

Beijing ready to 'China-ise' the West

Third option for East-West relations besides US protectionism and European capitulation

by Mojmir Hampl in Prague

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The West is slowly getting over the idea that China will ultimately 'westernise', that it will head, albeit in small steps, towards a liberal open society, economic liberalisation and the rule of law. The illusion that it is only a matter of time before the population's rising wealth will deprive the Chinese Communist Party of the power it wields is dissipating. Xi Jinping has turned himself from a mere president to a perpetual 'emperor' with an indefinite mandate.

China is enjoying growing wealth because the authorities have rightly set loose beneficial market forces. Many western firms and investors have profited from this, and many more crave China's custom. This means Beijing can now take the route of 'China-ising' the West. Unlike Russia, which is militarily strong but economically weak, China understands that whereas armaments can be deployed only occasionally and with great difficulty as a means of exerting pressure and furthering its interests, money and investment can be used more tactically and almost without limits. That is why Beijing is so interested in promoting its key economic interests, such as wider use of the renminbi.

China is a world power, but its currency is nearly insignificant in the global economy. The dollar and other Anglo-Saxon currencies still make up more than two-thirds of all foreign exchange reserves, even though the countries from which they come represent just 6% of the global population. The renminbi accounts for a ridiculously low 2%-3% of foreign reserves, and its share of global payments lags far behind what China's economic power might imply.

The Chinese currency is not fully convertible, cannot be used freely like other currencies, and is subject to unpredictable central management. However, liberalisation is gradually proceeding in this area as well. There are no longer mandatory quotas from the People's Bank of China for those who want to invest into mainland China with the renminbi. Including some debt securities into standard global bond indices has helped. But some capital controls remain, which makes planning exits from the market complex, and the renminbi cannot be traded offshore like other reserve currencies. There is no standard spot market or International Swaps and Derivatives Association documentation available in English.

Renminbi internationalisation cannot be achieved through the power of market forces alone, so Beijing has promoted the currency through other means. Promises of further liberalisation meant the renminbi was included in 2016 in the special drawing right – the International Monetary Fund reserve asset made up of a basket of currencies – despite China's currency not being freely usable or fully convertible. Beijing is incentivising governments and central banks to buy renminbi. Many western nations (among them Germany, Austria and France, as well as the European Central Bank) are doing so. In most cases they are not making full-blown investments, but rather are 'testing' (a couple hundred million euros or so) and preparing for the future. Quite why they would do that is unclear: either the renminbi will one day be a fully fledged, fully convertible international currency, in which case these institutions will be able to buy it at any time without preparing, or it won't, in which case it makes no sense ever to buy it. Yet even such 'testing' is of symbolic value to Beijing.

One person who senses intuitively that China is a rival to the West is President Donald Trump. As ever, though, he is acting ham-fistedly, failing to get to the heart of the matter and merely venting his 21st century mercantilism. As with Iran, it seems he wants simply to do the opposite of former President Barack Obama. As concerns the renminbi, Trump's approach paradoxically means that his wish to make a 'big new trade deal' with China might mean he will need to halt, or at least modify, the internationalisation of the renminbi, which had been supported so enthusiastically by the West during Obama's presidency. That is because a fully convertible and freely traded renminbi based on autonomous Chinese monetary policy might lead not just to a currency that gradually strengthens over time (something the West has longed for), but one which can also depreciate, as normal currencies do. Trump will be loath to accept it. He basically demands of the Chinese authorities that they ensure a strong renminbi (against the dollar) no matter what, as this makes US exports more competitive against the Chinese.

Compounding the confusion caused by Trump is the fact that the rest of the West has not adopted a general strategy for dealing with the new realities of China. In practice, there are three options. First, the West could fence itself off, at the expense of its own wealth. This is Trump's protectionism. Second, it could yield to Beijing and allow China to occupy increasingly dominant positions in the global economy and world politics. That is what some in Europe are already tending to do. The third option is to compete and to realise that in economics no peak is ever fixed and final. You can always climb higher and escape the competition if you have the will and the industry. In the story of the West and China, no one has yet proffered that option.

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