Yu Yongding, 'G20 and China: A Chinese Perspective', *China & World Economy*, Vol.13, No.1, 2005, pp.3-14

³² The term was coined by John Ruggie in 1983 to encapsulate a commitment to free markets tempered by broader commitments to social welfare and high employment, as distinguished from classical liberalism in the 19th century. See Ruggie, John Gerard, 'International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar

WTO, having once denigrated them. There has been a fundamental shift in Chinese International Relations thinking since the late 1980s and 1990s, with a growing recognition of global interdependence and globalisation.

China's internal developments and the world

A common assumption and a major premise of 'engagement' with China has been that the forces of economic reform and globalisation would spawn the growth of the middle class and redistribute power within the party, allowing new political forces to prevail. Many of the reforms taking place – financial sector, SOE reform, social security – are being implemented by technocrats; these changes in institutions in China are to some extent driving a wedge between party and state. The expectation in the West is that over time, this technocratic element will gain the upper hand and steer the Chinese polity towards democratic reforms. An official White House statement in 2000, soon after China's accession to the WTO, elucidates this line of thinking: 'China's accession agreement will deepen and help to lock in market reforms – and empower those in China's leadership who want their country to move further and faster towards economic freedom.'

Last year, the Chinese Academy of Social Sciences (CASS) released a report that suggested China's 'middle class' – or more appropriately, 'middle stratum' – accounted for 19 per cent of the country's 1.3 billion population in 2003. This is expected to rise to 40 per cent of the population by 2020, a figure close to the 50 per cent mark at which analysts believe that domestic politics will transform as a result. (Some Chinese economists are more circumspect, given the rise in unemployment and wrenching economic restructuring underway).

But an automatic translation to democratic politics does not follow – in other late developers such as South Korea and Taiwan, authoritarian regimes remained entrenched during the years of booming economic growth and a growing middle class. It seems dangerously naïve to expect that a growing middle class will lead to a smooth and desirable

Economic Order' in Stephen Krasner, ed., *International Regimes*, Cornell University Press, Ithaca, New York, 1983.

transition to a more pluralist political system. Eventually, there will be pressures for change but that may be decades away.

The communist party is reforming, as the Chinese leadership has come to acknowledge the existence of a rising middle class and look for ways to incorporate it into the political system. In his speech at the communist party anniversary in 2001, Jiang Zemin introduced the 'three represents' theory which was subsequently written into the party constitution, a call for new sectors of society – which was widely viewed as an appeal for 'capitalists' – to be admitted to the party. This new innovation acknowledged the growth of the private economy and the new social strata which has arisen. Since the late 1980s, there have been numerous moves towards expanding local governance and holding village elections although progress has been patchy. A Right to Information campaign is under way to root out corrupt officials, although the ultimate focus is on strengthening CCP rule. In 2003, elections for the local people's congresses were held in Shenzhen. The rule of law is being gradually introduced.

But political reform in China today, as it was in the 1980s, is focused on strengthening the party to deliver the economic reforms and also to strengthen the party's monopoly on power. What should be noted however is the quality of the new leadership in China. This 'fourth generation', which took over in 2002 are in significant ways different from the previous generation: they are younger, well educated (the vast majority of the new Politburo have university degrees), and they are civilian. They are technocrats who have been put in place to oversee China's modernisation.

But there is no denying the slow and deliberate nature of change in the Chinese system. In many ways, recent trends appear decidedly anti-democratic. Any activity that can threaten or undermine the party and government's rule will not be tolerated. The belief at top levels is reportedly that 'a spark from heaven can light up an entire plain'. The party is vulnerable to critiques of neo-liberalism and its problems – inequality, unemployment and uneven development – are seen to be increasingly manifest in China. The political model that China appears to be moving towards is a form of societal co-optation or corporatism,

analogous to political systems in other 'soft' authoritarian states in East Asia.

Conclusion

In the final analysis, it would be very difficult for the G8 to incorporate China in the near term into its ranks without a fundamental redefinition of its membership credentials. The absence of a genuinely democratic, participatory political process will alienate it from both the G8 and other large developing countries in the world detracting from China's ability to play a leadership role in global governance. When the G6 was founded in 1975, the Communiqué Declaration of Rambouillet stated that 'we came together because of shared beliefs and shared responsibilities. We are each responsible for the government of an open, democratic society, dedicated to individual liberty and social advancement.'

Paradoxically, while the G8 is of great symbolic importance, it is the financial G7 that wields influence over the global economy. Without early incorporation of China into the G7 finance group as a way-station to the G8, this powerful forum could find itself increasingly irrelevant in the economic landscape of the 21st century. The world would find itself in a perilous place with no forum in place to adequately govern an increasingly interlinked and complex global economy.

The arguments for incorporating China in the G8 are not the same as those for its most recent member, Russia. While both inclusions are premised on the concept of engagement, the China case is on the basis of its actual economic dominance and already high existing degree of integration, in many ways disproportionate for its stage in the historical economic cycle. This is not the same as influencing internal developments and exacting cooperation with western nations as the hope was with Russia, but working with China on the foundation that all parties would have too much to lose from non-cooperation.

The best way to achieve common global economic objectives would be to immediately offer the PRC membership to the financial G7, so that it could play an active role in policy setting and formation in the 21st century.

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About the China and Globalisation Project

The FPC's China project was launched with a series of seminars held at Downing Street, HM Treasury, Parliament and the Guildhall in May 2004. The Downing St Seminar was attended by the Chinese Premier Wen Jiabao and Prime Minister Tony Blair, and leading business and government figures from the UK. The launch included release of *The Beijing Consensus*, by Joshua Ramo, a publication that has since been translated and circulated to China's leaders. The launch saw the establishment of a formal partnership with the Chinese Academy of Social Sciences (CASS).

The FPC's China project aims to engage a broader group of actors with emerging new thinking on the social and economic consequences for China of globalisation and the impact of the rising Chinese economy on the future of globalisation. The China project will take Chinese perspectives as its departure point, focusing on three principal areas:

- ❑ how China's government, interest groups and diverse communities see their values and how they project these values to the world;
- ❑ outside attempts to understand and engage with the values of the Chinese government, leading interest groups and diverse communities; and
- ❑ the role of these diverse, often competing, Chinese actors in globalisation and global trends.

The 'China and Globalisation' project aims to penetrate beyond broad generalisations about China as some hypothesised monolithic actor yet to have its significant impact on global order. The programme will examine a variety of new issues and cutting edge ideas arising from the huge influence that the wealthier China and its diverse interest groups and communities are already having, both internally and externally on: energy and raw materials; public diplomacy; security and international order; development and governance; technology; and finance and the international economic order.