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ISSUE BRIEF

Trade and Financial Fragmentation:

New Challenges to Global Stability

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INTRODUCTION

The Scowcroft Center for Strategy and Security works to develop sustainable, nonpartisan strategies to address the most important security challenges facing the United States and the world. The Center honors General Brent Scowcroft's legacy of service and embodies his ethos of nonpartisan commitment to the cause of security, support for US leadership in cooperation with allies and partners, and dedication to the mentorship of the next generation of leaders.

There is greater uncertainty today about the future of global trade than at any time since the post-World War II trading system was created seven decades ago. This was true before the COVID-19 pandemic froze much of the world economy; the health crisis has added a new layer of uncertainty. We are at a historic inflection point: the global trade regime urgently needs renovation and updating to meet new challenges, yet it is fraying and fragmenting. Technology, geo-economics, and discordant national policies are mutually disruptive forces that are driving change and unprecedented volatility. This is the result of an intersection of several near and long-term trends—most prominently, China's rapid economic rise—that have highlighted a broad diffusion of global wealth and power from the West to the East and South. This long-term trend is reordering trade and investment patterns, changing the dynamics of globalization. Meanwhile, the political and economic fallout from the 2008 financial crisis and Great Recession has fostered an economic landscape marked by growing populist nationalism, US retreat from free trade to managed trade (e.g., tariffs/quotas), diminished global capital flows, and slower growth. The International Monetary Fund (IMF), which had in January projected global growth of 3.3 percent for 2020, revised its prediction

Over the course of two years with the support of the Carnegie Corporation of New York, the Atlantic Council's Foresight, Strategy and Risks Initiative Director, Mathew Burrows and Senior Fellow, Robert Manning have been developing a set of "rules of the road" for ensuring cooperation in areas of mutual great power interest. This report along with a companion one on emerging technologies are the first fruits of that effort to probe the challenges to global stability and to recommend solutions boosting global cooperation. This and the companion report have been informed by multiple exchanges with global experts from the United States, Europe, Russia, India, and China. Additionally, the webpage we are planning will include other related work and, over time, future work on the topic of multilateral cooperation, which we believe is the only way forward to ensure peace and prosperity.

in the wake of the pandemic to, perhaps optimistically, -3 percent[1] Most dramatically, new waves of technological change and digitization are transforming trade and posing challenges to the global trade system.

Perhaps as much as any single trend, the consequences of the deepening economic clash between the United States and China—the world's two largest trading powers which together account for some 45 percent of global trade—will be a major factor not only in increasingly decoupled US-China economic ties, but also in reshaping global and regional supply chains, the regional trade architecture, and, not least, the future of the World Trade Organization (WTO). US firms moving production out of China, US bans on technology trade and investment in China, and a bilateral enforcement mechanism will have a disruptive impact on global trade and its governance. A US technology boycott of China will almost certainly accelerate China's "Made in China 2025" effort to move up the value chain and localize technology supply chains. This would bifurcate trade and investment patterns. Much depends on the duration and eventual outcome of this unprecedented trade and technology war. From its onset seventy years ago in the aftermath of World War II, the global trading system—the General Agreement on Tariffs and Trade (GATT) and its successor, the WTO—has been a key driver of economic growth and prosperity. World trade grew almost ninefold, from $2.05 trillion in 1980 to $17.43 trillion by 2017. Global merchandise trade reached $19.67 trillion in 2018. From 2005 to 2017,[2] trade in services grew at 5.4 percent annually, faster than merchandise trade, rising to $13.3 trillion in 2017.[3] The economic damage inflicted by the COVID-19 pandemic, which was still unfolding at the time of writing, has led the WTO to forecast a 13 percent to 32 percent reduction in global trade for 2020.[4] In any case, stagnant middle-class wages and waves of immigrants escaping conflict and chaos in the Middle East helped create a populist backlash in Europe and the United States with regard to free trade, which continues to percolate. China's unanticipated sixteenfold growth since joining the WTO in 2001 fueled this backlash. China's rise reflects a broader shift in global production and consumption, and the rise of an increasingly non-Western global middle class estimated at 3.8 billion people—nearly half of the world's population.[5] This trend is illustrated by the shift in the geography of demand—advanced economies' exports to developing countries grew from $1.2 trillion in 1995 to $4.2 trillion in 2017.[6]

Some argue that a process of deglobalization is underway.[7] Brexit, for example, marks the first time since World War II that a nation has left a free trade agreement. US President Donald J. Trump withdrew from the Trans-Pacific Partnership (TPP), rejected the North American Free Trade Agreement (NAFTA) and the United States-Korea Free Trade Agreement (KORUS), renegotiated both NAFTA and KORUS, and has imposed tariffs on US allies under a dubious "national security" rationale. Since the collapse of the Doha Development Round in 2007, no effort has been made toward a new comprehensive WTO global accord. Instead, consensus among major trading states that the WTO needs to be reformed has led to efforts to update and modernize that institution. Trump's widespread imposition of tariffs on major trading partners and denigration of multilateral institutions, and creeping trade-restrictive measures worldwide—more than seven thousand adopted since 2008—are additional factors on which the future of the global trading system will turn.[8]

But a larger body of evidence suggests countertrends—more a transition in the patterns and character of globalization, less a decline in interdependence than a shift toward more market-driven regionalization—evident in shorter, more local and regional global value chains and proliferating regional and intra-

1 Yen Nee Lee, "'Severe and Unprecedented': IMF Warns Asia's Economy Will Not Grow at All in 2020 Because of Coronavirus," CNBC, April 16, 2020, https://www.cnbc.com/2020/04/16/coronavirus-imf-forecasts-zero-growth-for-asia-economy-in-2020.html.

2 World Trade Organization, *World Trade Statistical Review* 2018, 2018, https://www.wto.org/english/res_e/statis_e/wts2018_e/wts2018_e.pdf.

3 World Trade Organization, *World Trade Report 2019: The Future of Services Trade 2019*, 2019, https://www.developmentaid.org/api/frontend/cms/uploadedImages/2019/10/00_wtr19_e.pdf; World Trade Organization, *World Trade*; Statista, "Trends in Global Export Volume of Trade in Goods from 1950 to 2018," https://www.statista.com/statistics/264682/worldwide-export-volume-in-the-trade-since-1950.

4 World Trade Organization, Trade set to plunge as COVID-19 pandemic upends global economy, press release, April 8, 2020, https://www.wto.org/english/news_e/pres20_e/pr855_e.htm.

5 Homi Kharas and Kristofer Hamel, "A Global Tipping Point: Half the World is Now Middle Class Or Wealthier," *Future Development,* September 27, 2018, https://www.brookings.edu/blog/future-development/2018/09/27/a-global-tipping-point-half-the-world-is-now-middle-class-or-wealthier/.

6 McKinsey Global Institute, McKinsey & Company, *Globalization in Transition: The Future of Trade and Value Chains*, January 2019, https://www.mckinsey.com/~/media/McKinsey/Featured%20Insights/Innovation/Globalization%20in%20transition%20The%20future%20of%20trade%20and%20value%20chains/MGI-Globalization-in-transition-The-future-of-trade-and-value-chains-Executive-summary.ashx.

7 Harold James, *Deglobalization As a Global Challenge, Centre for International Governance Innovation*, CIGI Papers No. 135, June 2017, https://www.cigionline.org/sites/default/files/documents/Paper%20no.135WEB_1.pdf.

8 Marc Jones, "World Has Racked Up 7,000 Protectionist Measures Since Crisis: Study," Reuters, November 14, 2017, https://www.reuters.com/article/us-global-economy-protectionism/world-has-racked-up-7000-protectionist-measures-since-crisis-study-idUSKBN1DF005.

Container barge passing by in Shanghai, China. Increasingly, the center of gravity of the global trade and financial system is shifting East, toward China, and South. Source: Markus Winkler for Unsplash

regional trade agreements. In lieu of global trade talks, regional integration continues apace led by Asia (including South Asia), whose intra-regional trade in 2016 as a percentage of total reached 58 percent, surpassing that of NAFTA's 56 percent (comprising of Canada, Mexico, and the United States), and second only to the European Union's 27 member countries at 69 percent.[9] But, more than NAFTA and EU27, Asian economic integration, driven largely by Japanese auto and electronics investment in the 1980s and 1990s, and now by China's growth, is largely market-driven amidst what is known as a "noodle bowl" of overlapping bilateral and subregional free trade agreements (FTAs) and with the Asia-Pacific only now moving to consolidate such agreements into a comprehensive regional trade accord. While there is substantial intra-regional trade and investment, these three major economic clusters reflect the geographic concentration of world trade.

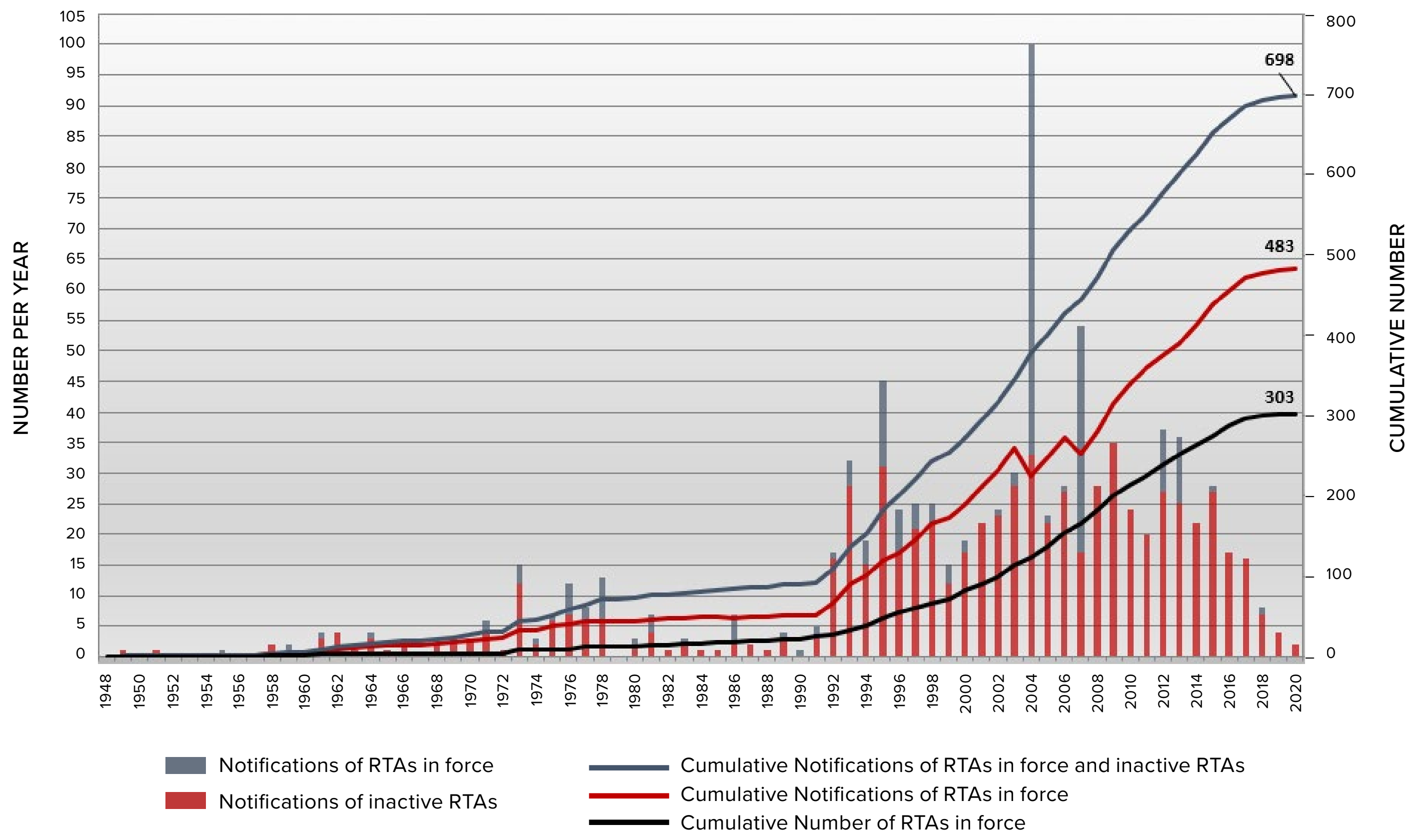
Another indicator of change rather than deglobalization is that despite profound policy uncertainties, global trade, prior to the coronavirus-induced economic recession, had continued to grow at a faster pace than global annual economic growth.[10] This buoyancy is a result of several factors, most prominently digitization, which has significantly lowered transaction costs, offsetting tariffs and accelerated still poorly measured trade in services and a growing role of the knowledge economy. This has facilitated the growth of global demand in developing nations—South-South trade—along with more regionalized supply chains. China's Belt and Road Initiative (BRI), a massive infrastructure plan to facilitate Eurasian connectivity, is another driver. China has, to date, invested $257 billion in BRI construction projects totaling $432 billion.[11] This has added a new factor to ongoing patterns of trade and investment: from US and Asian manufacturing investment in Association

9 Yuwa Hedrick-Wong, "Asia's Economic Ties Strengthen Amid Gathering Global Storm," *Forbes*, September 30, 2018, https://www.forbes.com/sites/yuwahedrickwong/2018/09/30/asias-economic-integration-against-global-disintegration/#122391b14279; Asian Development Bank, Asian Economic Integration Report 2018: *Toward Optimal Provision of Regional Public Goods in Asia and the Pacific*, October 2018, https://www.adb.org/sites/default/files/publication/456491/aeir-2018.pdf.

10 United Nations Conference on Trade and Development (UNCTAD), *Key Statistics and Trends in Trade Policy 2018*, February 4, 2019, https://unctad.org/en/PublicationsLibrary/ditctab2019d1_en.pdf.

11 Cecilia Joy-Perez, *The Belt and Road Initiative Adds More Partners, But Beijing Has Fewer Dollars to Spend, China Brief, Jamestown Foundation*, Volume 19, Issue 17, https://jamestown.org/program/the-belt-and-road-initiative-adds-more-partners-but-beijing-has-fewer-dollars-to-spend/.

Figure 1. Evolution of Regional Trade Agreements in the World (1948-2020)



Note: Notifications of RTAs: goods, services & accessions to an RTA are counted separately. The cumulative lines show the number of RTAs/Notifications that were in force for a given year. The notifications of RTAs in force are shown by year of entry into force and the notifications of inactive RTAs are shown by inactive year.

Source: Regional Trade Agreements, © June 2020 World Trade Organization

of Southeast Asian Nations (ASEAN) member states to the Asia-Middle East energy nexus that is driving oil and gas demand, and China's booming trade and investment in Latin America and Africa, these new polycentric patterns of trade are altering globalization. This is also reflected in an explosion of regional trade agreements—from fifty in 1990 to more than three hundred by 2019.[12] These agreements form a sometimes confusing web of intra-regional to bilateral accords (e.g., Chile has twenty-six bilateral agreements, the United States twenty, South Korea thirty-eight, all address limited tariff and non-tariff barriers).

GLOBAL AND REGIONAL TRADE SYSTEM

Africa and Latin America are also in the process of forging regional trade agreements, though Latin American states have been more focused on pursuing numerous subregional and intra-regional accords. Over the past three decades, Africa has sprouted a host of subregional trade and customs agreements, principally reducing tariffs and facilitating customs cooperation.[13] Reliant mainly on rents from extractive industries and agricultural exports, and processing agro-industry, Africa's trade is concentrated outside the region, though intra-African trade has gradually increased from 10 percent in 1995 to 17 percent in 2017. In 2018, amidst economic uncertainty and protectionist winds, Africa launched a more ambitious, sweeping Africa

12 WTO OMC, *Regional Trade Agreements Database*, http://rtais.wto.org/UI/PublicMaintainRTAHome.aspx.

13 The Common Market for Eastern and Southern Africa (COMESA), the East African Community (EAC), the Economic Community of West African States (ECOWAS), the Southern African Development Community (SADC), the Arab Maghreb Union (UMA), and the Community of Sahel-Saharan States (CSSS).

Continental Free Trade Agreement (AfCFTA). With a potential market of nearly one billion people and a $3 trillion GDP, AfCTA, which took effect in 2019, will reduce nearly all tariffs, but also cover trade in services, investment, intellectual property rights (IPR), and competition policy.[14] AfCFTA's success will require diversification of economies, and improved governance and enforcement capacity. Key questions are whether the African market is large enough to absorb export-model industrial growth and the degree to which emerging technologies will allow Africa to leapfrog stages of development.

Latin America, whose vast majority of trade is with the United States, China, and the EU, has a similarly small amount of intra-regional trade (17%) as Africa and lags on regional integration, with mainly subregional FTAs. The largest grouping is MERCOSUR (Argentina, Brazil, Paraguay, and Uruguay), which has eliminated most tariffs and adopted common external tariffs on imports outside the group. The combined GDP of MERCOSUR member states is $2.9 trillion. The second-largest grouping is the Pacific Alliance (Chile, Colombia, Mexico, and Peru), which has a combined GDP of $1.8 trillion. The Pacific Alliance has eliminated 92 percent of tariffs and is looking to sign FTAs with Asia-Pacific economies. The other subregional agreements are the Central America-Dominican Republic Free Trade Agreement (CAFTA-DR) and CARICOM, a common market comprising twenty Caribbean island states. There is an ongoing discussion within the region about establishing a Latin America-wide FTA. The Inter-American Development Bank (IDB) says such an FTA would increase the region's economy by $11 billion.[15]

But Latin America exemplifies another trend: growing intra-regional trade accords, hedging against US economic nationalism and global uncertainty. Chile, Mexico, and Peru joined the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which evolved from the TPP. Beyond Latin America, the EU-Japan Economic Partnership Agreement—an FTA between the world's largest and fifth-largest economies, respectively—is the most consequential intra-regional accord. The EU has also been aggressively pursuing FTAs with Australia, Canada, MERCOSUR, Mexico, Singapore, Turkey, Vietnam, and other nations.[16]

CPTPP and RCEP

Both Europe and Latin America are looking at the Asia-Pacific, a key driver of global growth, to expand trade and investment. Japanese Prime Minister Shinzo Abe has assumed a leadership role on this issue after Trump pulled the United States out of the TPP in January 2017. The TPP, pursued by the administrations of both George W. Bush and Barack Obama, was viewed as a pillar of US strategy in the Asia-Pacific. Trump's rejection of it appeared to be an act of strategic incoherence and a product of his disdain for existing agreements. It was particularly odd from a geo-economic perspective as China is now the largest trading partner of every US ally and security partner in the Asia-Pacific.

Well before Trump rejected the TPP, Abe demonstrated that upholding and updating the rules-based international order was a centerpiece of Japan's foreign policy strategy.[17] As such, his proactive effort to encourage the remaining members of the TPP (eleven, including Japan) to move ahead after the US withdrawal was unsurprising. The CPTPP, which took effect in January 2019, is one of the largest existing FTAs, representing about 13.5 percent of global GDP. [With US participation, the TPP would have represented nearly 40 percent of the global GDP.] The underlying political logic was that the TPP would set high standards that China would eventually need to adopt or lose markets.[18] Although Japan has sought to persuade the United States to reconsider its opposition to the TPP, it has thus far been unsuccessful. For Japan, reinforcing the US-Japan alliance and global partnership is an important part of its overall national strategy.

The CPTPP and its regional complement and perhaps competitor, the Regional Comprehensive Economic Partnership (RCEP), is one of most consequential of the proliferating FTAs, driven to some degree by Asia-centered global supply chains. ASEAN has played a central role in the existing regional FTAs and in those currently under negotiation, which have grown from six in 1991 to 303 in force in 2020. RCEP, driven by ASEAN, embraced by China, and complementary to, and in some respects a competitor of, the CPTPP, is currently bogged down in slow-moving negotiations and is of lower quality in

14 Vera Songwe, *Intra-African Trade: A Path to Economic Diversification and Inclusion, Brookings Institution*, January 11, 2019, https://www.brookings.edu/research/intra-african-trade-a-path-to-economic-diversification-and-inclusion/.

15 IDB (Inter-American Development Bank), Latin America and Caribbean single free trade agreement would reap $11 billion windfall, IDB study shows, press release, May 29, 2018, https://www.iadb.org/en/news/latin-america-and-caribbean-single-free-trade-agreement-would-reap-11-billion-windfall-idb.

16 European Council, "EU Trade Agreements," n.d., https://www.consilium.europa.eu/en/policies/trade-policy/trade-agreements/.

17 Cabinet Secretariat of Japan, "National Security Strategy," December 17, 2013, https://www.cas.go.jp/jp/siryou/131217anzenhoshou/nss-e.pdf.

18 Office of the Chief Economist, Global Affairs Canada, Government of Canada, "Economic Impact of Canada's Participation in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership," last modified February 20, 2018, http://international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/cptpp-ptpgp/impact-repercussions.aspx?lang=eng.

terms of standards and non-tariff issues when compared with the CPTPP. It is part of an effort to untangle the overlapping and confusing welter of bilateral FTAs—the Asian "noodle bowl."[19]

The CPTPP is a somewhat abridged version of the TPP. Twenty-two provisions from the original TPP agreement relating to intellectual property, investment, dispute settlements, new medicine and biologics, and endangered species were suspended under the CPTPP. The United States relentlessly pressed for each of these provisions prior to its withdrawal from the TPP. Other members of the TPP had readily accepted the US position and were willing to forgo their interests in favor of greater access to the US market. Once the United States withdrew from the TPP, rather than amending the agreement, Japan carefully sought to suspend provisions in the same areas that Washington had pushed for, simultaneously keeping the original agreement on the table but also creating a door through which the United States could rejoin the partnership in the future. Particularly sensitive issues, such as Malaysian concerns regarding state-owned enterprises' (SOEs') commitments and Brunei's regarding coal-related services, were also suspended. Issues like Vietnam's concerns about labor commitments and Canada's trepidations about local cultural content were addressed through side letters.

Even absent these obligations, the CPTPP is still pioneering lofty standards for multilateral FTAs. Chapters on SOEs, government procurement, and e-commerce remain unaltered from the original agreement. Modeling by the Peterson Institute for International Economics (PIIE) projects that CPTPP countries would gain $147 billion by 2030. In contrast, PIIE's simulation projected $492 billion in global income benefits if the United States had remained party to the TPP. No CPTPP nation gains from the absence of the United States, but the United States itself suffers the biggest net loss: the US economy goes from a projected gain of $131 billion from TPP-12 to a $2 billion loss as an outsider looking in on TPP-11.[20]

While CPTPP nations have the same access to US markets as they did before the agreement, the United States has lost the preferential treatment it would have had had it remained in the agreement. US agricultural exporters and exporters of US-based services are losing out on expanded access to Asian markets. For example, CPTPP member Australia, one of the United States' main agricultural export competitors, is enjoying tariff reductions on beef, dairy products, cereals and grains, sheep products, seafood, and rice.[21]

In structuring the CPTPP, Abe has sought to facilitate a relatively painless US reentry. For example, the recent US-Japan bilateral trade accord, though limited in scope, adopted a number of standards (particularly, the digital accord) that are compatible with the CPTPP. This would facilitate a US entry into the CPTPP if it reversed course.[22] If the United States returns, the CPTPP could simply activate the suspended provisions. Such a move would return the text of the agreement to the original language that the United States signed, but never ratified. One concern expressed by Japanese officials is that the United States would demand revisions and/or additions, such as a section on currencies.

Whether or not the United States enters the CPTPP, there is strong interest in the region and beyond to accede to the agreement. Indonesia, the Philippines, South Korea, Taiwan, and Thailand have all indicated an interest in joining the CPTPP, as has the United Kingdom. Despite unresolved historical issues between Japan and South Korea, Seoul has the easiest path as many of the provisions of the KORUS FTA are similar to those of the CPTPP and would require less negotiation and accommodation than other countries might face. China is, of course, the enormous missing ingredient. An expansion of the CPTPP and a US return to the agreement would create a compelling economic reality that would likely lead China to eventually accede to it.

Regardless of the United States' future plans, RCEP, in which China is a leading force, is slowly moving forward. It is an outgrowth of overlapping FTAs and requires that all members have an FTA with ASEAN. However, the existing ASEAN+1 FTAs are of varying scope and quality. RCEP never included the United States. And while it did include India, New Delhi dropped out of the talks in November 2019. RCEP members account for 32 percent of global exports and 28 percent of global GDP (both dominated by China). Seven of RCEP's sixteen member states are also members of the CPTPP, a factor that may make it easier to eventually merge with the CPTPP

19 Asian Development Bank, "Asian Free Trade Agreements: Untangling the Noodle Bowl," August 8, 2013, https://www.adb.org/features/free-trade-untangling-asia-s-noodle-bowl.

20 Jeffrey J. Schott, "TPP Redux: Why the United States Is the Biggest Loser," *Trade and Investment Policy Watch*, January 23, 2018, https://www.piie.com/blogs/trade-and-investment-policy-watch/tpp-redux-why-united-states-biggest-loser.

21 Department of Foreign Affairs and Trade, Australian Government, "CPTPP Outcomes at a Glance," n.d., https://www.dfat.gov.au/trade/agreements/in-force/cptpp/outcomes-documents/Pages/cptpp-outcomes-at-a-glance.

22 Congressional Research Service, "U.S.-Japan Trade Agreement Negotiations," updated January 16, 2020, https://crsreports.congress.gov/product/pdf/IF/IF11120.

and form a larger FTA for the Asia-Pacific (FTAAP), a long-term goal currently being studied by the Asia-Pacific Economic Cooperation (APEC).

While neither as far-reaching nor with as elevated standards as the CPTPP, RCEP currently includes many of the same areas as the CPTPP, including trade in goods, trade in services, investment, economic and technical cooperation, intellectual property, competition, dispute settlement, e-commerce, and small and medium-sized enterprises (SMEs). In the past, RCEP negotiations have stalled on several occasions over market access problems. India and others had been unable to agree on tariff schedule reductions and phase-outs. New Delhi's absence may render the negotiations less problematic. RCEP also lacks agreements on IPR, digital commerce, and investment rules.

However, RCEP negotiators have reached only partial agreements on economic and technical cooperation and on SMEs. For example, China, Indonesia, and Vietnam have restrictive policies on investment in the technology sector that still need to be reconciled. In addition, under the terms of the negotiations, China, Japan, and South Korea need to complete an FTA before RCEP can move toward agreement. China's mercantilist policies (see below) make that task difficult. One source of discord is the reality that RCEP countries are much more competitive than they are complementary with regard to the structure of their economies, producing similar agricultural, textile, electronic, and other goods in the regional supply chain. In addition, many of China's fourteen FTAs, such as those it has with ASEAN and Thailand, have been at least as much political statements as they have been economic market openings.

The CPTPP's launch may leave RCEP nations feeling pressured to finalize their accord. Since January 2019, the CPTPP has, in effect, stood as the benchmark for future trade agreements in the Asia-Pacific.

One important issue for Asia-Pacific nations is the relationship between global and regional trade liberalization. The former can catalyze the latter, and the latter can impede or complicate the former. Few expect another round of WTO global trade liberalization. But efforts to liberalize certain sectors and trade processes (the Trade Facilitation Agreement, which entered into force in 2017; the Information Technology Agreement; the Trade in Services Agreement; and e-commerce talks) are likely to be the focus of the WTO. Any future where the WTO continues to play a central role in world trade is contingent upon substantive reform, including, most importantly, of what is viewed as its crown jewel—the dispute settlement system.

Consensus on a global e-commerce accord would obviate the differences between the CPTPP and RCEP, and perhaps between China, the EU, and the United States on digital issues; the CPTPP chapter on digital commerce is the first effort at establishing comprehensive rules and could well serve as a building block for new global norms. The WTO is also engaged in talks to reach a global e-commerce accord. Seventy-six nations, including China, are participating in this effort. Talks have, however, stumbled on data localization issues.[23] Alternatively, the United States could explore the possibility of direct digital commerce agreements with CPTPP members or the possibility of accession to the digital commerce chapter of the CPTPP.

Technology Trends Reshaping Trade

From the invention of the wheel, railroads, and steam power to containerization and bar codes, technology has been a great enabler of trade. While all of the abovementioned regional efforts on trade, in the context of rapid urbanization and a growing global middle class, will help shape the flows and architecture of the future of trade, the technology revolution—increasing digitization, the cloud, artificial intelligence (AI)/robotics, 3D printing, and 5G/Internet of Things (IoT)—is transforming its form and composition.

Rapid digitization has already transformed trade, lowering costs and merging the physical and the digital, though digital value and services are undervalued in trade statistics. The world is only at the initial phase of AI and the algorithm-driven economy. The US International Trade Commission (ITC) estimates that global e-commerce transactions (including e-payments, etc.) totaled $27.7 trillion in 2016, 90 percent of it business-to-business (B2B), a 44 percent increase from 2012.[24] According to the WTO, international trade costs declined by 15 percent between 1996

23 Gary Clyde Hufbauer and Zhiyao (Lucy) Lu, *Global E-Commerce Talks Stumble on Data Issues, Privacy, and More, Peterson Institute for International Economics*, Policy Brief, October 2019, https://www.piie.com/sites/default/files/documents/pb19-14.pdf.

24 United States International Trade Commission, "Global Digital Trade 1: Market Opportunities and Key Foreign Trade Restrictions," August 2017, Publication Number 4716, Investigation Number 332-561, https://www.usitc.gov/publications/332/pub4716.pdf.

and 2014.[25] Many once traded commodities—books, music, games, and newspapers—are now sold and consumed digitally (40 percent of global music sales are streaming). Internet traffic continues to advance rapidly, with 2019 traffic projected to be 64 times its 2005 volume.[26]

Moreover, new global services are being created, from online academic courses to legal aid to telemedicine. The value of trade is increasingly in software, design, and other IP rather than in goods. This reality lowers the bar of entry to global markets for startups and small and medium-sized businesses across the globe. Yet, these digitally driven trends are almost certainly positioned to further accelerate the deployment of 5G wireless technology over the coming five to six years. This technology will be up to 100 times faster than current 4G broadband and enable the IoT and connections of billions of sensors and devices. In addition, 3D printing, which is still a niche technology, is expected to grow exponentially over the next two decades, again turning goods, in effect, into services as computer-aided designs are downloaded and the product manufactured at the point of consumption. Trade in services comprises about 23 percent of global trade and is projected to grow 60 percent faster than trade in goods, according to McKinsey & Company. Trade statistics do not take into account cross-border free digital services—Google, email, videoconferencing, and social media—which by some estimates add up to $8.3 trillion in value annually.[27] Moreover, McKinsey estimates that the deployment of 5G wireless technology and the IoT it will enable over the coming decade could be worth up to $11.1 trillion by 2025.[28]

Internet Balkanization?

The digital economy, now a near-mature technological sector, is a prime example of how even established, if fast changing, technologies can race well ahead of governance. By some estimates, the global data flows grew forty-five times from 2005 to 2014, exponentially faster than flows in trade or finance.[29] The US Department of Commerce found that in 2014, more than half of US trade in services was digitally delivered. A report by Japan's Ministry of Economy, Trade and Industry (METI) estimates that 50-56 percent of all trade in services is ICT-enabled.[30] Digital commerce already accounts for roughly 20 percent of global trade and is projected to increase to 25 percent by 2025.[31] This percentage of total trade is likely to accelerate by an order of magnitude over the coming decade. Consider the explosion of e-payments, for everything from ridesharing to food deliveries, to the coming impact of 3D printing.[32] Global mobile data traffic is also projected to increase sevenfold from 2017-22.[33]

Yet, there are only partial and incomplete rules for e-commerce, varying and contradictory from one regional and/or bilateral trade accord to the other, and a growing risk of fragmented digital regimes and a Balkanization of the Internet. Moreover, the overarching governance of use of software codes, data sharing, and/or commercialization of private content, storage of data, and where to draw the line on privacy all lack any globally agreed norms or minimal standards. An additional layer of concern is the explosion of social media with a widening variety of nefarious, sometimes lethal, consequences.

25 World Trade Organization, "World Trade Report 2018," 2018, https://www.wto.org/english/res_e/publications_e/world_trade_report18_e.pdf.

26 Cisco, "Cisco Annual Internet Report (2018-2023)," White Paper, updated March 9, 2020, https://www.cisco.com/c/en/us/solutions/service-provider/visual-networking-index-vni/index.html#~complete-forecast.

27 McKinsey Global Institute, *Globalization*.

28 McKinsey Global Institute, McKinsey & Company, "The Internet of Things: Mapping the Value Beyond the Hype," June 2015, https://www.mckinsey.com/~/media/McKinsey/Industries/Technology%20Media%20and%20Telecommunications/High%20Tech/Our%20Insights/The%20Internet%20of%20Things%20The%20value%20of%20digitizing%20the%20physical%20world/Unlocking_the_potential_of_the_Internet_of_Things_Executive_summary.ashx.

29 Rachel F. Fefer, Shayerah Ilias Akhtar, and Wayne M. Morrison, "Digital Trade and U.S. Trade Policy," Congressional Research Service, Summary, June 6, 2017, https://fas.org/sgp/crs/misc/R44565.pdf; James Manyika et al., "Digital Globalization: The New Era of Global Flows," McKinsey Global Institute, March 2016, https://www.mckinsey.com/~/media/McKinsey/Business%20Functions/McKinsey%20Digital/Our%20Insights/Digital%20globalization%20The%20new%20era%20of%20global%20flows/MGI-Digital-globalization-Executive-summary.ashx.

30 Hosuk Lee-Makiyama, *Expanding Digital Protectionism & Impact on Business, European Centre for International Political Economy*, n.d., https://ecipe.org/wp-content/uploads/2017/07/ECIPE-for-METI-JETRO-3.pdf.

31 Manyika et al., "Digital Globalization." See also "Retail e-Commerce Sales in the United States from 2016 to 2022 (in Million US Dollars)," Statista, n.d., https://www.statista.com/statistics/272391/us-retail-e-commerce-sales-forecast/.

32 Fefer, Akhtar, and Morrison, "Digital," 5-7. See also Manyika et al., "Digital Globalization."

33 CISCO, "CISCO Annual Internet Report (2018-23) White Paper," updated March 9, 2020, https://www.cisco.com/c/en/us/solutions/collateral/executive-perspectives/annual-internet-report/white-paper-c11-741490.html.

There are some global agreements and norms that cover aspects of e-commerce. WTO agreements that cover services (financial, legal, etc.) and various remedies on IP rights (e.g., trademarks, copyrights, legal protections, and remedies in the digital environment) offer only a partial framework.[34] There are numerous gaps in digital governance, as well as new challenges from evolving technologies, such as the growth of 5G/IoT, AI, the cloud, and cloud-based AI services. There is an urgent need to define rules and regulations on data services to ensure interoperability, and that fully account for the fundamental differences between e-commerce and global data services and trade as traditionally understood.[35]

At the same time, digital protectionism (e.g., localization of data requirements, forced transfer of source codes, restricting global commercial data flows, and/or cloud ownership) is rising while the Internet is becoming fragmented. Digital commerce depends on open and transparent global commercial, scientific, and academic data flows. The EU's General Data Protection Regulation (GDPR), implemented in 2018, is an important effort to create a global standard that safeguards privacy while not curbing commerce. The GDPR has gone a long way toward setting global privacy standards, which are adhered to by major international businesses. It is, however, vague in some areas and requires clarity and/or reform to compete in the world of AI algorithms.[36]

Unfortunately, the three key global actors—China, the EU, and the United States—appear to be evolving into separate and not entirely compatible digital regimes, a potential harbinger of a global economy fragmenting into competing blocs. China, Russia, and some other countries claim a doctrine of "Internet sovereignty." While there is a legitimate spectrum of varying approaches to privacy, governments controlling free flows of scientific and commercial data is contrary to the core idea behind the Internet. A number of emerging economies—for example, Brazil, India, Indonesia, and Vietnam—appear to be adopting or considering adopting restrictive digital policies. This Balkanization imperils the future of digital commerce, and hence, global digital trade and data services. The challenge is to find some minimal interoperable baseline standards and norms.

The EU and the United States differ over many tech issues. While the EU has moved ahead in developing standards and rules, the United States is just beginning to develop a comprehensive national framework, and only has a mix of national and state laws and regulations. China, the third digital superpower, is adopting policies and restrictions that are at odds with the EU and the United States. In the case of China, its "Great Firewall" is getting higher, imposing web censorship within the country and restricting the web presence of US tech firms, including Google and Facebook.[37] Such treatment has meant that, for example, Amazon has only 1.3 percent of China's e-commerce and is unable to appeal to Chinese consumers and compete with the dominant Alibaba and JD.com.[38]

In its 2019 National Trade Estimate, the US Trade Representative (USTR) highlights some of China's barriers to digital trade. It cites data localization requirements (forcing firms to keep data in the country of operations) and local computer facilities requirements, restrictions on data flows, restrictions on the use of secure lines and networks, restrictions on foreign direct investment (FDI) in cloud computing services, and "extensive blocking" of Internet content. Nevertheless, China is not alone. The report also cites data localization, limits on business data transfer, local data requirements, and Internet content restrictions in India; data localization and restrictions on Internet services investment and tariffs in Indonesia; and data localization and data flow restrictions in Vietnam and many other countries.[39]

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34 Fefer, Akhtar, and Morrison, "Digital," 13.

35 Susan Ariel Aaronson, *Data Is Different: Why the World Needs a New Approach to Governing Cross-border Data Flows, Centre for International Governance and Innovation*, CIGI Paper No. 197, November 14, 2018, https://www.cigionline.org/publications/data-different-why-world-needs-new-approach-governing-cross-border-data-flows.

36 Eline Chivot and Daniel Castro, *The EU Needs to Reform the GDPR to Remain Competitive in the Algorithmic Economy, Center for Data Innovation*, May 13, 2019, http://www2.datainnovation.org/2019-reform-the-gdpr-ai-a4.pdf.

37 Alan Beattie, "Data Protectionism: The Growing Menace to Global Business," *Financial Times*, May 13, 2018, https://www.ft.com/content/6f0f41e4-47de-11e8-8ee8-cae73aab7ccb.

38 Daniel Keyes, "Amazon is Struggling to Find Its Place in China," *Business Insider*, August 30, 2017, http://uk.businessinsider.com/amazon-is-struggling-to-find-its-place-china-2017-8?r=US&IR=T.

39 Office of the United States Trade Representative, "Fact Sheet on 2019 National Trade Estimate: Key Barriers to Digital Trade," March 2019, https://ustr.gov/about-us/policy-offices/press-office/fact-sheets/2019/march/fact-sheet-2019-national-trade-estimate.

There is a compelling need to, at the least, minimize real or potential negative consequences of this discordant situation to make compatible the digital regimes of China, the EU, and the United States with regard to e-commerce. This is a critical foundation—as the TPP tried to do, and as WTO talks on digital rules are seeking to do—without which global digital norms, and already rapidly growing digital commerce, soon to expand exponentially with the launch of 5G, IoT, and AI, risk Balkanization. The depth and scope of issues—and mutual downside risks—with regard to e-commerce, cybersecurity, and privacy led Microsoft President Brad Smith to call for a "new Digital Geneva Conference."[40] In light of the stakes and the urgency, these issues underscore a global economic diplomacy deficit—and given the current trends of fragmentation and economic nationalism, such a global effort, which has resonated in Europe, has not garnered support in the United States, China, or Russia.

The most important effort to date to create a comprehensive set of e-commerce rules and norms is reflected in the digital commerce section of the CPTPP. This section establishes nondiscriminatory treatment as the default norm. It will reduce all manner of barriers and prohibitions on digital commerce. It will, for instance, prohibit customs duties on electronic transmissions, ban data localization laws and laws that prevent FDI in clouds, and require that states proactively create consumer data protections and endorse equal Internet access (net neutrality).[41] Such provisions—some of which have been suspended in the hope of US reentry—are a useful precedent for regional and global standards. The renegotiated NAFTA (now called the United States-Mexico-Canada Agreement, USMCA) adopted many of the TPP's provisions, as has the EU-Japan Economic Partnership Agreement.

Digital commerce has been a major issue in US-China trade talks. There is pressure on China to roll back a number of provisions in its 2017 national security and cybersecurity laws.[42] China has hardened its position on control of data, which has exacerbated US-China economic friction. Abe, significantly, made global governance of data commerce a major theme of the G20 meeting in Osaka in June 2019 in an effort to boost WTO digital accord talks. The CPTPP and US-Japan trade accord discussed above could be building blocks for a global or near-global agreement.

The divergent US, EU, and Chinese digital regimes, however, cast a shadow over the entire digital universe. Enormous government and private sector resources have been dedicated to address internet vulnerabilities, in tandem with the rise of a global cybersecurity services market valued at $167 billion, and projected to expand to $248 billion or larger by 2023. Yet, despite such efforts, the dark web, cyber hacking, ransomware, and industrial cybertheft have not appreciably declined, although attribution of such misdeeds has improved dramatically. Some argue that AI's machine learning algorithms will become a tool that will help counter cybersecurity threats.[43]

Is a Rules-Based Architecture Possible?

If current trends persist, the future of an inclusive regional and/or global trade architecture is uncertain. The complexity of the US-China economic relationship, China's mercantile industrial policies, and trade differences will require sustained negotiations to reach new understandings. Many of the possibilities and parameters for both regional and global trade regimes over the coming decade will be shaped by the outcome of these negotiations.

At the global level, avoiding the worst case—a fragmented global trade regime—will require a sort of concerted US-EU-Japan-South Korea-Australia effort in the WTO and, more broadly, the G20, to push back and challenge Chinese policies that have been inconsistent with its WTO commitments and are driving efforts to radically reform the WTO. This allied cooperation should expand to building consensus on harmonizing standards and norms for 5G telecommunications, AI, CRISPR/gene editing, and other emerging technologies.

40 Sam Meredith, "Microsoft Calls for 'New Digital Geneva Convention' After Spate of High-Profile Cyberattacks," CNBC, January 26, 2018, https://www.cnbc.com/2018/01/26/microsoft-calls-for-new-digital-geneva-convention-after-spate-of-high-profile-cyberattacks.html.

41 Office of the United States Trade Representative, "Trans-Pacific Partnership Final Text: Chapter 14: Electronic Commerce," n.d., https://ustr.gov/sites/default/files/TPP-Final-Text-Electronic-Commerce.pdf. See also "The TPP's Electronic Commerce Chapter: Strategic, Political, and Legal Implications," Council on Foreign Relations, November 9, 2015, https://www.cfr.org/blog/tpps-electronic-commerce-chapter-strategic-political-and-legal-implications.

42 "China Passes New National Security Law Extending Control Over Internet," *Guardian*, July 1, 2015, https://www.theguardian.com/world/2015/jul/01/china-national-security-law-internet-regulation-cyberspace-xi-jinping; see also, Jack Wagner, "China's Cybersecurity Law, What You Need to Know," *Diplomat*, June 1, 2017, https://thediplomat.com/2017/06/chinas-cybersecurity-law-what-you-need-to-know/.

43 Martin Giles, "AI for Cybersecurity Is a Hot New Thing—and a Dangerous Gamble," *MIT Technology Review*, August 11, 2018, https://www.technologyreview.com/s/611860/ai-for-cybersecurity-is-a-hot-new-thing-and-a-dangerous-gamble/; Ryan Goosen et al., "Artificial Intelligence Is a Threat to Cybersecurity. It's Also a Solution." BCG, November 13, 2018, https://www.bcg.com/publications/2018/artificial-intelligence-threat-cybersecurity-solution.aspx.

No less urgent or important for a rules-based economic system is the future of the WTO. Its long-term challenge—how to pursue future trade liberalization as a technology revolution unfolds with a more multipolar set of stakeholders—is daunting enough. But, the WTO faces a quiet and more urgent crisis that is impacting its ability to function: uncertainty about the WTO's enforceable dispute settlement system. Detailed assessment is beyond the scope of this report, but a recent PIIE report offers an important critique and path forward.[44] Reforming WTO processes and fixing the dispute settlement system is in the common interest, otherwise there is no legitimate referee for the world trade system.

The International Monetary Fund (IMF), the World Bank, and the WTO have issued a joint paper and the EU and China have also offered white papers on how to reform the WTO.[45] The United States backed sweeping reform and has offered ideas for e-commerce reform that largely build on the provisions in the original TPP. It has also issued a lengthy critique of the WTO dispute settlement system. Beyond the current negotiations on e-commerce, all actors cite the urgent need to fix the now dysfunctional dispute settlement system, and, more broadly, as the EU paper says, "rebalance the system and level the playing field, address market access, discrimination and regulatory barriers to all sectors of the economy." There are a range of issues such as more transparency and obligatory reporting requirements (e.g., on subsidies), a strengthened trade review mechanism, and graduating "developing economies" assuming more responsibilities and obligations that are needed to level the trade playing field. This will almost certainly be a protracted process, something that should be a continuing priority in the G20. At the end of the day, success is likely to be elusive. Whether the United States and the EU can find a mutually acceptable formula to reform the WTO's dispute settlement system is an open question.

Nonetheless, the financial dimension of globalization is arguably the most impacted by the 2008 crisis. Global cross-border capital flows have dropped by 65 percent, with much of the decline resulting from a plunge in cross-border lending.[46]

INTERNATIONAL FINANCIAL SYSTEM

Status of and Challenges to the Economic Order

Unlike the global trade system, the international financial system does not as yet exhibit outward signs of fragmentation. But the dark cloud looming over the global economy, which is slowly restarting as COVID-19 recedes, is testing a global financial system, now in uncharted waters, even more than the 2008-09 Great Recession. More than two decades after the 1998-99 Asian financial crisis and a decade after the 2008-09 global financial crisis and Great Recession—events that profoundly shaped the economic policy views of world leaders and their constituents—there has been broad financial stability and modest adaptions to the changing weight of emerging actors in the Bretton Woods system. Nevertheless, even before the COVID-19 pandemic froze much of the global economy, there were concerns about the Bretton Woods system's durability and unresolved tension between global and regional financial mechanisms. The current global lockdown has already led to more than 100 nations requesting emergency assistance from the IMF.[47] How the IMF, the World Bank, and regional financial institutions address the post-COVID-19 economic challenge will determine the stability of the system. For example, some veteran financial policy advisers such as former US Treasury Secretary Lawrence H. Summers have suggested a need for global responses of similar magnitude to that the United States has taken to shore up its economy. In an opinion piece in the Washington Post, Summers and former British Prime Minister Gordon Brown suggested debt forgiveness to the poorest nations and that the IMF issue well over $1 trillion in Special Drawing Rights (SDRs) to stabilize indebted developing nations.[48] The United States, which has veto power over IMF decisions, has not acceded to any additional IMF resources.

Despite much speculation about its displacement by the RMB, euro, or the SDR basket of currencies, the US dollar's role as the major global reserve currency has, if anything, strengthened—

44 Tetyana Payosova, Gary Clyde Hufbauer, and Jeffrey J. Schott, *The Dispute Settlement Crisis in the World Trade Organization: Causes and Cures* (Washington, DC: Peterson Institute for International Economics, 2018), https://piie.com/system/files/documents/pb18-5.pdf.

45 International Monetary, World Bank, and World Trade Organization, "Reinvigorating Trade and Inclusive Growth," September 30, 2018, https://www.wto.org/english/news_e/news18_e/igo_30sep18_e.pdf; European Commission, "WTO Modernisation," Concept Paper, September 2018, http://trade.ec.europa.eu/doclib/docs/2018/september/tradoc_157331.pdf.

46 Susan Lund et al., "The New Dynamics of Financial Globalization," McKinsey Global Institute, August 2017, http://www.mckinsey.com/industries/financial-services/our-insights/the-new-dynamics-of-financial-globalization.

47 Kristalina Georgieva, "A Global Crisis Like No Other Needs a Global Response Like No Other," *IMFBlog*, April 20, 2020, https://blogs.imf.org/2020/04/20/a-global-crisis-like-no-other-needs-a-global-response-like-no-other/.

48 Gordon Brown and Lawrence H. Summers, "National Governments Have Gone Big. The IMF and World Bank Need to Do the Same," *Washington Post*, April 14, 2020, https://www.washingtonpost.com/opinions/2020/04/14/national-governments-have-gone-big-imf-world-bank-need-do-same/.

the US dollar now accounts for 62 percent of global currency reserves. Substantial structural and political impediments to the euro and/or RMB becoming competing global reserve currencies are likely to persist until 2030 or beyond. (See discussion below.)

This reality, which has enabled the United States to unilaterally impose extraterritorial sanctions with the threat of losing access to the US financial system, has alarmed many in Europe and Asia. It could lead to fragmentation if global-scale alternative forms of payment for trade and financial transactions are eventually devised. Moreover, global institutions still do not fully reflect the steadily increasing weight of emerging economies in the world economy—Asia accounts for around two-thirds of annual global growth.

At present, two key questions regarding the future governance and effectiveness of the IMF loom. One is a prospective legitimacy issue, the ability (and political will of) the United States and the EU to further adapt IMF governance to reflect the shift in the center of gravity of the global economy to the East and South. This question will almost certainly be underscored by the financial stresses from the economic crisis caused by the COVID-19 pandemic. The degree of financial stress will be driven by whether a restored economic growth momentum will be evident by 2021 or if there will be a slow, protracted recovery.

The second question is born out of the degree of frustration due largely to IMF inefficacy and mistakes during the Asian financial crisis and the contentiousness of the eurozone crisis in 2010: a need to resolve tensions and uncertainties between global and Regional Financial Arrangements (RFAs), and for a more effective crisis management framework for coordination between them. Should there be an automatic link to the IMF, what should be the basis for cooperation, or are some RFAs potential alternatives to the Fund? How the international financial institutions respond to the current crisis is likely to impact the answer to that question.

The 1997-98 Asian financial crisis brought into stark relief for the Asia-Pacific and other developing nations the problem of liquidity and restoring financial stability in times of crisis. The problem of how to effectively cooperate with RFAs was brought front and center for the IMF by the difficult experiences of the eurozone crisis, particularly because the EU was a mature RFA, closely linked to and its institutions modeled after the IMF.

In the twenty years since the Asian financial crisis, new official arrangements have been put in place globally to address the risk of financial crisis and instability. The IMF has seen its role affirmed, its governance structures reformed, and its capacity enhanced. The G20 process has added legitimacy to global economic governance. It has demonstrated effectiveness in global crisis management and has new measures aimed at fostering resilience. The IMF's global role notwithstanding, the trauma of financial shocks and lingering concerns about the terms of IMF conditionality have spurred Asian efforts to create their own financial safety nets to address balance-of-payments and short-term liquidity problems. The economic shutdown caused by the COVID-19 pandemic is posing still greater liquidity problems for many developing nations and some developed economies as well. How the IMF, World Bank/International Finance Corporation (IFC), and related institutions respond to this burgeoning debt crisis may shape the trajectory of regional financial mechanisms and their relationship with Bretton Woods institutions.

At present, most efforts to create regional shock-absorbing mechanisms are by design linked to the IMF. However, resentful of their dependence on the IMF and anxious to cordon off their respective financial systems from the next global financial crisis, Asian economic managers continue to hedge with RFAs. These arrangements are largely untested and there are questions about the adequacy of coordination with the IMF. The risk of fragmentation of the global monetary order, while not imminent, remains a latent possibility, one that is perhaps only one financial crisis away. The COVID-19-induced economic crisis could become the crisis that breaks the camel's back if most economies have not restarted by the fall of this year.

The quest for regional financial shock absorbers has spurred the development of more robust RFAs, most consequentially, with regard to magnitude and scope, in Europe, Asia, and in the BRICS countries—Brazil, Russia, India, China, and South Africa. While the Latin American Fund and Arab Monetary Fund already exist, these are orders of magnitude smaller—with less than $10 billion in reserves—and lack the resources and wherewithal to respond independently to major financial/liquidity crises. In the current fractious geopolitical environment, and as emerging economies like China and India seek weightier roles in global institutions, if another financial crisis of the magnitude of the one in 2008, as the current COVID-19-induced crisis could become, or a regional crisis that is beyond the capacity of regional mechanisms occurs the integrity of the global system could be at risk.

The specter of the IMF being superseded by regional monetary funds may appear far-fetched, but when the next financial crisis hits, region-centric trends in globalization and RFAs amid growing connectivity (e.g., BRI) could spark financial contagion that will be difficult to contain. The G20 had already

called on the IMF to strengthen the global financial safety net well before the pandemic.[49] At a virtual meeting in April, G20 finance ministers agreed to freeze all principal and interest on low-income nations' debt until the end of the year.[50] But, as discussed above, many financial experts suggest such debt will need to be forgiven, and IMF resources substantially expanded.[51] That is to say, an order of magnitude along the lines of the United States' $3 trillion financial package.

Whether this predicament is of too great a magnitude for regional mechanisms to cope with, incentivizes their separation, or pushes these regional bodies toward more global financial coordination remains an open question.

CMIM: The Asian Case

The 1997-98 Asian financial crisis and ill-considered IMF-imposed conditionality for bailouts led Japan to propose an Asian Monetary Fund in 1999. The idea dissipated in the face of US opposition. However, in May 2000, the finance ministers of the ASEAN+3 took a more modest step creating the Chiang Mai Initiative (CMI), a bilateral currency swap network. This was accompanied by the Economic Review and Policy Dialogue (ERPD), a process to enhance transparency and mutual financial surveillance. The United States begrudgingly accepted this effort with the warning that any such endeavors should be linked to the IMF.[52]

Holding more than $6 trillion in foreign exchange reserves (China's share is $3.2 trillion), roughly half of the global total, the Indo-Pacific region (China, Hong Kong, India, Japan, South Korea, and Taiwan) has the latent wherewithal to transform itself into an Asian Monetary Fund.[53] But it is still a considerable distance from a policy consensus, the technical expertise and experience, or the political will to separate from or compete with the IMF. Nonetheless, the 1997-98 crisis generated a concerted regional effort to protect against future crises and to undertake policy reforms that are geared toward long-term financial resilience and economic growth. When faced with the 2007-09 global financial crisis, the Asian region survived without major dislocations.

Since its beginning as a network of bilateral currency swap arrangements for short-term liquidity problems, the CMI has incrementally evolved, though its final trajectory remains uncertain. After creating the CMI, in 2010, ASEAN+3 finance ministers and central banks increased the total resources to $120 billion and changed the name to CMI-Multilateralization (CMIM). In 2012, the finance ministers decided to double this amount to $240 billion. This went into force in 2014 along with a new precautionary crisis prevention facility for rapid disbursement in the event of immediate liquidity problems. The CMIM's Precautionary Line would allow members to draw unlinked IMF funds every six months for up to two years. The five largest ASEAN countries could access up to $22.76 billion in combined linked and unlinked funds. Longer-term funds, and any amount more than 30 percent of a country's quota, would require CMIM facility approval, in close consultation and cooperation with the IMF.[54,55]

The CMIM is roughly divided into major creditors (China, Japan, and South Korea), which have committed 80 percent of the $240 billion, and the most prospective borrowers, the ASEAN 10 (Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam), which have committed the remaining 20 percent. The CMIM has a complex decision-making structure that precludes any one member from dominating. Related to the proportion of foreign currency reserves their central banks have committed (it is important to note that there is no paid-in capital), China, Japan, and the ASEAN 10 each have equal voting shares of 28.41 percent, while South Korea has a smaller share of 14.77

49 International Monetary Fund, "Adequacy of the Global Financial Safety Net—Considerations for Fund Toolkit Reform," policy paper, December 19, 2017, https://www.imf.org/en/Publications/Policy-Papers/Issues/2017/12/19/pp121917-AdequacyOfTheGFSN.

50 Davide Barbuscia, Marwa Rashad, and Andrea Shalal, "G20 Countries Agree Debt Freeze for World's Poorest Countries," Reuters, April 15, 2020, https://www.reuters.com/article/us-health-coronavirus-g20-statement/g20-countries-agree-debt-freeze-for-worlds-poorest-countries-idUSKCN21X29A.

51 Ajay Chhibber, "Global Solutions to Global 'Bads': 2 Practical Proposals to Help Developing Countries Deal with the COVID-19 Pandemic," *Future Development*, April 22, 2020, https://www.brookings.edu/blog/future-development/2020/04/22/global-solutions-to-global-bads-2-practical-proposals-to-help-developing-countries-deal-with-the-covid-19-pandemic/. See also, Joseph E. Stiglitz, "Internationalizing the Crisis," Project Syndicate, April 6, 2020, https://www.project-syndicate.org/commentary/covid19-impact-on-developing-emerging-economies-by-joseph-e-stiglitz-2020-04.

52 Masahiro Kawai, "From the Chiang Mai Initiative to an Asian Monetary Fund," ADBI Working Paper Series No. 527, May 2015, https://www.adb.org/sites/default/files/publication/160056/adbi-wp527.pdf.

53 "Total Reserves (Includes Gold, Current US$)," World Bank, n.d., https://data.worldbank.org/indicator/FI.RES.TOTL.CD?view=chart; Elvis Picardo, "10 Countries with the Biggest Forex Reserves," Investopedia, March 7, 2020, https://www.investopedia.com/articles/investing/033115/10-countries-biggest-forex-reserves.asp.

54 C. Randall Henning, *Global and Regional Financial Governance: Designing Cooperation, Council on Foreign Relations*, September 2016, 5-6, https://www.cfr.org/content/publications/attachments/Discussion_Paper_Henning_Financial%20Governance_OR.pdf.

55 See Kawai, "From the" for a detailed history of CMIM evolution and details on the Precautionary Line.

percent. A two-thirds supermajority is required to approve a decision.[56] It is also worth noting that beyond the CMIM, its member states have an additional $160 billion in bilateral currency swaps among them.[57]

Under the current arrangement, CMIM members may draw up to 30 percent of their quota without an approved IMF program. The question of the CMIM's link to the IMF has been a topic of debate since its inception and has not abated. For more than five years, CMIM member states have debated raising the credit portion that is delinked from the IMF to 40 percent. Political divisions, high regard for the IMF among many Asian participants, and the absence of any compelling crisis have undermined this debate.

In 2011, in an effort to close the gap and prompted by the ERPD, the ASEAN+3 (ASEAN 10 plus China, Japan, and South Korea) ministers agreed to establish the ASEAN+3 Macroeconomic Research Office (AMRO), based in Singapore, to create their own institution to monitor member economies and advise CMIM decision-making.

The process of building AMRO's capacity is still in its early stages, though significant progress has been made. AMRO has rotating directors and six advisers—three from the "+3" nations and three from the ASEAN 10. It has grown considerably from its initial staff of twelve. In 2016, it officially became a separate, formal international organization. In 2017, AMRO publicly released its Regional Economic Outlook for the first time. But the extent to which AMRO should disclose its macroeconomic country assessments and policy recommendations is still a matter of some internal debate.[58] While AMRO's evolution continues, its chief economist, Hoe Ee Khor, said, "CMIM is in its very early stage."[59] Whether AMRO will attain the ability to be forthright and with candor publicize its members' macroeconomic and financial strengths and weaknesses—and recommend sometimes painful policy solutions—is another question. Some argue that well into the future, AMRO will be too small and lack the quality and size of the IMF to compete with it and would be well-advised to recognize a division of labor with the IMF.[60]

Internal debate on the scope and role of the CMIM continues. Whether the CMIM is equipped to respond to another financial contagion is a key question. It has been pointed out that the IMF packages for South Korea ($58.2 billion) and Indonesia ($42.3 billion) were of a magnitude beyond that which the CMIM could match. Some have advocated options like the doubling, or more, of the CMIM's capacity to $500 billion and/or transforming the CMIM from pooled reserves to a fund with members providing capital.[61] Such aspirations, however, represent an isolated view as they would likely transform the CMIM into an IMF competitor or alternative organization like the Asian Monetary Fund—a highly ambitious and risky course for an entirely unproven institution.

The CMIM's trajectory will be shaped by the interplay of political rivalries and internal tensions between its major creditors and prospective borrowers. Competing visions of the world order may be a factor: Abe is ardently committed to sustaining the current rules-based order; China, which to date remains invested in the IMF, has sought to provide public goods to fashion new, more Sino-centric institutions like the Asian Infrastructure Investment Bank (AIIB), the BRI, and the BRICS New Development Bank and Contingent Reserve Arrangement (CRA). China has also expressed an interest in turning its RMB into a competing global reserve currency, though, given the internal dynamics of the Chinese economy, that remains at best several decades into the future.

Indeed, the single-most important point about the CMIM is that it has never been utilized. How it would work remains in the realm of the hypothetical. It is worth noting that when South Korea had major liquidity problems during the 2007-09 global financial crisis, it did not turn to what was then the CMI or the IMF, but instead executed a $30 billion currency

56 C. Randall Henning, "The Chiang Mai Initiative" in *East Asian Financial Cooperation*, Policy Analyses in International Economics No. 68, Peterson Institute for International Economics, October 2002, 11-31, https://piie.com/publications/chapters_preview/345/3iie3381.pdf.

57 Chalongphob Sussangkarn, "Does the Chiang Mai Initiative Multilateralisation Make a Difference?" East Asia Forum, May 31, 2017, http://www.eastasiaforum.org/2017/05/31/does-the-chiang-mai-initiative-multilateralisation-make-a-difference/.

58 Kawai, "From the."

59 Hoe Ee Khor, "Chiang Mai Initiative Multilateralization (CMIM): Progress and Challenges," ASEAN+3 Macroeconomic Research Office, March 2017, http://www.imf.org/~/media/Files/News/Seminars/2017/The-future-of-international-monetary-system-for-asia/31dr-khorkim.ashx.

60 Kawai, "From the."

61 Ibid.

swap with the US Treasury. As C. Randall Henning, a professor of international economic relations at American University's School of International Service, writes: "Until [CMIM] disburses, questions will linger over whether the member states of the region have the political cohesion and technical mechanisms required to operationalize such assistance."[62]

In the interim, as has been the case in Asian and other developing country liquidity crises, another aspect of the US dollar being the world's global reserve currency is that it often plays the lender of last resort. The IMF is not being weakened or supplanted by an Asian alternative, nor is there any momentum in that direction. On the contrary, recognizing the complementary role they can play, there has been a desire to link the global and regional components. Serious mistakes notwithstanding, the IMF's rich track record, monitoring and surveillance capacity, and battle-tested and lessons-learned financial crisis response experience is unlikely to be rivaled by any regional RFA.

BRICS Contingent Reserve Arrangement (CRA)

While Japan catalyzed Asian RFA initiatives at the turn of the century, China has since driven new RFAs and other new multilateral lending banks. Though more modest in scale than the CMIM, the BRICS Contingent Reserve Arrangement (CRA) was launched at the same time as the New Development Bank in 2014 and came into force in July 2015. Like the AIIB, both were animated in response to the 2007-09 global financial crisis, and both were seen as China-backed efforts to forge institutions of "South-South" cooperation between emerging economies and separate from the Western-dominated Bretton Woods institutions. Like the CMIM, the CRA is designed as a "self-managed" precautionary safety net to ease members' balance-of-payments pressures.[63]

The CRA has total committed resources of $100 billion, with individual commitments from China ($41 billion); Brazil, Russia, and India ($18 billion each); and South Africa ($5 billion). As with the CMIM, it is committed, pooled capital of each nation's central bank, not a fund.[64] Similar to the CMIM, member states can draw up to 30 percent of their quota without having a parallel IMF accord; the other 70 percent is linked to the IMF. Each nation has a director, with a "one-man, one-vote" decision process. Unlike the CMIM, the CRA has no surveillance capacity and essentially relies on the IMF. Members must be in compliance with IMF surveillance and disclosure obligations (Article IV of the IMF's Articles of Agreement). Given its modest size, the CRA could only be a supplement to the IMF, not an alternative. In any case, unlike the CMIM, there has been little further development of the CRA decision-making processes.

Another important parallel with the CMIM is that the CRA has never been utilized. To understand the fervor that spurred the creation of the CRA, one must not underestimate the enormous economic disruption and sense of systematic unraveling at the peak of the 2007-09 financial crisis. In 2008, many feared a level of financial failure more severe than anything since the 1930s. As the recovery unfolded and a sense of stability took hold, the psychology of a "new normal," however fragile, emerged. The emphasis on emerging economy alternatives to the IMF gradually dissipated.

Similarly, despite initial fears in the United States that the AIIB would be a disrupter of the Bretton Woods multilateral development banks (MDBs), to date, most of its loans have been in partnership with either the Asian Development Bank (ADB) or the World Bank, and it appears more an addition—like the African and Latin American development banks—complementary to the World Bank/IFC. Regional financial safety net mechanisms, for the moment at least, appear to be complementary additions to the existing rules-based order.

2010-15 Eurozone Crisis

In contrast with the CMIM and the CRA, which were regional reactions, the effort to cushion against the next global financial crisis, the eurozone crisis of 2010-15, was a seminal experience for both the EU and the IMF. It underscored the need for more effective regional-global coordination. With the European Commission, the European Stability Mechanism (ESM) with $900 billion in capital, a regional single currency, and a European Central Bank (ECB) one could be forgiven for thinking that sovereign debt crises like that in Greece and problem states like Cyprus, Italy, and Portugal might, with a bit of help from the IMF, be eminently manageable. But precisely because of the deep working and structural ties, and institutional culture (e.g., analytical and surveillance experience) of European institutions—the European Commission, the ECB, and the ESM—the frustrating and antagonistic protracted crisis

62 C. Randall Henning, *Global and Regional Financial Governance: Designing Cooperation, Council on Foreign Relations*, September 2016, https://www.cfr.org/content/publications/attachments/Discussion_Paper_Henning_Financial%20Governance_OR.pdf.

63 Brazil's Ministry of Foreign Affairs, "Treaty for the Establishment of a BRICS Contingent Reserve Arrangement," BRICS Information Centre, July 15, 2014, http://www.brics.utoronto.ca/docs/140715-treaty.html.

64 Ibid.

between the IMF and the EU institutions was, for the IMF, a revelation of the inherent problems of working with RFAs to manage a crisis. The ESM, for example, is modeled after IMF governance practices and has collaboration with the IMF written into its founding treaty, specifically calling on euro area members requesting financial aid from the ESM to make similar requests to the IMF.

The contentiousness of the ESM and the IMF's approaches to the Greek sovereign debt crisis reached a boiling point in 2012 as the IMF pressed for conditionality (large debt write-downs) that the ECB strongly opposed.[65] Similarly, ECB-IMF differences over how to manage severe sovereign debt problems in Italy, Portugal, and other EU nations earlier in the 2010s pointed to differing imperatives driving the IMF and divergent calculations underpinning the European Monetary Union and the ECB. Obviously, Europe has a different dynamic with the EU being a monetary union (albeit one lacking a corresponding fiscal union) different from the one that operates within Asia. The fundamental issue of regional imperatives versus the IMF's global financial role is a salient theme facing RFAs writ large.[66]

In sharp contrast with the CMIM and the CRA, whose crisis management relationships with the IMF have never been tested, the 2010 eurozone crisis brought into sharp relief the following challenges: what is the sequencing for troubled member states to seek help from RFAs versus the IMF; what are the respective roles of RFAs and the IMF; who decides the quantity of debt that is sustainable; how are differences in conditionality of the structure and timing of financial assistance programs resolved; and, not least, the pace of decision-making in a crisis, which tended to be more lumbering in the EU as compared with the IMF. All of these issues would almost certainly loom larger in IMF collaborations with less-experienced RFAs such as the CMIM or the CRA in future financial crises.

Whither the IMF?

In July 2017, then IMF Managing Director Christine Lagarde shocked many when she said in a speech in Washington: "[If] we have this conversation in 10 years' time…we might not be sitting in Washington, DC. We'll do it in our Beijing head office."[67] Her remark was a telling acknowledgement of the Asia-Pacific becoming the new global center of economic gravity; IMF Articles of Agreement require the Fund's headquarters to be located in the member state with the largest quota.[68] This points to a prospective looming showdown when China surpasses the United States as the largest economy and demands that IMF voting power be redistributed accordingly.

That is a vision of IMF adaptability that in 2008 many in China would have anticipated was fast approaching amidst the US subprime mortgage-triggered financial crisis. Indeed, there was at the time a mood of triumphalism among many in China who saw the financial crisis as the demise of the reign of the US dollar and the US model of capitalism, the "Washington Consensus."[69]

The financial crisis spurred doubts about the future of the Bretton Woods institutions—and the role of the US dollar. In an extraordinary statement in 2009, Zhou Xiaochuan, then the governor of China's central bank, the People's Bank of China, published an essay in English and Mandarin on the bank's website arguing, "The desirable goal of reforming the international monetary system…is to create an international reserve currency that is disconnected from individual nations…." Zhou proposed that the IMF's basket of currencies, the SDR, replace the US dollar as the world's reserve currency.[70]

Zhou's proposal reflected long-simmering discontent in China and other emerging economies at the dominance of the United States and other Group of Seven (G7) states over the global economic system in which the center of economic gravity has dramatically shifted toward the Pacific.

As a result of the 2010 G20 reforms, China still appears entrenched in the IMF (albeit expecting a larger voice in the next round of reforms) even as it has taken the lead in fostering new parallel institutions like the AIIB, the CMIM, and the CRA. The IMF reforms agreed to at the 2010 G20 meeting and subsequent inclusion of the RMB in the SDR taken together marked an important shift in the global financial

65 Rebecca M. Nelson, Paul Belkin, and James K. Jackson, "The Greek Debt Crisis: Overview and Implications for the United States," Congressional Research Service, April 24, 2017, https://fas.org/sgp/crs/row/R44155.pdf.

66 Ibid.; "This Time in the Euro Debt Crisis, the IMF Will Come Bearing Gifts for the Greeks," *Guardian*, May 22, 2016, https://www.theguardian.com/business/2016/may/22/greece-euro-debt-crisis-imf-bearing-gifts.

67 Technically, Christine Lagarde misspoke as the IMF's Articles of Agreement say the Fund's headquarters are to be in the nation with the largest quota and China will not likely be the largest quota holder in 2027. "IMF Could Be Based in Beijing in a Decade: Lagarde," Reuters, July 24, 2017, https://www.reuters.com/article/us-imf-china-lagarde/imf-could-be-based-in-beijing-in-a-decade-lagarde-idUSKBN1A922L?il=0.

68 IMF, "Articles of Agreement," n.d., https://www.imf.org/external/pubs/ft/aa/pdf/aa.pdf.

69 John Williamson, "Did the Washington Consensus Fail?" outline of speech at the Center for Strategic and International Studies in Washington, DC, Peterson Institute for International Economics, November 6, 2002, https://piie.com/commentary/speeches-papers/did-washington-consensus-fail.

70 Zhou Xiaochuan, "Zhou Xiaochuan: Reform the International Monetary System," *BIS Quarterly Review*, No. 41 (2009), http://www.bis.org/review/r090402c.pdf.

architecture. Key features of the 2010 reforms were: China and other emerging economies increased their voting shares, with China's nearly doubling from 3.9 percent to 6.4 percent (making it the third-largest IMF shareholder); members of the IMF's Executive Board would all be elected (rather than appointed, mainly by G7 nations); and the IMF quotas would be doubled to roughly $755 billion. Moreover, there has been an increase in the presence of Chinese nationals within the ranks of the IMF's senior staff, including a deputy managing director.[71]

On November 30, 2015, the IMF's Executive Board approved the inclusion of the RMB in a new SDR valuation basket. The RMB would be the fifth currency alongside the US dollar, the euro, the Japanese yen, and the British pound. Explaining the decision, Lagarde said: "The Renminbi's inclusion reflects the progress made in reforming China's monetary, foreign exchange, and financial systems, and acknowledges the advances made in liberalizing and improving the infrastructure of its financial markets. The continuation and deepening of these efforts, with appropriate safeguards, will bring about a more robust international monetary and financial system, which in turn will support the growth and stability of China and the global economy."[72]

The key point is that the decision assumed "the continuation and deepening" of China's monetary and financial reforms—it was anticipatory, based on a liberal interpretation of IMF criteria (currency must be "freely usable"). "The inclusion of the RMB in the SDR basket," an IMF official proclaimed, "consolidates the RMB's internationalization process."[73] It is generally true that the RMB is very gradually becoming internationalized (estimated at 2.07 percent of global currency reserves). However, the RMB's path to internationalization has not been linear, and Beijing has backtracked since the IMF included the RMB in the SDR basket.

Faced with difficult choices pitting economic stability against RMB liberalization, Beijing has retreated from the latter since the November 2015 IMF decision and has placed more controls on capital flows. The portion of Chinese foreign trade in RMB shrank from 26 percent to 16 percent by the end of 2016, and RMB deposits in Hong Kong, its largest offshore center, were down by nearly 50 percent from 2014 by early 2017.[74,75] China has been deeply dependent on Hong Kong for a full range of its financial services, and it is unclear the extent to which its new National Security Law will disrupt Hong Kong's role as Asia's premier financial hub and what the impact will be on China. RMB's use in global bond markets is down 45 percent since its 2015 peak.[76] Concerned about capital outflows and currency pressures, China has already drawn down more than $1 trillion of its foreign currency reserves. It has yet to control its enormous debt of some $34 trillion (combined public and private debt, including shadow banks). The debt has ballooned from 162 percent of GDP in 2008 to 266 percent in 2018.[77]

Despite the market reform decisions taken at the 19th National Congress of the Communist Party of China in 2017 and Chinese President Xi Jinping's frequent promises of more reform and economic opening, China's moves to transform its investment-driven, state-centric economy into one based more on consumption, services, and innovation are erratic at best. The tension between the pledge of "market-based allocation of resources" and the commitment to "support state capital" has become stronger. Chinese loans to the state sector have been increasing, totaling 80 percent in 2016, while only 11 percent went to the private sector.[78] Chinese corporate, shadow bank, and property debt bubbles have yet to be fully addressed. By all evidence, China's economic dynamic is likely to change slowly. The $840 post-Coronavirus economic rescue and stimulus package promised at the May 2020 National People's Congress, comprised of business bailouts, fiscal spending and government bond issues appear to reinforce the state-

71 International Monetary Fund, "Senior Officials of the International Monetary Fund," n.d., https://www.imf.org/external/np/sec/memdir/officers.htm.

72 International Monetary Fund, IMF launches new SDR basket including Chinese Renminbi, determines new currency amounts, press release, September 30, 2016, http://www.imf.org/en/News/Articles/2016/09/30/AM16-PR16440-IMF-Launches-New-SDR-Basket-Including-Chinese-Renminbi.

73 International Monetary Fund, "IMF Adds Chinese Renminbi to Special Drawing Rights Basket," *IMF News*, September 30, 2016, http://www.imf.org/en/News/Articles/2016/09/29/AM16-NA093016IMF-Adds-Chinese-Renminbi-to-Special-Drawing-Rights-Basket.

74 Gabriel Wildau and Tom Mitchell, "China: Renminbi Stalls on Road to Being a Global Currency," *Financial Times*, December 11, 2016, https://www.ft.com/content/e480fd92-bc6a-11e6-8b45-b8b81dd5d080.

75 Jennifer Hughes, "Renminbi Internationalization Remains Elusive," *Financial Times,* January 30, 2017, https://www.ft.com/content/1bac9e56-d706-11e6-944b-e7eb37a6aa8e?mhq5j=e5.

76 Benn Steil and Emma Smith, "The Retreat of the Renminbi," Project Syndicate, June 22, 2017, https://www.project-syndicate.org/commentary/decline-of-the-renminbi-by-benn-steil-and-emma-smith-2017-06.

77 Enda Curran, "China's Debt Bomb," Bloomberg, September 17, 2018, https://www.bloomberg.com/quicktake/chinas-debt-bomb.

78 Tom Mitchell, Xinning Liu, and Gabriel Wildau, "China's Private Sector Struggles for Funding As Growth Slows," *Financial Times*, January 22, 2019, https://www.ft.com/content/56771148-1d1c-11e9-b126-46fc3ad87c65.

driven economic pattern.[79] Indeed, at the 19th Party Congress in October 2017, Zhou, the outgoing central bank governor, warned of a "Minsky moment" (where overconfidence leads to collapsing economies), and wrote on the central bank's website that China was accumulating "hidden, complex, sudden, contagious" risks.[80]

Nonetheless, given the financial assertiveness China has demonstrated with the creation of the ambitious trillion-dollar BRI and the AIIB, and aggressive lending by its state banks, if the United States blocked further redistribution of IMF quotas and voting shares Beijing could, over time, be tempted to lead a regional move in a direction more independent of the IMF, perhaps even to an alternative order.

In any case, the United States has recognized that RFAs can, in times of financial crisis, inject liquidity as well as provide policy insights based on local expertise and buy-in from local political stakeholders. The United States also has favored an upfront understanding of the principles and modalities of coordination between the IMF and RFAs so as to reduce the risk of misjudgment through hasty action in a crisis. Speed in a crisis may be important, and thus prior understandings among RFA participants presumably reduce the risk of policy judgment mistakes. The modalities of such coordination remain to be agreed upon. This is increasingly difficult in the current geo-economic environment.

To this end, much like the EU, the United States and Japan have supported a robust linkage of RFAs to the IMF as necessary for bringing coherence to the global safety network. IMF involvement also provides a basis for cross-regional learning with respect to financial crises. If US support for the IMF weakens, the coherence and effectiveness of crisis response may be endangered.

As RFAs have proliferated and the risks of fragmentation have grown, the G20 in November 2011 adopted a broad set of nonbinding "Principles for Cooperation Between the IMF and Regional Financing Arrangements." These principles endorsed enhanced cooperation between the IMF and RFAs, while recognizing that these institutions have comparative advantages and would benefit from the expertise of the other. The principles seek to offer an overarching collaborative framework of common norms while respecting regional differences.

Based on the difficulties and disputes evidenced in IMF-EU management of the Cypriot, Greek, and other European debt crises, agreeing to guidelines for IMF regional safety net cooperation is an issue best addressed before the next crisis unfolds. The IMF and G20 processes offer an avenue for the United States and like-minded countries to work toward more specific norms and operational guidelines related to the relationship between the IMF and RFAs.

Areas where more specific guidance would be advisable include: alignment with respect to lending and policy conditionality; greater transparency and sharing of information and even joint missions; and improved clarity on resolution of differences with respect to debt sustainability.

Ironically, apart from the United States, where support for and contributions to the Bretton Woods institutions have waned, there is sustained support for these institutions among the majority of their member states. There is, however, mounting frustration amongst emerging economies and some leading shareholders that the IMF needs to demonstrate institutional adaptability in terms of reforming voting shares to reflect the realities of the world economy, as well as its ability to respond to crises and rapidly changing realities.

Through trial and error in its efforts to restore financial stability following financial crises over the past two decades, the IMF has taken a leading role in addressing systemic threats to financial stability. The IMF's learning curve on the policy side and additional resources provided by member states, combined with structural reforms that have given China and emerging economies like India and Brazil a larger voice, have helped reinforce its perceived legitimacy. The G20 process, including the Financial Stability Board (FSB) that was established in response to the 2007-09 global financial crisis, has also proved to be critical to managing global crises.

Yet the trends of fragmentation in the global trade system, US and Chinese economic nationalism, trade and tariff wars, and the disparagement by the United States of multilateral institutions pose new risks. All the above discussed efforts to better coordinate preparation for —and management of— future financial crises could easily unravel. Specifically, there are growing questions about whether the United States and other IMF member states can reach agreement on the current 15th General Review of quotas, which aims to increase

79 Frank Tang, Jun Mai, and Sarah Zheng, "China pledges largest-ever economic rescue package to save jobs and livelihoods amid coronavirus", *South China Morning Post*, May 28, 2020, https://www.scmp.com/economy/china-economy/article/3086569/china-pledges-largest-ever-economic-rescue-package-save-jobs

80 "Close to Retiring, China's Central-Bank Chief Warns of Financial Risk," *Economist*, November 9, 2017, https://www.economist.com/news/china/21731180-zhou-xiaochuan-trying-burnish-his-legacy-close-retiring-chinas-central-bank-chief-warns.

and redistribute quotas. The IMF currently has $1.4 trillion in financial resources. This will be reduced in 2020. Restrictions on resources that can be used for lending and a cautious gearing ratio have resulted in less than $900 billion being currently available for new IMF lending.[81]

The United States currently has the largest voting share in the IMF based on its quota (16.52 percent). As an 85 percent vote is required to approve decisions, Washington has an effective veto. European quotas and voting rights are apportioned to individual nations, not the EU. Taken together, however, EU member states' total quotas exceed those of the United States. But based on the factors that decide actual votes, as a practical matter, US voting rights exceed those of the EU. In any case, China has just 6.09 percent of voting rights.

The Trump administration has indicated that it is opposed to a redistribution of quotas, which would also require another increase in overall quotas. There is speculation that the United States might be more amenable to quota redistribution if there is agreement to alter IMF policies in a direction Washington favors. For example, adopting tougher surveillance of trade and exchange rate policies. In any case, the IMF could adjust to a political stalemate by increasing its bilateral borrowing arrangements and multilateral ones, the New Arrangements to Borrow (NAB), in order to obtain more resources to be able to act as a global financial safety net. But this option is problematic because approval from the US Congress will be required for the United States to participate. China and other emerging economies have little choice given the United States' ability to veto any IMF decision.

What is the cumulative impact of both declining US support for the IMF and obstinance to change on IMF legitimacy?

Global economic dynamics continue apace. The Organisation for Economic Co-operation and Development (OECD) increasingly accounts for less of the world's GDP, while emerging economies—Brazil, China, India, and Indonesia—account for more. Yet institutional arrangements have, since the G20 and IMF reforms in 2010, remained largely static.

As no major shift in IMF governance is likely in the near term, over the coming decade pressure may build to reapportion IMF quotas and voting shares to reflect global GDP. There are several possible options. One suggested by C. Fred Bergsten, a former PIIE director, would give parity to the United States, the EU, and China, perhaps 15.5 percent each, thus giving all veto power.[82] Another could be to change the IMF charter so that less than 85 percent of the vote would be required for decision-making. Another option would be one of modest, incremental change, as occurred in the 2010 reforms. In such a scenario, Europe, which is somewhat overrepresented (i.e. in terms of total voting shares of individual EU member states) would stand to lose the most.

Projecting forward to China becoming the world's largest economy, as Lagarde imagined, would the United States then accept less than the required 15 percent and give up its veto? Would it agree to 15 percent or more voting rights for China? Would the IMF move its headquarters to Beijing? Under IMF strictures, any change in quota must be agreed to by the nations involved. While this has so far been a hypothetical question, the financial crisis triggered by the COVID-19 pandemic has the potential to force the issue in the near future. Would the IMF be able to sustain its global role, or would China, a pivotal actor in both the CMIM and the CRA, initiate a new monetary fund? The current geo-economic competition between the United States and China could easily expand from trade and tech to include finance. Part of such a troubling scenario is the reality that China is the largest owner of US Treasury bonds—roughly $1.2 trillion. While it would be mutually destructive and a low-probability event, China could sell off substantial amounts of US Treasuries as a last resort for trade and tech punishment.

The Anomalous, Unchallenged US Dollar?

One reason that such scenarios may be far-fetched is an anomalous reality: while the center of gravity of the global economy continues to shift from the West toward something more resembling pre-modern times when China and India accounted for a preponderance of the world economy, the US dollar remains the world's unchallenged global reserve currency. This, despite European and Chinese chagrin at US economic and political privileges, and increasing weaponization (e.g., sanctions) that accrue to the United States. Echoing earlier sentiments often heard in China, in September 2018, Jean-Claude Juncker, the then president of the European Commission, frustrated by US extraterritorial sanctions, vowed to have the euro challenge the US dollar as a global reserve currency. The euro, he said, "must become the active instrument of a new sovereign Europe."

81 Edwin M. Truman, *Survival of the International Monetary Fund and Global Economic Cooperation, Peterson Institute for International Economics*, Policy Brief 19-5, April 2019, https://piie.com/publications/policy-briefs/survival-international-monetary-fund-and-global-economic-cooperation.

82 Ibid.

Trump's imposition of extraterritorial sanctions after rejecting the Iran nuclear accord has catalyzed efforts to find alternative payment systems to the dollar. France, Germany, and the United Kingdom, for example, created Instex (Instrument in Support of Trade Exchanges) based on the euro, but this is problematic. It is, in effect, a complex multicountry bartering exchange system so far limited to consumer goods and medicines not covered by US sanctions.[83] China has tried to increase use of the RMB in trade. It launched an oil futures market as 80 percent of its oil imports are in US dollars. This is a problem as most nations exporting oil have currencies pegged to the US dollar. Sino-Russian trade is increasingly done in RMB and rubles. However, this accounts for about only 18 percent of their bilateral trade despite Sino-Russian efforts to move away from the US dollar. Even China's BRI loans are all in US dollars, though China is increasingly likely to use the leverage of its BRI infrastructure connectivity to conduct more trade in RMB.

For the foreseeable future, either the euro or the RMB overtaking the US dollar as the world's anchor currency remains largely in the realm of aspiration. While in theory both the euro and the RMB could be global reserve currencies on par with or displacing the US dollar, in both cases there are sizable structural impediments that will require transformational policy shifts in both the EU and China to enable them to displace the US dollar. With trade and trade financing largely conducted in US dollars, and amidst economic uncertainty, the demand for US dollar assets, a safe haven, remains high.

With regard to the euro, it would require a lot "more Europe," as French President Emmanuel Macron and German Chancellor Angela Merkel have often said in response to the eurozone crisis. The EU is a monetary union absent a fiscal union. There is no EU-wide sovereign debt, but an individual nation state debt. A deep, EU-wide bond market, with the backing of the ECB, is one prerequisite for the euro becoming a lead global reserve currency. But EU division on economic policies, banking regulations, as well as foreign policy, now further challenged by rising populism, suggests little movement in that direction. The eurozone's conservative fiscal policy, marked by an emphasis on debt reduction, points to a dearth of euro assets to invest. This is in contrast to the US Federal Reserve, which in response to the 2008 run on liquidity acted as a global lender of last resort providing US dollars via currency swap lines. The ECB was slow to move in this direction—even in coming to the aid of some weaker eurozone economies.[84] It would require a major revision of EU macroeconomic policies for the euro to become the lender to the world and a magnet for safe-haven investment rivalling the United States.

Similarly, notwithstanding Beijing's ambitions, for the RMB to assume a global reserve currency role would require a major revamping of China's financial system. Beijing is gradually increasing the use of the RMB in trade and engaging in more currency swaps. But these are small steps. More fundamentally, China is slow to address its debt bubble—a massive $7-plus trillion combined public-private debt, some 266 percent of its GDP. Moving away from capital controls to allow free movement of capital and allowing the RMB to float freely, creating a deep, transparent bond market are basic steps that run counter to Beijing's current financial policies. This would also require much improved regulatory transparency and corporate governance at a time when China's economic policies are becoming more state-centric. Who will view holding RMBs as safe? The RMB is a long way from having the capacity to absorb large-scale global financial flows.

On top of these obstacles for the euro and the RMB, the US dollar's role is further reinforced by what is known as a "network effect," its dominance in foreign exchange markets in the pricing and trading of oil and other core commodities.[85] History suggests transitions of primacy of reserve currencies is a protracted, gradual process. It also suggests that it may not be a question of either/or in terms of global reserve currencies, and that several currencies can play that role to varying degrees. It is worth noting that although the US economy surpassed the UK's in 1870, it was not until the 1920s that the US dollar replaced the pound sterling as the world's leading reserve currency.[86] One wild card, however, given the unraveling of global institutions and US disregard for multilateral institutions, is the fear that the United States will either drive the international economic system toward fragmentation or be unable to play an adequate leadership role in holding it together in the face of the challenges and trends

83 Justin Scheck and Bradley Hope, "The Dollar Underpins American Power. Rivals Are Building Workarounds," *Wall Street Journal*, May 29, 2019, https://www.wsj.com/articles/the-dollar-powers-american-dominance-rivals-are-building-workarounds-11559155440.

84 For a detailed assessment of eurozone obstacles and dilemmas see Christian Odendahl and Adam Tooze, *Can the Euro Rival the Dollar? Center for European Reform*, December 4, 2018, https://www.cer.eu/insights/can-euro-rival-dollar.

85 Barry Eichengreen, Livia Chițu, and Arnaud Mehl, "Network Effects, Homogeneous Goods and International Currency Choice: New Evidence on Oil Markets from an Older Era," Working Paper Series No. 1651 European Central Bank, March 2014, https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1651.pdf.

86 Barry Eichengreen and Marc Flandreau, "The Rise and Fall of the Dollar, Or When Did the Dollar Replace Sterling as the Leading International Currency?" National Bureau of Economic Research, Working Paper No. 14154, July 2008, https://www.nber.org/papers/w14154.

discussed above. The challenge of reviving the post-COVID-19 global economy may be the supreme test.

Blockchain: The Rise of Cryptocurrencies

Another factor that could accelerate the demise of the US dollar's dominance is technology and the prospect of digitization of national currencies. Perhaps the most heralded new tech tool, if not cure-all, to not only improve cybersecurity but alter the financial world is called blockchain. A blockchain is an open-source, time-stamped transaction or block of data shared across a network of computers. Each block is protected by cryptographic algorithms and must be verified and accepted by all others. The blocks are bound together. Once a record has been added to the chain it cannot be changed internally. This limits the possibility of hacking. Blockchain eliminates the need for intermediaries and establishes trust as the integrity of data in every transaction must be verified by all in the chain. Blockchain began in 2009 as the mechanism to buy and sell the cryptocurrency, Bitcoin, but has evolved into what many see as the Next Big Thing in digitization. It is also seen as a means to enhance data privacy.[87]

While debate continues about the viability of cryptocurrencies (with no nation's treasury backing them, why are they credible?), blockchain is becoming a mainstream cybersecurity tool with major US financial institutions investing hundreds of millions of dollars in an effort to have a more secure financial database. Blockchain, which has provided the ballast for a global financial tech (Fintech) industry now competing with major multinational banks, may be an important tool in such national digitization efforts. IBM has created an entire division on blockchain; venture capital firms in Silicon Valley have invested more than $500 billion since 2017; and some projections forecast a $2.3 billion market for blockchain technology by 2023.[88] There has also been a proliferation of cryptocurrencies for which there are no regulations or accountability.

The impact of blockchain cryptocurrencies on the global financial system is an issue of growing importance on which the IMF, the US Commerce Department's Bureau of Industry and Security (BIS), and other international financial institutions need to assess and fashion appropriate regulation. Unlike the Internet that has governing institutions (e.g., the Internet Corporation for Assigned Names and Numbers, ICANN), blockchain has no approved standards or norms. As the use of blockchain spreads, the need for shared norms, standards, and accountability becomes more imperative. A number of central banks, including in the United States, are actively studying the idea of digitizing their currencies. China has filed eighty-two patents on the various aspects of digitizing currencies, suggesting advance planning.[89] Some fear that along with the BRI seeking to integrate Eurasia's infrastructure, including digital infrastructure, an attempt by China to digitize its currency might be a path for the RMB to rival the US dollar as a global reserve currency.

CONCLUSION

The global financial system has yet to display the fraying and fragmentation seen in the global trade system. But the trends of regionalization and exclusive nationalism, now supercharged by great power competition, combined with digitization and emerging technologies suggest that the status quo is unlikely to persist. The current economic downturn, the most severe since the 1930s, and attendant financial stresses that may exceed those experienced in 2008, promises to be a colossal challenge. Failure to adequately mobilize a coordinated and cooperative economic response could leave major economies, particularly China and the EU, feeling an urgency to go their separate ways. Such a development could catalyze efforts to create rival reserve currencies to challenge the US dollar and trigger either the fragmentation or reordering of the global financial hierarchy.

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87 Nathaniel Popper, "Tech Thinks It Has a Fix for the Problems It Created: Blockchain," *New York Times*, April 1, 2018, https://www.nytimes.com/2018/04/01/technology/blockchain-uses.html.

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