

## The IMF's China Card

By *Kenneth Rogoff*

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Why China should bail out the International Monetary Fund

The Chinese economy is on the tip of everyone's tongue these days, and with good reason. The seemingly inexorable Chinese economic expansion is bootstrapping the rest of Asia out of recession. After a decade of stagnation, even Japan is showing signs of life again thanks to China, which may soon displace the United States as Japan's number one trading partner.

Yet all the good news about China obscures an unavoidable problem. Nobody—but nobody—can keep growing at China's frenetic pace year after year without risking a major crisis. Evidence of financial bubbles abounds. The Chinese banking system, weighed down by years of state-directed lending to profitless government enterprises, is an accident waiting to happen. China supposedly invested more than 40 percent of its gross domestic product last year, and clever as the authorities may be, that money can't have all gone to sound, profitable projects. (If it did, growth would be even higher.) So the bad-loan problem must be getting bigger, not smaller.

And don't forget the small matter of China's fixed exchange rate against the U.S. dollar. Every major international economic crisis of the past 15 years—save Brazil's crisis in 2002—has been rooted in an exchange rate that remained too fixed for too long. China may be safe for now, partly because strict capital controls lock domestic savers into the bankrupt banks. As trade continues to relentlessly expand, Chinese investors will be better and better able to evade controls. Someday, events will conspire to bring on a crisis and the lid will blow. And a currency crisis in the world's second largest economy will have spectacular global reverberations, not to mention devastating effects on China's 1.3 billion people. No fools, the People's Bank of China is groping for an exit strategy. But there are many landmines, and whether they will be able to move far enough, fast enough, remains to be seen.

So, suppose you are the intrepid soul tapped to replace the recently departed Horst Köhler as managing director of the International Monetary Fund (IMF), the agency charged with maintaining global financial stability. What *do* you do about China?

First, you must accept that if China experiences a disastrous financial crisis, you simply may not have enough money available to bail the country out, i.e., to give China large enough subsidized bridge loans to avert default. Recall what happened when giant India needed an IMF loan in 1991—the bailout tied up a sizable fraction of the IMF's resources. And although the IMF was able to rescue the Brazilian economy with \$30 billion in loan packages in 2002 (on top of an earlier \$15 billion commitment), China's economy is more than twice as large.

At present, the IMF only has some \$150 billion in resources it can lend (another \$40-50 billion is on tap, but not painlessly). And lots of IMF money is already tied up in Brazil and Turkey, as well as in Argentina, a nation that has demonstrated precious little enthusiasm to repay its debts to anyone. Yes, China may be “too big to fail,” in the sense that, if it runs into trouble, the IMF—

and the international community it represents—can do no more than hold its breath and await the resounding thud.

A World Bank strategy might be in order instead. Send some officials to Beijing, write some academic papers, deliver a few supportive speeches, and maybe lend a few billion dollars here and there. The bank can then claim a lot of credit if things go well and blame the IMF if the economy collapses. Actually, the World Bank did exert a positive influence when Chinese authorities began opening up the economy in the 1980s, providing China's government with useful information on other countries' experiences. But later, during the Asian financial crisis of the late 1990s, the Chinese did not take kindly to the public and private pressures to devalue the yuan from then World Bank chief economist Joseph Stiglitz. (Such efforts seem especially ironic now that, just a few years later, many are calling for China to *revalue* the yuan.) In small part due to this mistake—arguably the worst policy call of the Asian crisis—the World Bank's influence in China has notably diminished over the past decade.

Here's a better proposal: Deploy your clout as IMF boss and push the Group of Seven (G-7)—a club of the world's major economic powers—to include China, and rename itself the G-8. Then the G-7 countries could save some postage when their bi-annual finance ministers' statement protests China's exchange rate policy, as it did this past February. And because the IMF can't really bail out China out anyway, wouldn't it be much smarter to have China join the nations that ultimately stand ready to bail out the IMF? After all, China enjoys more than \$400 billion in foreign exchange reserves, or nearly twice the IMF's current lending capabilities. Just move China over to the other side of the ledger! In a single stroke, you can improve regional representation at the IMF and stockpile the financing you'll need when your own bad loans (don't forget Argentina) start piling up. And just pray China itself doesn't have a crisis.

*Kenneth Rogoff, a regular contributor to FOREIGN POLICY, is professor of economics and Thomas D. Cabot professor of public policy at Harvard University.*