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The pendulum of global economic power started swinging back from West to East during the latter half of the 20th century, reversing a westward shift starting way back in the 18th century. It started with post-war Japan's re-emergence in the 1960s, then the emergence of the `miracle economies' of East and South East Asia, followed by the rise of China and, finally, growth acceleration in India during the final years of the 20th century. Such historic shifts in relative economic power get reflected in the formal architecture of international economic relations with a significant lag since the declining powers are naturally resistant to change. However, the swing in Asia's favour has been underway for several decades now, buffeted from time to time by negative and positive shocks. While it was slowed down by the Asian financial crisis of 1997, it has been accelerated by the current economic meltdown. The present crisis has adversely affected all countries, but its impact in Asia has been much less severe than in the West and Japan. Within G20, it has significantly strengthened the relative positions of emerging Asian economies like India and especially China. Accordingly, China decided to use last months G20 summit to launch its bid for a leading role in the global financial architecture.

That architecture is now archaic, reflecting the relative economic strength of countries that existed at the end of World War II rather than those that obtain today. Aware of this imbalance, G7 countries have started giving a few scraps to countries like China and India. Both are now members of the Financial Stability Board, the apex institution established to monitor global risks of financial crisis. Their voting shares in the International Monetary Fund (IMF) will also be slightly increased through an accelerated quota reform process.

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However, post-reform the US will retain its de facto veto power with a 17 per cent share and the US, EU and Japan will together still control 53 per cent of IMF shares. Individually, the shares of US, Japan, UK and France will still be larger than China's share of under 4 per cent. Impatient with these little handouts, China has launched a multi-pronged campaign to claim a seat at the head of the table.

Shortly before the G20 summit, Zhou Xiaochuan, governor of the Chinese central bank, suggested that the dollar should be replaced by SDRs as the new reserve currency. The huge dollar reserves held by central banks and other global investors would be severely eroded if the dollar were to suddenly depreciate. Yet, these investors cannot easily diversify away from the dollar since this itself would trigger dollar depreciation. The Chinese are particularly concerned: an estimated $1 trillion out of their total reserves of around $2 trillion are held in dollar assets. The SDR exchange rate is a weighted average of exchange rates of the major convertible currencies. Accordingly, under Zhou's proposal, China and other countries could convert their reserves from dollars to SDRs at current exchange rates without any erosion in their value.

Implementing such a proposal would also mark the end of the dollar as a reserve currency. The US would no longer be able to finance its huge current account deficit by massive capital receipts from the rest of the world. Nor could it simply print dollars to finance its deficit. Like any country facing a reserves crunch, it too would have to go seeking loans from the IMF or other surplus countries (read China). Such a tectonic shift in global power relations was almost unimaginable until recently. Zhou's proposal did not get much attention in the G20 summit, but President Hu Jintao also announced there that China had firmed up currency swap arrangements totalling about $95 billion with several countries.

In a third move the ASEAN+3 (China, Japan, South Korea) have now created an Asian version of the IMF. Euphemistically called the Chiang Mai Initiative, the fund was launched on May 3 at the Asian Development Banks annual meeting in Bali with an initial capital of $120 billion.

The history of this initiative is interesting. When the idea of an Asian Monetary Fund was first mooted by Japan in 1998 at the height of the Asian financial crisis, it was firmly rejected by the IMF, the US Treasury and other western powers. In typical Asian style, the proposal was humbly withdrawn, but quietly refloated as a modified initiative the following year at an ADB annual meeting in Chiang Mai. Ten years later the fund has become a reality, but Japan now has to contend with China for leading it.

The relative roles of different Asian currencies in this fund are yet to be determined, but clearly the Chinese yuan has arrived and the meltdown of the dollar as a reserve currency has begun. The US-led western alliance has two options before it. It can give China a leading role in the G7-dominated financial architecture or face an alternative architecture led by China. Heads i win, tails you lose. Meanwhile, India is yet to find a role for itself in this new great game.

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