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The Beginning of the China-led New Financial Order and Korea's Countermeasures

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1. China's Steps toward Building a New Financial Order

The emergence of China in the international financial order can be analyzed in three aspects: strengthening its position within the IMF system led by the West, establishing a new financial order through multilateral development banks (MDBs) like the AIIB and NDB, and the internationalization of the renminbi (RMB).

China has steadily demanded an increase in its share in the IMF. Following the effectuation of the reform plan in 2016, China became the third largest member of the IMF and the RMB is now included in the SDR basket. China also succeeded in launching the AIIB by formulating a consensus on the necessity for launching an alternative multilateral development bank in Asia where the ADB had a monopoly. On the other hand, RMB internationalization is executed based on a set of internal and external goals: stabilizing inflation and the engine for internal reform, and consolidating the international status of China. As a result, RMB settlements accounted for approximately 2% in world trade, while investment accounted for 16.6% in 2015. However, the RMB still accounts for only 0.6% of the global bond market, and only 1.1% of global foreign reserves. As such, although the internationalization of the RMB has achieved some degree of success, it is hardly keeping up with the extent to which China's economic power is growing.

Table 1. International Status of RMB

Items		Share, %	Time
RMB share in percent of Global total	Cross-border payments	1.9	August 2016
	Overseas direct investment	16.6	December 2015
	Bond and bill	0.59	December 2015
	Foreign exchange reserves	1.1	December 2014
Foreign share in percent of China	Stock	2.1	December 2015
	Bond	4.7	
	Loan	2.8	
	Deposit	3.5	

Source: PBoC, International Monetary Institute of Renmin University

KIEP Korea Institute for International Economic Policy

2. Current Situation and Related Tasks

Internal Reform Issues

For the China-led financial order to take root, China should continue to pursue further reforms and openness regarding free convertibility, capital accounts, and the exchange rate. China, however, is maintaining a cautious approach. Some of the reasons for this are as follow. First, there are concerns about an outbreak of financial crisis through the opening up of China's capital account. Second, there are fears that there will be an increase of non-performing loans and decrease of interest rate in the event of non-interference by China's financial authorities. As China also has tried to maintain a managed floating system and to allow capital opening only on an experimental basis, it will not be easy for it to expand its influence in the international financial market in a short period of time. Moreover, as the recent appreciation of the yuan has weakened, the impetus for internationalization of the RMB has weakened.

The Newly Launched Financial Institutions and Their Positioning

The recently launched AIIB, NDB and the Silk Road Fund are financially contributing to China's national strategy known as “The One Belt, One Road (Belt and Road)” initiative and the internationalization of the RMB. The AIIB and NDB are different from existing MDBs in that their establishment was mainly aimed at infrastructure investment, and that China holds a significant stake in these banks, as well as in that it plans to raise capital for these banks in yuan, and has established a quicker and easier loan procedure. It is also noteworthy that the AIIB is devoted to transportation and power infrastructure investments in countries along the Belt and Road, while the NDB focuses on renewable energy infrastructure investments in BRICS countries. SCODB, which is to be newly established, focuses on infrastructure investment in Central Asia. The Silk Road Fund, the national fund into which Chinese government bodies such as the State Administration of Foreign Exchange have invested, will act as a dependable fund for the Belt and Road projects by swiftly and boldly making investment decisions. Since both the AIIB and NDB are MDBs, they have to go through certain procedures when reaching financing and investment decisions. However, they lack in internal capabilities such as the know-how to operate international organizations and understanding about the global infrastructure market.

Therefore, financial support for the Belt and Road initiative is likely to be led by the Silk Road Fund for the time being, with the AIIB and NDB assisting. But these institutions face considerable challenges in the future, such as difficulties in finding bankable projects in Eurasia, as well as raising funds from domestic and overseas sources. The new financial order led by China will gradually become clearer if the institutions show remarkable progress, and if the internationalization of the RMB gathers momentum from the Belt and Road initiative.

RMB Internationalization Review

Meanwhile, China has realized some achievements in terms of RMB internationalization since 1997, such as the expansion of RMB settlement in world trade and the development of offshore RMB markets. The trade settlement function and the investment currency function of the RMB have also improved. Having been added to the SDR currency basket has elevated the global status of the RMB more than ever. Until recently, however, the

Chinese government has prioritized economic growth and export expansion through currency depreciation rather than stabilizing the exchange rate for internationalization. Thus, China is faced with several tasks, such as minimizing the effects that the exchange rate shock accompanying RMB internationalization will have on its domestic economy, as well as responding to the disruption in the reform and opening-up policy caused by external factors, and managing prudent finance regulation and risks related to floating funds flow.

In any case, the internationalization of the RMB is a national strategy of China, and the relevant system will be improved during its 13th Five-Year Plan. In addition, the countries along the Belt and Road are becoming increasingly clear as a key area of internationalization for the RMB, although discussions are underway to form a yuan currency bloc that will include China mainland, Hong Kong and Taiwan.

3. Prospects and Policy Implications

Taking all the three abovementioned aspects together, it will be difficult for China to dramatically change the current international financial order in the short term, when taking into consideration the Chinese financial goals and internal capability, the speed of progress in AIIB's projects, and the West's containment policy toward China.

In conclusion, the China-led new financial order is still in its infancy. In terms of the Belt and Road initiative, projects in Southwest Asia are speeding up while projects in Southeast Asia are slowing down. This is because of the expansion of economic power and border disputes in the South China Sea, and neighboring countries are wary of the expansion of China's influence. In the same vein, China-led financial institutions such as the AIIB and NDB are also hampered by a lack of support from neighboring countries. The internationalization of the RMB is still in its development stage, and it seems premature to discuss the RMB currency bloc, as the Chinese government might establish a more sophisticated strategy for the regional currency order to establish a considerable position in the international monetary order.

Korea, however, will have to secure its own national interest by establishing mid- to long-term strategies and specific countermeasures against the new financial order, which is encapsulated in the newly launched international financial institutions and internationalization of the RMB.

Above all, Korea needs to actively and accurately adopt a bandwagon policy, since China will carefully deal with domestic problems like insufficient financial capacity and the existing order centered on advanced countries. Korea should discuss policy coordination with China preemptively, especially while China remains in an uneasy situation due to its lack of international financial capability and delays in the Belt and Road projects due to the vigilance of neighboring countries.

For example, Korea needs to evaluate and preemptively participate in institutions and organizations led by China, as it participated as a founding member of the AIIB. For this, it will be important to establish an organic cooperation system between the government and the private sector. In addition, Korea should pursue a so-called two-track strategy to lead the Northeast Asian Development Initiative while at the same time taking a proactive stance in Southeast Asia, Southwest Asia and Central Asia, where China-led financial order will be expanded. As a concrete measure, it will be necessary to prepare a plan to set up a differentiated offshore RMB hub from Hong Kong and Singapore by issuing a RMB bond through cooperation with Chinese financial institutions. Korea should take the lead in establishing the AIIB Institute and setting it up in Korea. In order to prepare itself for increasing infrastructure investment driven by China, Korea should strengthen the international competitiveness of Korean financial institutions. In the mid- to long-term it needs to concentrate on establishing a Korea-led development financial institution which will focus on development in North Korea. KIEP

Table 2. International Comparison of Financial Companies in Infrastructure Financing

Company competitiveness	Korean	Western	Japanese	Chinese
Total Competitiveness Score[1]	**2.94**	**5.45**	**4.94**	**3.40**
Sectors[2]				
Project feasibility and risk analysis	3.29	5.39	5.08	3.15
Capital financing	3.11	5.51	5.59	4.37
Deal sourcing channel and networks	2.95	5.76	5.09	3.69
Financial advisory and arrangement	2.80	5.71	4.97	3.28
Track record and market reputation	2.88	5.68	5.22	3.24
Offering distinctive services	2.68	5.10	4.55	3.31
Asset management	3.36	5.14	4.95	3.17
Generating ancillary revenue	2.73	5.35	4.47	3.15

Note: 1. Maximum value is 7.

2. Bold lettering represents core competitiveness sectors.

Source: Survey by the authors