

Dynamic Engagement:

China's Preference to the International Monetary Cooperation*

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Abstract: Since China participated in the International Monetary Fund and the World Bank in 1980, the relationship between China and the international economic institutions has become more complicated. With sustained economic growth, China emerges as an important international player. How to understand the interaction between China and the international economic institutions is one of the important themes of world politics. The paper provides a domestic explanation for China's preference formation to the international monetary cooperation. The rational and process of China's domestic reform heavily influence its international behavior. The domestic reform dynamics facilitate China's acceptance of the international norms.

Prepared for the Conference of *China, the European Union, and the Restructuring of Global Governance*, Brussels, Belgium, 6th and 7th May, 2010

* I am grateful to Robert Keohane, Ngaire Woods, and other GLF fellows Anna Arroio, Arunabha George, George Gray Molina, and Pooja Sharma.

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Introduction

It was with uncertainty and doubts that China took the first step to open its door to the outside world and attempted to integrate with the international community in the late 1970s. At that time, the western countries began being concerned the consequences of China's entry to the major international institutions. At least two decades ago, the scholars and observers of developed countries stated becoming worried about the challenges to the existing international institutions posed by a rising China. Specifically, the problem they saw was whether China would change the international institutions or whether the international institutions and their developed founding countries would "tame" China. Recently, against the backdrop of China's continued economic growth and the economic tsunami that hit the United States and other industrialized countries, the rising China's challenge or threat to the existing international institutions seems much more plausible and concrete than ever before. What are the real interactions between China and the international institutions in the past three decades? Has China attempted to or successfully altered, more or less, the international norms and rules? If so, in what terms and how has China responded to the international institutions? What factors affect China's preferences and policies toward the international institutions?

This article uses the example of China's relationship with international monetary institutions to illustrate the process and driving forces of China's participation in the international monetary institutions. The article argues that China's preference toward the international monetary institutions is the function of China's domestic reform rational, process, and pace. In particular, the article explores the conditions under which China would accept the international norms and rules, as well as the conditions under which it would tend to propose reforming agenda? What could be China's demands to the international monetary institutions?

The article begins with a brief review of the debates and struggles between developing and developed countries over the policies of international economic institutions. It then presents the argument that uses domestic reform process and rational to understand China's reactions to the international monetary institutions. In the subsequent section, the analysis of three cases show the conditions under which China accepts the international norms and rules, and the factors that affect the terms of China's reform demands. The final section discusses the implication of understanding China's post-crisis behavior toward the international monetary cooperation.

Power and International Institutions

Developing countries seem to cause considerable disturbance to the operation of established international institutions and their industrialized supporters. When these developing countries cannot achieve economic growth, welfare promotion, and poverty reduction, they are likely to use their political power to intervene in the international institutions and to challenge the international principles, norms, and

rules preferred by industrialized countries. When some of these developing countries, especially the larger ones, achieve substantial economic growth, industrialized countries tend to become more concerned about the implications of these new emerging powers. The developing countries are assumed to be the outsiders of the existing international institutional arrangements. In order to maintain a stable international order, many researchers explore the conditions under which these outsiders could be accommodated, examine the nature of these emerging powers, and focus on defining prerequisites for them to fully participate in the international institutions.

Based on the intense conflict between the North and the South over international economic institutions in the 1970s, Stephen Krasner argues that the relations between industrialized and developing countries are bound to be conflictual. He assumes that Third World states behave in the same as other states in the international system, and that these countries also seek to increase their power and wealth. Because of the inherent vulnerability of developing countries, they are likely to change the rules of the game in world politics. Developing countries prefer authoritative international regimes to market-oriented regimes, as the former provides for more stable and predictable international transaction. He notes that developing countries use the call for a New International Economic Order as a mobilizing and ideological instrument to challenge the liberal international order. In light of his argument, he concludes that the tension between the North and the South will be an enduring characteristic of the international system.¹ Krasner's argument has at least two incisive points. First, he emphasizes the tension between power capabilities and transnational principles and norms. On one hand, the international regime reflects the power structure of the international system, but on the other hand, the sovereignty equality principle empowers the countries without capacities to exercise this right. He further attempts to explain the behavior of developing countries or the weak outsiders from their internal sake and logic. His argument, however, is based on the assumption that developing countries are not developing, and that developing countries will prefer authoritative regimes rather than market-oriented regimes, since the former regimes will alleviate developing countries' vulnerability. Nevertheless, the development of developing countries in East Asia and parts of Latin America presented a different scenario and raised different problems. The challenge of weak developing countries turned into power transition or emerging powers theme. Thus, will the new emerging powers overturn the existing order? How will the international system accommodate the new rising powers? And what kind of policies should be undertaken by the leading countries?²

China is the most obvious example to show this sort of theoretical reorientation. Before China adopted its open-door policy and began participating in the international organizations, China was seen as a revolutionary or revisionist country for its political

¹ Krasner 1985, 3-31; 267-314.

² Ikenberry 2008; Schweller 1999, 1.

ideology. However, since the end of 1970s, China has tried to integrate itself into the international community. After three decades of economic growth, the propositions about China are now dominated by the implication of a rising China on both the international system and American hegemony. Scholars are concerned about the consequences of China's economic growth and increased material power on the international order, international regimes, and the United States position.

From the perspective of realism, power competition is inevitable in international anarchy, and international relations are described as the rise and fall of great powers. The leading nations cannot remain their dominate position constant, given the uneven economic growth rates among countries and technological and organizational breakthroughs.³ Realists argue that the international institutions reflect the power relations among states. The institutions are created and imposed by the leading countries, and therefore serve their own interests best.⁴ As new powers emerge, they require the reform and restructuring of the existing international institutions to suit their interests. In their view, a rising China will be a challenger to international order and American leadership.

Offensive realism goes further. John Mearsheimer provides a pessimistic understanding of power transition. In his view, international relations are power struggle among states in the anarchic arena and military capability is the most useful instrument to survive in international anarchy. Increasing economic strength transforms to military capacities, and the upward competitive spiral is inevitable. For Mearsheimer, the international structure encourages great powers to “act offensively and seek hegemony”; survival is the foremost motive of great powers; and military forces are the ultimate and most effective way to compete. According to the realist tradition, a rising China casts a shadow over the existing international system and hegemon. Sooner or later, China will challenge and attempt to overturn the international institutions.⁵

Liberal institutionalism has a different perspective on emerging powers, international order, and the role of institutions. In its framework, institutions can promote international cooperation, since international institutions can overcome collective action, reduce transaction costs, and provide more information.⁶ International institutions increase the possibility of peacefully solving conflicts among states. When some countries with systematic impacts emerge, reforming and restructuring international institutions is one feasible way to accommodate these powers. Robert Keohane points out that the institutions are essential for human life in a “partially globalized world” and argues that effective institutions could be designed and maintained. In his view, the type or pattern of international institutions is relevant. The institutions that we demand should overcome the governance dilemma on a

³ Kennedy 1987.

⁴ Ikenberry 2001, 27; Gilpin 1981, 42-43.

⁵ Schweller 1999; Lampton 2008, 14.

⁶ Keohane 1984; Martin 1998.

global scale.⁷ Keohane emphasizes three factors for institutions: accountability, participation, and persuasion, by which to strengthen the legitimacy and effectiveness of institutions. Under this institutional logic, some scholars provide detailed reform agenda for global economic governance in particular. Ngaire Woods argues that existing global institutions have not caught up with the development of globalization and the main global economic institutions are in crisis. In order to reinvigorate these institutions, it is necessary to accelerate the speed of reform and the restructuring of existing international institutions and increase their participation. In her reform proposal, Woods advocates some specific measures to reshape existing international economic institutions: redefining the mandate and priorities of these institutions, reforming their governance structure, and a geographic shift of their headquarters.⁸

As for the subject of a rising China, other scholars provide another approach to think about the relationship between an emerging power and international institutions. They assume that China is a realist country, and its increasing economic power will eventually transfer to political strength and become a full-fledged player in international arena. However, different from realists, these observers stress the important role of institutions. Ikenberry points out that one of the most distinct features of contemporary international order is the existence of the Western-centered, open, and rule-based international institutions.⁹ After the end of the World War II, the United States created extensive intergovernmental institutions to organize the post-war international order.¹⁰ Against this background, a wrenching hegemonic transition could be avoided. The leading country can use the existing international institutions to shape or confine the international environment in which China will play the game. An open, integrated, and rule-based international order has more capacity to accommodate rising powers. According to Ikenberry, as long as the United States effectively maintain and promote the openness and durability of the existing order, it will be feasible to integrate the emerging countries, not only China, into the established order, and achieve the triumph of the liberal order.

Constructivists go further on the relationship between international institutions and new rising powers. Alastair Iain Johnston begins with the empirical puzzle: why China agreed to cooperate in security institutions that did little to enhance its relative power.¹¹ He found that Chinese foreign policy makers who have inherited a hard realpolitik ideology, adopted cooperative behavior to security institutions since 1980, which happened without obvious material benefits. Johnston argues that this pro-group cooperative behavior is a function of the social interaction of humans. He highlights the role of socialization, and outlines three microprocesses of socialization: mimicking, social influence, and persuasion. In this framework, he integrates the learning process, reputation or image, and belief together to explain China's

⁷ Keohane 2001; Buchanan and Keohane 2006.

⁸ Woods 2008; 2007.

⁹ Ikenberry 2008.

¹⁰ Ikenberry 2001.

¹¹ Johnston 2007.

international behavior. This framework has at least two insights: treating policy preferences as an endogenous factor rather than exogenous, fixed factor, and tracing the preferences formation and change in the social interaction. However, it is still difficult to explain why and how China's policy preferences changed in the first place in the end of 1970s. And it is likely to overestimate the role of international institutions for shaping China's choice and overlook the China's autonomy to make critical choice.

These explanations and theories yield varied approaches to understanding and interpreting Chinese behavior in international institutions. All of these approaches have explicit policy implications for the established countries, particularly the United States, and new emerging powers as well. Just like Johnston put it that "participation in international institutions has not been a major focus of Chinese foreign policy studies",¹² there are a couple of question unanswered. First, what factors influenced the degree of China's preferences change toward international institutions in the first place? Just like Johnston's suggestion, we should ponder preference formation and change problem and treat it as an endogenous factor. It is clear that China has experienced rapid involvement in international institutions since 1978. Two time points are worth being examining carefully: 1978 and 1992. At former time point, why did China determine to open its door and therefore actively participate in international institutions? The latter raised the question why did China continue its domestic reform and international participation under being isolated and hostile circumstance? Theories which highlight the teaching role of international community view the engagement of China adopted by the second Clinton administration as a way of teaching Beijing about norms and rules.¹³ But Chinese leaders' choice was made prior to the engagement policy, do we have better explanations?

Second, is China a status quo state or a revisionist state? This dichotomy is less helpful to understand China's participation in international institutions. In essence, the theoretical position determines the judgment. For a hard realist, China will be, sooner or later, a challenger to international order, and try to reform and restructure the principles, norms, rules, and procedure serving Chinese interest. For less hard realist, whether China will be a status quo country or not depends on United States' choice. The United States should continue its engagement policy, make China be a responsible stakeholder, and shape the choice of a rising China.¹⁴ And others believe China is no longer a system challenger but broadly a system maintainer, and China is working within the existing institutions, rather from the outside.¹⁵ Nevertheless, this dichotomy ignores that China as a new emerging power has interests in reform of the international institutions, as well as maintaining them. It is hard to explain why China's behavior in international institutions varies by issue areas and over time. In some issue areas, China has strong policy assertion, such as against the Bilateral

¹² Johnston 2007, xxii.

¹³ Johnston 2007, 2.

¹⁴ Christensen 2009.

¹⁵ Foot 2006, 79; Ikenberry 2008.

Surveillance 2007 of IMF, and unilateral aid in Africa. At the same time, in other areas, China seems indifferent to these institutions, for example, China participates less actively in the UN Security Council, or is less enthusiastic about the IMF reform before 2008.

Third, what kind of international institutions does China expect or prefer? The literature roughly falls into two categories about Chinese or emerging powers' requirements for the international institutions: to challenge and overturn the institution, and to follow and integrate into the institutions. In essence, these two kinds of literature share, to some extent, similar realism premises. But they have different evaluation of the nature of the relationship between emerging power and institutions, and various response policies to the emerging powers. The literature is mainly from the supply side, exploring the alternative reform proposals of international institutions, and ignores the demands of new emerging powers.

Without explanations from the demand side, it is hard to clarify the emerging powers' requirements and ensure its intentions. The literature has tried to reveal the nature of Chinese strategic culture, the international environment in which China plays, the interaction between China and the international environment, and presented policies coping with China, but it seems still anxious and uncertain about China's participation in the institutions. Even when China tried to keep a low profile, for example, shortly after June 4, 1989, Deng Xiaoping put it that "adopt a sober perspective; maintain a stable posture; be composed; conserve your strength and conceal your resources; don't aspire to be the head; do something eventually,"¹⁶ this statement actually increased western anxiety about China's true intention. Just like David Lampton described, the relationship between China and the United States is a double gamble. America has bet that China will be a responsible stakeholder in the international system, and accept rather than overturn the international principles and norms with its power growth. At the same time, China has bet that Washington will not seek to systematically frustrate the development of China. "These 'bets' have been placed not only by the leadership of each country but by their middle classes and societal organizations as well, and the stakes are high."¹⁷

Therefore, we need an explanation of China's participation behavior in the international institutions from the domestic politics. We should explore the conditions under which China will accept international norms, or refuse these norms, and the way in which China has integrated in the international institutions and puts forth its demands to the institutions. The next section attempts to provide an approach to understanding and interpreting China's international behavior from its domestic reform logic.

The Argument

¹⁶ Cited from Lampton 2007, 16.

¹⁷ Lampton 2007, 274.

China's participation in the international economic institutions is a function of the process and dynamics of its domestic reform. China's domestic economic, political, and social reform has heavily influenced the Chinese people's welfare and the country's international behavior. The way of how China's reform has unfolded provides Chinese leaders lessons of how to integrate into the international institutions. From China's reform process and characteristics, it will be more helpful to explore the conditions under which China will and will not accept international norms, and to estimate the requirements China is likely to propose given its economic growth. A few existing research already pays attention to the domestic politics dimension. For example, Susan Shirk points out that the leadership competition within the Communist Party of China is a source of policy innovation.¹⁸ Moreover, Michel Oksenberg and Elizabeth Economy use the following variables--the objectives of the leader, the nature of the regime, Chinese domestic politics, and deeply rooted Chinese Strategies and tactics—to explain Chinese behavior in world affairs.¹⁹ The following section summarizes the process, characteristics, and dynamics of China's reform, and analyses how these factors affect China's participation behavior in the international economic institutions.

The Process and Characteristics of China's Reform

China's economic reform is seen to be different from the big bang that was undertaken by the East European countries, and is a process of propagation in which regions and sectors reform one after another. There are three characteristics of China's reform process.²⁰

First, the reform began without a well-defined blueprint. There was no a carefully plotted reform strategy. China's reform did not proceed after an ideal or pre-designed framework or timetable. During the initial phase of reform, Chinese leaders only had a general idea and simple objectives: to double the national economy at the end of the twenty century and to become a medium income country in the middle of the twenty first century. However, there were no designed strategies to achieve these objectives. Deng Xiaoping describes the reform process as “crossing the river by groping stones.” The reform started in the agriculture sector and in special economic zones along the coastal areas. It then expanded to the industrial sectors. New non-state owned enterprises appeared and their importance increased dramatically. Naughton puts it, “reform proceeds by a series of feedback loops—reform begets further reform. A microeconomic reform (resulting in competition for state firms) creates a macroeconomic problem (a squeeze on government revenue), which impels further microeconomic reforms (more profit-oriented regulation of state firms).”²¹ Due to the lack of blueprint, experimentation-promotion is a specific pattern of how China pushed its reform forward. With the reform deepening, the reform strategy and objective gradually emerged. Deng Xiaoping's “Southern Journey Speeches” and the

¹⁸ Shirk 1984, 1996.

¹⁹ Oksenberg and Economy 1999, 3.

²⁰ Wu 2005; Naughton 1995, 2007; Lin, Cai and Li 1994.

²¹ Naughton 2008.

14th National Congress of the CPC in 1992 put forward the reform objective of establishing a socialist market economy. Since then, China's reform is viewed as entering a new era of "overall advance of reform".

Second, the reform process is driven mainly by the specific problems during the transition. China has designed many interim institutional arrangements. The dual-track system is to ensure the survival and development of non-traditional planned economy sectors and actors in the command economy system. In a planned economy, almost all capital and material are allocated by administrative order, and price is just a measurement for accounting among economic units. But as non-state enterprises developed, the central government needs to design special institutional arrangements to ensure these economic actors are able to access the resources and foreign currencies. Therefore, at the beginning of the reform, the dual track price system and foreign exchange system appeared. The dual track system played a positive role in the rapid development and non-state sectors and the smooth transformation from a central planned economy to a socialist market economy. The Chinese leaders adopted new institutional arrangements by practice and specific problems faced in the reform process. The central government takes the responsibility to identify the problems and makes policy choices. The series of events about globalization in the last decade of twenty century, such as the Asian financial crisis and WTO Seattle ministry conference, made Chinese leaders redefining their framework to discover the problems and make responses. Hu Jintao states that the Chinese leadership "should steer development direction from the mutual connection between international and domestic situations; grab development opportunities from the reciprocal interaction between international and domestic conditions; create development conditions from the reciprocal complementary international and domestic advantages; and command whole development scenario by comprehensive utilizing international and domestic factors."²² For Chinese leaders, the reform is a process of self promotion and development under the complex international and domestic challenges.

Third, China's reform is incremental reform. After the failed experiment of increasing enterprise autonomy, China adopted some patching-up measures to keep the state sector running and switched its main effort to non-state sectors for new growth. This strategy is called incremental reform.²³ Incremental reform means that the reform does not deal with the redistribution of asset stock in the initial phase, but focuses on how to use market mechanism to allocate the incremental asset. Incremental reform can reduce the adjustment costs and keep the balance between reform speed and social stability. Thereby, incremental reform can avoid the next reform step could be the last.²⁴ While the traditional state-own enterprises are still operated by administrative order, yet the allocation of resources in the new emerging sector is mainly by market. Moreover, the reform process was gradual. China's reform

²² Cited from Li 2007, 17.

²³ Wu 2005, 57.

²⁴ McKinnon 1993.

process appeared expansive characteristic: from the agriculture sector to the industry sector, from rural to urban areas, from special economic zones to coastal provinces and then all countries, from non-state enterprises to state-owned enterprises, and from tax and fiscal to financial and trade liberalization etc.

China's behavior in the international economic institutions is influenced by these reform characteristics. First, China does not have a clear and definite picture about the reform and restructuring of international institutions, just like how it did not have one for its domestic reform. Second, China's demands to international institutions are made on the basis of its domestic reform. When domestic reform requires it to participate more in the international institutions, China will do so to achieve its domestic objectives. Third, Chinese leaders try to actively identify the challenges in the international arena, before making decisions about whether to accept international norms and rules. Finally, China will insist on an incremental way to propose its reform requirements to the international institutions. China will tend to accept incremental reforms. Some hypotheses about China's participation behavior in international institutions, such as whether China prefers multilateral, bilateral, or unilateral way, whether China is a responsible stakeholder etc, overlook these characteristics of China's participation process.

The Dynamics of China's Reform

For those concerned with China's rise, the future of China's reform appears uncertain. Will China continue its economic reform? Is it possible that China reverses its reform process? Will China accept international principles, norms, and rules, or overturn them? How will China use its increasing economic power? For the pessimistic observers, they see a high risk that China will face serious challenges in deepening its reform, because of its domestic political conflicts and authoritarian regime. They argue that the reform process depends on a few Chinese leaders, and that there are no institutional arrangements to guarantee the reform moving forward rather backward. Leadership turnover would not only allow the new government to reverse the reforms, but also confiscate considerable wealth and punish those who were successful under the reform. The discretion of a small group of leaders may eliminate the prospects of any reform program. On the other hand, the optimistic observers believe that the reform process is hardly reversible. The internal logic of how the reform has unfolded already created autonomous momentum for pushing the reform forward. This problem is relevant to what China will become and what China's preferences toward the international institutions could be.

In the late 1980s, China experienced great economic and political disturbances. Some scholars even thought that China was in deep crisis. Tang Tsou argues that the Tian'anmen crackdown is another reflection of the polarized trend in Chinese contemporary political history. Tsou notes that the institutional structure and social expectation have not developed to allow Chinese through bargaining, negotiation, and

a series of compromises and mutual adjustments rationally to solve conflicts.²⁵ He believes that there was a fundamental political crisis after 1989, which was essentially confrontation and conflict between the domestic left and right. He was pessimistic about China's future. Against this backdrop, Harold Jacobson and Michel Oksenberg predicted that the process of China's participation into international institutions would be "more protracted, more difficult, and more internally divisive than the early and mid-1980s",²⁶ because its domestic political situation has become more conservative. It is true that after 1989 China has not only been isolated by the main industrialized countries, but has also had intense domestic debates about its future. Some conservative political elders and scholars blamed the market-oriented reforms, for which resulted in the political and economic upheavals in the late 1980s. However when Deng Xiaoping made his famous Southern journey speeches on reform and the socialist market economy in early 1992, the reform and opening up policy regained momentum. In the same year, the 14th National Congress of the CPC set forth the reform target of establishing a socialist market economy. These political movements stood for a new stage for China's reform. Why and how could China recover from the crisis and regain the reform momentum?

Some economists argue that China's gradual reform is irreversible because of its internal logical sequence.²⁷ Yifu Lin, Fang Cai and Zhou Li emphasize the path-dependent effects. When it chose a catching-up development strategy in 1950s, that is, making heavy industry as its development priority, China had to establish a planned economy to control the interest rate, foreign exchange rate, wage, and main materials prices. The reform logic is the same. When China adopted initial reform steps, the planned macroeconomic system could not accommodate the new non-state sectors, market oriented micro-management, and resource allocation system. As a consequence of these changes, decentralization and partial marketization made the reform process irreversible. China's reform began with the micro-management institutions by increasing their managerial autonomy. The improvement in the micro incentives created a new stream of resources. There is a generally consistent logic to the way planned economy dissolve. The interrelatedness of command economies makes the transformation process irreversible. Thus, a positive transformation process may be set in motion even without a clear or comprehensive commitment to a reformed market economy at the outset.²⁸

From a political economy perspective, Gabriella Montinola, Yingyi Qian, and Barry Weingast argue that the system of special federalism provides political foundations for China's economic reform.²⁹ This kind of market-preserving federalism has made the Chinese reform process hard, if no impossible, to reverse. They emphasize three principal factors: decentralization, a shift of ideology, and the opening-up to outside

²⁵ Tsou 1994, 135-138.

²⁶ Jacobson and Oksenberg 1990, ix.

²⁷ Lin, Fang, and Li 1994, 246-266.

²⁸ Naughton 2008, 309.

²⁹ Montinola, Qian, and Weingast 1995.

world. These changes resulted in a Chinese style federalism that largely preserved the reform's progress. The provincial leaders who have had much greater power and more resources under the decentralization and fiscal reform progress, and these developments increase their capacities to oppose the central government to protect their interests. Therefore, they believe that this institutional change will guarantee that the reform moves forward. However, there are some shortcomings to their theory. The market-preserving federalism reasoning assumes that the powerful provincial leaders have no incentive to be promoted to the central government, and their arguments are based on the fact that the central government was in a weak fiscal position in comparison with the local governments in the early 1990s. Their incentive assumption of powerful provincial leaders is obviously wrong. As for the fiscal capacity of the central government, we have already witnessed that the capacity of the central government for macroeconomic management and its fiscal expenditure has increased since 1994. Nevertheless, their research shows the necessity to provide an institutional explanation for China's reform.

Junru Li, Chinese official theorist (ideology interpreter of Communist Party), holds similar arguments about the irreversible process of the reform. He argues that when China shifted its policy priorities from "class struggle" to economic development, it had to replace the planned economy with a socialist market economy; when Chinese leaders accepted the market economy, ownership reform was inevitable and the coexistence of various ownerships appeared; with the development of non-public ownerships and non-state sectors, the policies should be adapted to the strata changes and new interest groups. He believes that this logical sequence of reform will make the political development deepen.³⁰

Some studies about the relationship between China and international institutions reflect this logic. The case study of China's participation in international energy institutions by Todd Johnson notes that the market can act "as a natural enforcer of reform." China's continuous economic development leads to its increasing demand for energy. To achieve these demands, China has to accelerate its speed of opening up to the foreign energy enterprises, which help China to exploit oil and gas reserves.³¹ Lester Rose illustrates the process of China's involvement in the international environmental regimes. She notes that China had to establish more institutional arrangements to facilitate the participation process and build more open decision-making and implementation institutions.³²

Here, I argue that China has taken a series of political institutional adjustments and explain how these institutional adjustments protect the whole reform and reduce the opportunity to organize anti-reform coalitions. These institutional reforms are more important than the so-called Chinese style federalism or mere economic logic. There are two aspects of these institutional adjustments: the restructuring of the highest

³⁰ Li 2007, 29-30.

³¹ Johnson 1999.

³² Rose 1999.

decision-making institutions and a series of “administrative system reforms” (xingzheng jigou gaige). Through these adjustments, the pro-reform leaders and bureaucrats are further empowered.

First, the composition of the Politburo of Central Committee of the CPC has changed over time. The Politburo is the highest decision-making institution in China. It is a small group of the highest level leaders, consisting of members from the Communist Party, the State Council, and the military. Members of the Politburo are elected by the Central Committee of the CPC. The changes of the Politburo began in the initial phase of the reform. The first institutional adjustment was regarding compulsory retirement. In the governance practice of Communist Party, there is no normal exit mechanism for political leaders, which sometimes leads to succession struggles. This is why some observers are concerned about the consequences of leader succession in non-democratic countries and worry that leadership succession may cause policy turnover. The CPC adopted a series of institutional adjustments to ensure the continuity of reform policy. In 1982, the CPC made a decision to abolish the long-life tenure of political leaders, which set a preliminary standard for exit mechanism. During 1982-1992, the CPC set up a Central Consultative Committee as an interim institution to accommodate elderly political leaders. Since then, the age ceiling has become the most formal norm for power transition. There are two consequences of this compulsory retirement norm. First, it reduces the average term of Politburo members. Since the 14th National Congress of the Communist Party of China in 1992, the average duration³³ as a member of the Politburo is about 11 years, that is, about two terms. The composition of the Politburo has also changed. First, the percentage of one term Politburo members was 71%, 32%, 65%, and 40% over the past four terms since the 14th CCCPC (table 1). The percentage of members who remain for three terms or more is about 20%. These figures not only show the political cycle of Chinese politics, but also illustrate the consequence of the compulsory retirement norm. It reduces the opportunity and increases the costs of organizing political opposition, which allows the reform to move easily forward. Second, in terms of distribution by sectors and regions, the composition of the Politburo has also varied over time. Before 1992, about 50 percent of Politburo members were from the military. On the contrary, there are only two members from the military since the 14th CCCPC in 1992. Except nine Standing Committee Members, the Politburo of the 17th CCCPC (elected in 2007) consists of six members from local governments, four members from the executive branch, four from the party system (including one related to the National Congress and one related to the People’s Consultative Congress), and two from the military. About half the members are the real implementers of the reform.

³³ The calculation is based on each member’s real or expected years (those will continue their jobs until the expected retirement year) in the position.

Table 1: The Composition of Politburo of CCCPC by Term of Office

(number/percentage)	14 th CCCPC	15 th CCCPC	16 th CCCPC	17 th CCCPC
One term	15 (71%)	7 (32%)	15 (65%)	10 (40%)
Two	6 (29%)	10 (45%)	5 (22%)	10 (40%)
Three and more		5 (23%)	3 (13%)	5 (20%)

Second, the administrative system reform is the political institutional adjustment that empowers the departments and ministries relevant to the market economy and opening-up policy. The administrative system reform is Chinese-styled governance restructuring. This kind of reform is not like Susan Shirk's prediction that Chinese leaders rarely have the capacity to impose painful policies over the heads of bureaucrats.³⁴ Until now, there have been six rounds of reforms on the governance structure. In 1982, the compulsory retirement norm was set up: a minister has to retire in 65 and a deputy minister in 60. In 1988, the reform focused on separating enterprise operation from administrative order (*zhengqi fenkai*), whereby much more management autonomy was given to state-owned enterprises and direct intervention by the government in enterprise operation was avoided. Subsequently, in order to adapt to a socialist market economy, the major goal of the reform in 1993 was to redefine the government's functions and role in a market economy. The reform in 1998 was the most drastic one. Many departments related to the planned economy were streamlined or integrated into other departments. Fifteen departments were abolished, such as the ministries of electricity, coal industry, metallurgy, chemistry, and post, etc. After China joined the WTO, the Chinese government felt it necessary to restructure its ministries to face the new challenges. The Development and Plan commission was reformed and renamed as the Commission of Development and Reform. State-Owned Asset Supervision and Administration Commission (SASAC), the Banking Regulatory Commission, the department of Commerce, and the Supervision and Administration Commission of Food and Drug were also established. Among them, the establishment of the SASAC was one of the most important adjustments. The purpose of the SASAC is to increase the competitive capacities of the large and medium state-own enterprises in the international market. In 2008, the sixth round of institutional adjustment was adopted with the "giant department" or "eclectic department" idea as the guideline. One of the adjustments is to establish a mechanism of coordination and distribution responsibilities among the Development and Reform Commission, the department of Finance, and the People's Bank of China (the Chinese Central Bank). These three departments were placed in charge of macroeconomic management and long-term strategy, fiscal policy and taxation, and monetary policy and financial sector reform, respectively. This adjustment increased the central bank's role and power in economy, and reflects the rising leverage of the financial and banking sectors.

Although no western style democratization has occurred in China yet, the

³⁴ Shirk 1993, 334.

institutional adjustments in response to domestic and international challenges have made China's reform hardly, if not impossible, reversible. If this logic is correct, we can provide alternative answers for what and when China will put forward its reform proposals about international institutions, what norms and rules China will prefer, and whether China is a status quo state. China's marketization reform will lead it to accept the international economic principles and norms. When it completes its economic reform, China is likely to raise its reform.

The Hypotheses

To construct the argument that China's participation in the international economic institutions is a function of the process and dynamics of its domestic reform, I draw on a number of hypotheses to explain how domestic reform affects China's international behavior.

When the international principles and norms conform to the domestic reform policy, China is likely to accept these principles and norms.

When the rules and decision-making procedure of international institutions are restructured to constrain China's ongoing policies autonomy, then China is likely to oppose, even if their underlying principles and norms are in accordance with China's reform objective in the long term.

The Chinese government will adopt its reform policy based on the domestic and international situations. After China achieves its financial reform, China is likely to show greater willingness to participate in reform of the international monetary and financial institutions. China is also likely to insist on incremental and gradual reform.

In the following sections, I select three cases of China's relationship with the international monetary institutions to illustrate the process and logic of China's participation behavior. The first case is that China realized current account convertibility in 1996, which shares the logic of China's acceptance of international norms. Domestic reform progress required the government to realize the convertibility of the current account. Before this decision, China had already adopted a series of institutional arrangement reforms. The second case is to show the conditions under which China will oppose the reform efforts of international economic institutions. China strongly opposed the Bilateral Surveillance 2007. The third case is about China's policy choices after the 2008 financial crisis, which shows the logic underlying these decisions. Through this case, we attempt to provide some ideas on how to think about the way China could influence international monetary cooperation.

The Realization of Current Account Convertibility

The initial engagement between China and the IMF was seen as a successful one for both sides.³⁵ Some studies underscore the role which the IMF has played in China's reform process. For instance, William Feeney argues that "the IMF has been

³⁵ Jacobson and Oksenberg 1990, 57-59.

especially helpful in reforming China's foreign exchange regime."³⁶ From his view, the interaction between China and the Fund was much like a learning process by Chinese authorities, and that the Fund exported its expertise and provided technical assistance. However, the reality seemed much more complicated. In 1980, China introduced an internal settlement rate on foreign exchange without notifying the IMF. Before 1994, China had adopted a dual track system of foreign exchange. It was not until 1996 that China realized its current account convertibility. What factors can help to explain these realities? What is the real reason pushing China to conduct foreign exchange reform, bank reform, and financial sector reform? Under what conditions did China accept the norm of current account convertibility?

The IMF was established in order to avoid the global economic destruction and prevent countries from adopting beggar-thy-neighbor policies. The experience between two World Wars had shown exchange restrictions and competitive exchange depreciations had negative effects on international trade and were likely to lead international friction. Therefore, in the IMF Articles of Agreement, the objectives of the IMF were set as to promote international monetary cooperation through a permanent institution; to promote exchange stability, maintain orderly exchange arrangements among members, and to avoid competitive depreciations; and to assist in the establishment of a multilateral system of payments.³⁷ In this regard, Article VIII, especially section (2), (3), and (4), defines specific obligations to which member states should make commitment to avoid restriction on current payments and discriminatory currency practices, and convert foreign-held balances. However, the Article XIV provides the transitional clause which allows member states to avail themselves. If member states want to accept Article VIII, they should notify the Fund that they would accept Article VIII obligations and no longer avail themselves of the transitional provision of Article XIV.

China participated in the Fund and the World Bank in 1980³⁸ and notified the Fund it would accept Article VIII obligations and achieve the current account convertibility in 1996, which means removing restrictions on current international payments and transfers. This is a clear example to show the conditions under which China would accept international norms and rules. Did the process be driven by the international pressures, new ideas, or other factors? China spent 16 years to make commitment to achieve current account convertibility. During the period, China had made various institutional adjustments in order to adapt to the domestic reform consequences. The process of China's acceptance of Article VIII illustrates how the domestic reform affects China's international behavior.

The Process of Institutional Adjustments

When China adopted opening-up and reform policies after the Third Plenary Session of the 11th CCCPC in December 1978, China had to reform and restructure its

³⁶ Feeney, 244.

³⁷ Article I (i), (iii) and (iv) of the Articles of Agreement.

³⁸ For a detailed discussion, see Jacobson and Okesenberg 1990, chapter 2 and 3.

government structure to respond to the pressures and challenges brought about by the reform. The administrative decentralization in the initial reform phase led to increasing economic activities of new actors and in new sectors. The Chinese authority made a series of institutional adjustments: some of which were interim, while others conformed to market principles. These reforms laid the foundation for the realization of current account convertibility. There were two major reforms conducted on banking sector and foreign exchange management institutions in relation to current account convertibility.

The bank and financial institutions of the planned economy were unable to adapt to the administrative and economic decentralization that occurred in the late 1970s. Wu Jinglian summarized the characteristics of the financial system under a planned economy, including the following features:

1. Money is the only financial asset.
2. Money is “passive” in that it is used only as a tool for pricing and accounting...Only industrial and commercial enterprises are allowed to obtain credit from the state bank, while credit among different enterprises is strictly prohibited.
3. The bank is only considered as the cashier for the state fiscal system, and one institution played the roles of both the central bank and commercial banks, resulting in the so-called “mono-bank system.”
4. The bank plays an insignificant role in inter-temporal allocation of financial resources. Its financing to enterprises is limited to only credit financing for “non-budgeted working capital”...
5. Households and individuals are not allowed to participate in any financial activities other than opening deposit accounts in the bank.³⁹

These constituted the financial context of China’s reform and opening-up policies. As long as the allocation of capital was determined by the central planner in the form of fiscal appropriations, state-owned enterprises were the sole form of production units, and the bank was the only form of financial intermediary, the planned financial system could sustain. When the right to self-management of collectives in rural area was reaffirmed by the central government and agricultural procurement prices increased, the monetary activities around agriculture expanded; when non-state enterprises and commercial enterprises were allowed and encouraged, the financial demands of these sectors emerged and strengthened; and when the state-owned enterprises received more autonomous decision-making power, the bank had to streamline and design its loan policies. The institutional adjustments in the banking sector were coincidentally in accordance with market economy principles and norms.

The establishment of the Central Bank. In the context of a planned economy, the People’s Bank of China (PBC) was the only bank in China.⁴⁰ The PBC served not

³⁹ Wu 2005, 218.

⁴⁰ In name, the People’s Construction of China, the Agricultural Bank of China, and Bank of China already existed,

only as the central bank of China to issue money, but also dealt with saving, lending, and insurance as a commercial bank. With the reform moving further, the PBC evolved to perform exclusive the functions of a central bank. The first step was to separate commercial finance business from the PBC. In September 1983, the state council decreed *The Decision on of the PBC Exclusively Playing the Role of the Central Bank*. According to this decision, the PBC as an administrative institution would exclusive handle the problems of financial regulation and enacting and implementing monetary policies. Soon after in 1993, the state council pointed out that it was necessary to strengthen the PBC's capacity for macroeconomic management. In 1995, The People's Bank of China Law was enacted and implemented, which formally and legally established the PBC as the central bank.

Commercial Banks. China's commercial banks emerged from the functional transformation of the PBC. Since 1979, the Agriculture Bank of China (ABC), the Bank of China, and the (People's) Construction Bank of China (CBC) successively separated from the PBC, and played the roles of supporting agriculture production, foreign exchange management, and investment financing business respectively. In 1984, the Industrial and Commercial Bank of China (ICBC) was established, making up the so-called big-four state-owned commercial banks with the former three banks. The consequence of the establishment of the commercial banks reflected the general shift of China's economic reform from agriculture, foreign exchange, and investment financing to industrial and commercial sectors. In the mid-1980s, in the face of the unprecedented development of town and village enterprises (TVEs), there were much stronger capital demands by these new actors. In 1986, the Chinese authorities allowed the big-four state-owned banks to cross their traditionally defined division of sectors to conduct their business. At the same time, the state council approved the entrance of commercial banks, and a number of joint-venture commercial banks were set up.⁴¹

The second major reform relevant to the current account convertibility was the foreign exchange management reform. Since 1949, China has successively chosen a self-seclusion development strategy (1949-1971) and an import substitution strategy (1972-1978). Then China had suffered with the shortage of foreign exchange for a long time. Against this backdrop, China adopted a strict control policy on the foreign exchange. The Chinese authorities required all foreign exchanges earned from exports to be surrendered at the official exchange rate, and thereafter allocated the foreign exchange according to administrative order. China also encouraged export for satisfying its import demands. Overvalued Chinese currency (renminbi, RMB) resulted in importers' advantage over exporters. Only when the domestic market relatively separated from the international one, the overvalued currency could sustain.

but actually were directly or indirectly affiliated to the PBC. During 1969-1978, the PBC was integrated into the department of finance for a while.

⁴¹ Besides these banks, there are medium and many local banks in China, such as rural credit cooperatives, rural commercial banks, urban credit cooperatives, and postal saving etc. At the same time, a few foreign-funded financial institutions are in operation in China.

When China opened its door, the priority of foreign trade was to solve the shortage of foreign exchange. In 1979, the state council passed *Some Rules on Greatly to Develop Foreign Trade and to Accumulate Foreign Exchange*, by which a new internal settlement foreign exchange rate was created and would be implemented since 1981. This decision actually devaluated the RMB.

At the same time, in order to encourage enterprises to export and earn foreign exchanges, the Chinese authorities introduced a foreign exchange retention arrangement, meaning that the enterprises could keep a share of foreign earnings. The foreign exchange retention system could be used for enterprises' import or sold on the swap-market. In 1980, the Bank of China began conducting foreign exchange trading service in 12 cities. In 1988, in order to comprehensively push forward the contracting system on foreign trade (duiwai maoyi chengbao jingying zeren zhi), the state council decided to set up foreign exchange swap market, and allowed the enterprises to buy and sell foreign exchanges at the market price. These adjustments partly reduced the negative effects of the overvalued RMB on export. With the growth of foreign trade and increasing size of the swap-market, the Chinese authorities gradually devaluated the RMB and the gap between the official and swap-market foreign exchange rate decreased. By 1993, 80 percent of foreign trade was settled at the swap market price. In 1993, the Third Plenary Session of the 14th CCCPC presented that creating conditions to realize the convertibility of the RMB. For the Chinese government, it was not necessary to maintain the dual track foreign exchange rate system. The results of previous policy choice and institutional adjustments made it possible and necessary to unify the official and swap-market foreign exchange rate. Since January 1994, China adopted a new foreign exchange rate management system: introducing a unified, managed floating foreign exchange rate regime; the system of exchange settlement and sale replacing the foreign exchange retention system; establishing foreign exchange market mainly through banks; and abolished the command order of allocation of foreign exchange. These developments laid the foundation for the current account convertibility. Soon later, China notified the IMF that it would accept the IMF's Article VIII and realize current account convertibility since December 1, 1996.

It is true that China's acceptance of the IMF's Article VIII was affected by the IMF and other organizations. Some scholars note that the IMF had played a critical role at certain junctures.⁴² As William Feeney notes that the unification of the dual foreign exchange rates and realization of current account convertibility were with strong IMF support.⁴³ Nicholas Lardy argues that the European Union had pressured China to achieve current account convertibly in the discussion of the Working Party on China's status in the General Agreement on Tariffs and Trade.⁴⁴ However, the process of realization of current account convertibility shows much more complicated policy changes. The domestic economic decentralization and corresponding institutional

⁴² Jacobson and Oksenberg 1990, .

⁴³ Feeney, 243-244.

⁴⁴ Lardy 1994, 106.

adjustments were the driving force for China's realization of current account convertibility. As Naughton put it, "the 1994 foreign exchange reforms were part of the coordinated package of fiscal, financial, and trade reforms that were rolled out simultaneously at the end of 1993 and beginning of 1994."⁴⁵ The final commitment to Article VIII was the result of the prior institutional adjustments and reflected China's domestic reform demands.

Against the 2007 Decision on Bilateral Surveillance

The surveillance is one of the core functions of the IMF. There are two aspects of the surveillance: bilateral surveillance, which evaluates the exchange rate policies of individual member countries; and multilateral surveillance, which monitors the world economy and international financial stability. The task of bilateral surveillance is to evaluate whether the exchange policies of individual member state are consistent not only with its own interest but also with the interest of international financial system. The surveillance of the IMF legally is based on the Article IV of the Fund's Articles of Agreement and the 1977 Decision on Surveillance over Exchange Rate Policies. Article IV was introduced in order to respond to the collapse of fixed exchange rate during 1971-73, when the United States abandoned the fixed par value for US dollar in terms of gold. The present version of Article IV was designed as part of the Second Amendment of the Articles, replacing the original the "par value system" clause. The Article IV stipulates that the member states can choose whatever foreign exchange arrangement they like, on one hand; and the Fund should promote the orderly exchange arrangements and a stable system of exchange rates. The core focus of Article IV is external stability, which means the member states cannot adopt certain macroeconomic policies caused external instability.

The Article IV is naturally in favor of the industrialized countries which adopted floating foreign exchange rate regime. It legalizes the market-driven exchange rate fluctuations. Thus, it actually avails the countries adopted floating exchange rate regime from the obligations of Article IV, especially when the surveillance focuses on the foreign exchange rates. On the contrary, the countries which still maintain fixed exchange rate regime are in disadvantageous position in the Fund's surveillance framework, since the term of external stability implies that the exchange rates and balance of payments flows are two sides of the same coin.⁴⁶ With respect to exchange rate policies, the Article IV stipulates that member states must avoid manipulating exchange rates to gain an unfair competitive advantage over other members. The 1977 Surveillance Decision is the specific measure to implement the norms of Article IV. The 1977 Decision introduced *Principles for the Guidance of Member's Exchange Rate Policies* (PGMs), according to which the Fund conducts appraisal of member states' commitment to Article IV. It stipulates that "a member should avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage

⁴⁵ Naughton 2007, 389.

⁴⁶ IMF 2006a, 4.

over other member”; “a member should intervene in the exchange market if necessary to counter disorderly conditions”; and “members should take into account in their intervention policies the interests of other members.” The PGMs clarified the obligations of the member states and the conditions under which member states are allowed to intervene the foreign exchange rates. The 1977 Surveillance Decision has served as the foundation for the Fund’s surveillance for 30 years, partly because the trade share of members with fixed exchange rate has been relative small, and partly because the obligations of Article IV and the 1977 Surveillance Decision were ambiguous.

As Mr. Rodrigo de Rato came into office as the new IMF Managing Director in 2005, he launched a strategic review to consider how to reform and restructure the Fund and how to make the Fund relevant to the globalization. After research and discussion, the Managing director proposed a medium-term reform strategy. One of the core points is to strengthen the Fund’s surveillance. The medium-term strategy notes that the terms of Article IV are too extensive and sometimes make the surveillance fail to persuade member states to adopt right policies. The surveillance has become procedural and diffuse, so it is necessary to reformulate the surveillance. Later, the IMF Executive Board approved a new Decision of Bilateral Surveillance in 2007. The 2007 Surveillance Decision got strong support from the United States. The United States Treasury Secretary Henry Paulson insisted that, “for the IMF to remain modern and relevant, it must reinvent itself...First and foremost, the IMF must fundamentally reform its approach to surveillance over exchange rates. Let us be clear: exercising firm surveillance over members’ exchange rate policies is the core function of the institution.”⁴⁷

The 2007 Surveillance Decision offers a new future direction of the IMF. The new decision introduced a concept of external stability as the bilateral surveillance principle, which means the imbalance of current account and capital account. Moreover, the decision clearly defines the exchange rate manipulation. Under the 2007 Surveillance Decision, the foreign exchange rate becomes the core surveillance objective. It is seen as the modernization of the 1977 Surveillance Decision. Meanwhile, the 2007 Decision deteriorates the position of members with fixed exchange rate polices. These countries will shoulder the major burden to adjust their foreign exchange rate when confronting trade imbalance problems. On the contrary, the floating exchange rate countries have much more autonomy, for their exchange rates are determined by the market.

China has strongly opposed the 2007 Surveillance Decision. As Deputy Governor of the PBC Hu Xiaolian put it, “in strengthening surveillance, the Fund should be realistic and not overestimate the role of exchange rates. Biased advice would damage the Fund’s role in safeguarding global economic and financial stability.”⁴⁸ Even after

⁴⁷ IMF 2007, 104.

⁴⁸ IMF 2007, 104.

the 2007 Decision was approved, China continued its opposition effort. At the IMFC meeting in 2009, Deputy Governor of the PBC Yi Gang said “the 2007 Decision distracted the attention of the Fund and the international community from real systemic risks, and delayed policy responses.... We call for a timely thorough review of the 2007 Decision in order to avoid a recurrence of past mistakes.”⁴⁹ It is obvious that China worries that the 2007 Decision could be used against China. In essence, the 2007 Decision, to some extent, targeted China’s exchange rate and the large amount of trade surplus. Why has China opposed the foreign exchange surveillance? Why does China prefer stable foreign exchange rate to floating exchange rate arrangement?

In essence, China supports the IMF to strengthen its surveillance especially after the Asian financial crisis in 1997, and it is willing to solve the global imbalance as well. Why has China opposed the 2007 Bilateral Surveillance? What factors could help explain China’s preference to stability of exchange rate policy? First, Chinese officials have a different explanation about the prerequisites of how to maintain the stability of the international monetary relations. They tend to separate the trade surplus from the exchange rate policies. Chinese officials argue currency appreciation may not rebalance the international trade. The examples of Japan and Germany already show this point. Then China would like to solve the trade imbalance by other measures rather than floating exchange rate or RMB’s appreciation.⁵⁰

Moreover, China insists that the focus of surveillance should be macroeconomic policies of the industrialized countries and short-term capital flows. In China’s view, these are the potential risks of the stability of the international monetary system. Thereby, the main mandate of the Fund should be to maintain the international financial stability and the stable foreign exchange rates among industrialized countries. Almost at every International Monetary and Financial Conference (IMFC), the Chinese representatives emphasize that the IMF should monitor the capital flows, and enhance surveillance over major industrialized countries.

Finally, it is obvious that stable and undervalued RMB is helpful for Chinese exports. This does not mean that the Chinese government intentionally manipulates the foreign exchange rate to gain the unfair competitive advantages. For the central government, the huge amount of foreign exchange reserves created costs and risks for the whole economic system. According to estimation, 310 billion US dollars are appropriate amount for China’s international trade and exchange rate stability. Over 2.3 trillion foreign exchanges result in the inflation pressures and asset risks under the international currency fluctuations. The domestic politics could help explain why stable foreign exchange rate is preferred and could be maintained. The uneven geographic distribution of export and consequent political structure make stable foreign exchange rate preferred. The international trade has geographically concentrated on the east coastal provinces, such as Guangdong, Shanghai, Zhejiang,

⁴⁹ Yi 2009, 3.

⁵⁰ Wu 2008.

Jiangsu, Beijing, and Tianjin etc. The heads of these provinces are the members or potential members of the Politburo of the CCCPC. The experience as the leader of these provinces enhances the opportunity to be promoted to the central government. About half members of the Politburo relates to these provinces, either they are the leaders of these provinces now or they worked as the leaders in command in these provinces. For these provincial leaders, they need achieve economic development during the term of office, which enhance their opportunity to be promoted. Under this political structure and promotion system, it is difficult to change the stable exchange rate preference without domestic institutional adjustments.

China's Choice after the Financial Crisis

China's economic growth stands out in the financial crisis context. The industrialized countries agree to allocate more quotas of the IMF and the World Bank in order to reflect the contemporary economic power realities. China, with other new emerging powers Brazil, India and Russia, has played great role in the contemporary world politics for reinvigorating the world economic momentum. These developments intensify some observers' anxieties about China's threat or challenge to the international institutions. Optimistic observers point out that the industrialized countries can use the international institutions to accommodate China and make it be in accordance with the international principles and norms. Meanwhile, the pessimists tend to worry about the power transition friction or conflict. For China, it is gaining more voice power in the international economic institutions, on one hand; it is also confronting much stronger pressures to restructure and transform its policies and institutions on the other hand. What are the implications of the financial crisis for China? Is it an opportunity for China to rise as a global power, or not? What will China probably do to respond to the consequence of the financial crisis?

In retrospect, three important events heavily influenced China's engagement with the international monetary cooperation: Asian financial crisis in 1997, China's entry to the WTO in 2001, and the financial crisis of 2008 and following trade protectionism and exchange rate pressures. As previous section discussed, one of the main functions of the CPC is to identify the problems relevant to economic development, and to figure out solutions to these problems. These three events made the Chinese authorities redefine the problems and challenges confronting the globalization. The Asian financial crisis frustrated China to realize the capital account convertibility. The commitment to the WTO of opening financial sectors led to further bank and financial reforms. This financial crisis could accelerate the speed of making the RMB convertible and financial sectors restructuring. The rational and process of domestic reform will make China's transformation conform to the international principles and norms.

The Asian financial crisis of 1997 impeded China to achieve capital account convertibility, but promoted financial sectors reform. In 1993, the Third Plenary Session of CCCPC and the state council proposed that China would gradually realize

the current account and capital account convertibility. In the end of 1996, China notified the IMF to accept the obligations of Article VIII and achieved current account convertibility. At that time, China has tried to realize the capital account convertibility. In September 1997, Minister of Finance Liu Zhongli presented that China “supports the extension of the Fund’s jurisdiction to capital account and we endorse the inclusion of capital account convertibility in the Fund’s purpose.” The 1997 Asian financial crisis altered China’s policy choices. In the following statement at the annual meeting of the IMF, Chinese representative expressed a different view that capital account convertibility should be carried out in an orderly and well sequenced manner. Furthermore, the financial crisis prompted the Chinese government to accelerate its financial reforms. In 1997, the National Financial Working Meeting (quanguo jinrong gongzuo huiyi) was held by the first time.⁵¹ The working meeting is one form of political mobilization, by which the CPC coordinates and informs the high level leaders, and makes them comply with the party’s policy priority. Thus, the Chinese authorities adopted a series of reforms to invigorate the banks and financial institutions. First, measures had been taken to enhance the authority of the central bank. Imitating American Federal Reserve System, nine large branches of the PRC were established to replace the provincial branches based on the administrative regions. Second, the function of the financial supervision and insurance supervision separated from the central bank. The Securities Regulatory Commission and the Insurance Regulatory Commission were created. Third, ministry of Finance issued 270 billion RMB bonds to increase capital for the commercial banks. In 1999, four financial asset management companies were set up in order to purchase and deal the bad loans from big four state-owned banks. The reform made the main banks’ capital adequacy ratio over 8 percent.

China’s accession to the WTO in 2001 was another major driving force to financial sector reforms. Facing the pressure of gradually opening the financial sectors in five years, the Second National Financial Working Meeting was held in 2002. The purposes of the meeting were to enhance competitive capacities of the financial sectors, to strengthen supervision capacity, and to promote the financial market. To these ends, first of all, the Chinese government adopted measures to transform the state-owned commercial banks into joint-stock banks, and then listed them on the stock exchange market. Second. The Bank Supervision Commission was established in 2003. Third, the authority and level of the central bank was promoted further. The Third National Financial Working Meeting of 2007 focused on the exchange rate and foreign reserves. After the meeting, the Central Huijin Investment Ltd was established, which is a state-owned investment company, in other words, it is China’s sovereignty wealth fund. China’s reform is a continuous reformulation process adapting to the changing international and domestic circumstances. China’s financial reform is

⁵¹ The national working meeting or the central working meeting focusing on specific issue area is the highest level meeting on certain issue area. In general, it consists of members of Central Committee of CPC, including the Politburo members, ministers of state council, secretaries of provincial committee of CPC, and governor of provinces. The Central Economic Working Meeting and Agriculture Working Meeting convene every year. The working meetings on other issue areas will convene according to the decision of central committee or the Politburo.

different from the market-oriented one of the East European countries and former Soviet Union. Thus, there was no well-defined blueprint for the financial reform at the beginning. The government goals of the financial reform were continually reformulated with the economic reform deepening. The accession to the WTO is a strong driving force, which leads China to establish marketization objective of financial system reform.

China has its own reform agenda for the international monetary system. The demands include: the mandate of the Fund is to maintain the international monetary and financial stability; the sources of the international financial crisis are systematic risks; the Fund should enhance the surveillance over major industrialized countries and capital flows; the Fund should increase the representation of the developing countries and accelerate the quota reform; the Fund should increase developing countries' representation in its staffing structure and enhance the transparency of the selection of the head of the Fund, etc.⁵² These requirements, however, are just part of China's response to this financial crisis.

Along similar lines that China has responded to the prior shocks, this financial crisis has made the Chinese government consider conducting further and deeper domestic reform as well. China uses this way to confront the new challenges. While China complains the weakness of the existing international monetary arrangement, it will adapt to the instinct weakness by domestic reforms.

The ongoing financial crisis tends to increase China's voice in the international economic institutions. At the same time, it also posed great challenges to China, including the RMB appreciation, trade protectionism, and China's financial security. Under this controversial context, China resumed the discussion about the direction of the international monetary arrangements and the reform strategy that China should undertake. It is said that the Fourth National Financial Working Meeting will be held in the second half this year. Chinese authorities would adapt to the changing international and domestic environments to design its further reform agenda and formulate its preference to the international monetary cooperation.

Internationalization of the RMB or the Asian Monetary Cooperation Mechanism?

The financial crisis exposed the weakness of the existing international monetary arrangements. The non-reserve currency countries are disadvantageous in the international monetary system. On one hand, these countries have to accumulate a number of exchange reserves to ensure the foreign trade and other international transaction. On the other hand, these countries also need to adjust their domestic policies responding to the international foreign exchange rate fluctuation. Against this backdrop, Chinese scholars and policy makers are discussing two policy options for the problem. Some scholars argue that China should learn from the European monetary cooperation experience to establish an Asian monetary cooperation

⁵² Summarized from the each speeches given by China's representatives at the IMFC meetings.

mechanism. They note that the Asian monetary cooperation already had a good development since the Asian financial crisis in 1997. The Chiang Mai Initiative is a multilateral exchange swap network, which is designed to fund the members when it suffered with sudden capital outflows. Moreover, the Asian Debts Market was already introduced. These developments will help China to cushion the disadvantages from the international monetary system.

Others emphasize the importance of the diversification of international currencies, and argue that China should accelerate its speed to internationalize the RMB. The final objective of China's financial reform is to transform the RMB to one of key international currencies. The RMB will gradually become the international currency, which could be used as accounting unit, settlement currency and exchange reserves. No matter which approaches will prevail, China is likely to promote its financial reforms and gradually achieve a modern, flexible, and competitive financial system in the next ten years. Specifically, it is great possible China will realize the capital account convertibility, achieve the RMB convertibility, adopt more flexible foreign exchange rate, and build Shanghai as the international financial center.

China acknowledges the importance of reforming the international monetary system, but the existing reform efforts overlook the systematic vulnerability. For China, it would be better to strengthen own capacity through further domestic reform than to depend on protracted and controversial reforms to the existing international monetary system.

Concluding Remarks

The rational and process of China's domestic reform affect its participation behavior in the international economic institutions. It is true that China has learned how to cope with the international institutions by practices. Only when the international institutions' recommendation were compatible with its internal reform direction, China will be easy to accept these norms and rules. This paper emphasizes the autonomy of China's government. The domestic reform rational and process can better explain why China participated in the international institutions in the first place and how the participation will unfold in the future.

Moreover, China is seen itself as a transition economy. The reform is a process of self-development and self-promotion. This identity is helpful for China to accept the international norms and rules. Finally, though China has no western style democratization until now, the market oriented reform is likely to proceed. Along the reform process, China has adopted a series of institutional adjustments, which provide the basis for the further pro-market reform. The domestic explanation could be complementary to the status quo or not dichotomy analysis.

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