COMPREHENDING CHINA'S STANCE IN GLOBAL FINANCIAL GOVERNANCE

COMPREHENDING CHINA'S STANCE TOWARD GLOBAL FINANCIAL GOVERNANCE: A TWO-STAGE MODEL

By

FALIN ZHANG (B.A., M.A.)

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AUTHOR: Falin Zhang, B.A., M.A. (Sichuan University), M.A. (McMaster University)

SUPERVISOR: Professor Robert O'Brien

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Abstract

China's attitude and foreign policies in global financial governance are not consistent. A two-stage model, which is comprised of formation of *Guojia Liyi* (interests and preferences of China, 国家利益) (Stage I) and decision-making process (Stage II), is established to explain China's policy inconsistency in global financial governance. Through this model, the thesis makes two major explanations for policy inconsistency. First, China's *Guojia Liyi* in various global financial governance institutions and/or events may be different. These different *Guojia Liyi* are constituted by personal epistemic interests, interests of the state and national interests and are constrained by both material and ideational factors, particularly the domestic and international political economic environment, state ideology and interpretation. Therefore, China's policies based on these *Guojia Liyi* vary. Second, even if the *Guojia Liyi* formed are the same in different events or institutions, the final actions are not always in accordance to the *Guojia Liyi* due to the influence of some factors on the specific decision-making process, such as lobbying, institutional conflicts and others. The two-stage model explains the policy inconsistency through both ontological and epistemological integration. Ontologically, this model considers structure and agent and treats both state and decision-makers as units of analysis. Epistemologically, this model incorporates both rational and cognitive school of thoughts by separating *Guojia Liyi* formation with specific decision-making processes and considering time as a crucial variable.

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List of Abbreviations

ANZ - Australia and New Zealand Banking Group Limited
ASEAN - Association of Southeast Asian Nations
BCBS - Basel Committee on Banking Supervision
BIS - Bank of International Settlement
BOC - Bank of China
BRIC – Brazil, Russia, India and China
CASS - Chinese Academy of Social Sciences
CBA - China Banking Association
CBRC - China Banking Regulatory Commission
CGFS - Committee on the Global Financial System
CGG - Commission on Global Governance
CIRC - China Insurance Regulatory Commission
CMB - China Merchants Bank
CPC - Communist Party of China
CPSS - Committee on Payment and Settlement Systems
CRA - Credit Rating Agencies
CSRC - China Securities Regulatory Commission
CTIA - China Textile Industry Association
DRC - Development Research Center of the State Council
DS – Developmental State
EMTA - Emerging Markets Traders Association
FALSG - Foreign Affairs Leading Small Group
FEALSG - Financial and Economic Affairs leading Small Group
FPA – Foreign Policy Analysis
FSB - Financial Stability Board
FSF - Financial Stability Forum
IAIS - International Association of Insurance Supervisors
IASB - International Accounting Standards Board
ICMA - International Capital Market Association
IFRS - International Financial Reporting Standards
IIF - Institute of International Finance
IMF - International Monetary Fund
IMS - International Monetary System
IOs – International Organizations
IOSCO - International Organization of Securities Commissions
IPE - International Political Economy
IR - International Relations
ISDA - International Swaps and Derivatives Association
MDBs - Multilateral Development Banks

MOF - Ministry of Finance of China
MOFCOM - Ministry of Commerce of China
NDRC - National Development and Reform Commission
NGOs – Non-Governmental Organizations
OECD - Organization for Economic Co-operation and Development
OTC – Over-the-counter
PBC - People's Bank of China
PLA - People's Liberation Army
PR Office - Policy Research Office
PSC - Central Politburo Standing Committee of the Communist Party of China
QE - Quantitative Easing
SAT - State Administration of Taxation
SDRs - Special Drawing Rights
SIFIs - Systematically Important Financial Institutions
SIFMA - Securities Industry and Financial Markets Association
SWIFT - Society for Worldwide Interbank Financial Telecommunication
UIA - Union of International Association
UN – United Nations
WB - World Bank
WFE - World Federations of Exchanges
WTO - World Trade Organization

Declaration of Academic Achievement

Parts of this thesis were published in a peer-reviewed journal or presented in academic conferences:

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Chapter One: Introduction

Global Governance and China

Since the early 1990s when the Cold War formally ended, informational technological advance, exacerbation of many transnational issues, such as international security in the post-cold war era, environmental degradation and international financial and economic crises, have together accelerated the globalization process. Against this backdrop, global governance has not only become an empirical fact, but a buzzword in academic circles of nearly every social science discipline, especially political science and economics. In political science, the academic study on global governance begins with three publications in the early 1990s, namely the publication of *Governing without Government* in 1992 (Rosenau & Czempiel, 1992), the publication of the Commission on Global Governance's *Our Global Neighborhood* in 1995, and the inauguration of the *Global Governance* journal and its first quarterly volume in 1995---*Global Governance: A Review of Multilateralism* (Dingwerth & Pattberg, 2006, p.185; Yunker, 2004, p.504). Subsequently, many works on global governance or global civil society appeared in the middle and late 1990s, such as, to name but a few, Simai (1994), Desai & Redfern (1995), Lipschultz & Mayer (1996), Weiss & Gordenker (1996), Diehl (1997), Paolini et al. (1998), Hewson & Sinclair (1999), Vayrynen (1999), Tehranian (1999) and Young (1999).

As the currency of the term "global governance" and the boom of related literatures, global governance "is all over the place" (Dingwerth & Pattberg, 2006, p.185), "appears to be virtually anything" (Finkelstein, 1995, p.368) and "has become one of the leading mantras" (Yunker, 2004, p.504) in contemporary academic debate about world politics. Among the vast literature are criticisms of it as both a concept and an empirical fact. As a concept, like other concepts in political science, such as globalization and international regime, it is criticized for lack of an accurate and agreed-upon meaning. Dingwerth and Pattberg (2006, p.188), for instance, argued "the confusion surrounding the meaning of global governance stems mainly from the fact that the concept is evoked not only where governance in the sense in which it has been introduced in political theory is at issue, but also in a variety of further contexts". The term "governance" is now employed in many setting with different meanings, such as "global governance" in international relations (IR), "good governance" in development policy, "multilevel or European governance" in European Union studies, "corporate governance" in finance and management, and many other usages in public policy like "urban governance" (Walters, 2004, p.28).

As an empirical fact, global governance is criticized for its ineffectiveness and illegitimacy. By examining three dimensions of global governance, the provision of global public goods, processes of transnational regulation and efforts to spread universal human rights, Davis (2012, p.273) suggested that "existing institutions and process (of global governance) are incoherent and illegitimate, if legitimacy is to be defined in terms of citizens' participation in decisions where trade-offs amongst competing values take place". Yunker (2004, p.503) even argued that global governance "suggests and implies a degree of order and control in the international community far beyond that which presently exists" and is a myth that "has emerged to help people cope with the uncongenial and presumably unavoidable reality that we are living in a world in which global governance is impossible, and in which therefore the international condition is most accurately described as 'international anarchy'". Despite these criticisms, global governance has become a remarkable phenomenon in the empirical world, a crucial concept in IR studies and an epochal characteristic of this age.

In the wake of the 1997 Asian financial crisis and 2008 global financial crisis, emerging powers, especially Brazil, Russia, India and China (BRIC), have come to the fore in global economy and governance. As the biggest emerging economy, China's status and strategy in global governance has aroused wide attention. Consequently and roughly, three competing views have been put forward. The first view argues China is a revisionist power in the international system and global governance, which is "primarily concerned with its own power and prestige above all other considerations, seeking to remodel the international system and order for its own benefit and in its own interests" (Combes, 2011, p.5). The arguments of this view are closely related to political realism that posits that rational and self-interested states are the primary actors in the anarchic international system and are inclined towards competition and conflict or their own survival and security (Grieco, 1990). As a result, "states recognize that the best way to survive in such a system is to be as powerful as possible relative to potential rivals" (Mearsheimer, 2006, p.160). According to this theoretical view, a rising China in terms of economic growth will inevitably challenge the existing power of balance and tend to change the international order in China's favour.

The second view, which is more popular in recent years, is that China is more likely a status quo power that actively seeks to work within the existing international system without challenging the current order. This view is, theoretically and mainly, based on the Neoliberal institutionalism, which holds that although states are competitive and in conflicts, inter-state cooperation is still possible through international institutions. In this view, many scholars argue China is cooperative and a status quo power in the international system. Johnston (2003, p.56), for example, argues if China is not a wholly status quo power, it at least "is more status quo-oriented relative to its past". Kim (2004) observes that except where sovereignty-bound issues are involved, such as Taiwan issue, China is a status quo power without any unsettling revisionist or norm-defying behaviour in the international system. Shirk (2008, p.108) asks "why shouldn't China support the status quo", given the flourishing of China in the current system. One potential theoretical explanation of these observations, as Neoliberal Institutionalist contends, is that China has paid more attention to absolute gains, rather than relative gains.

In contrast, the third view holds that China is neither an absolute revisionist nor a pure status quo power. Some scholars focus on other factors like culture, knowledge and ideas, rather than only the realist power of balance. For example, Haas (1992) holds that epistemic communities play a crucial role in shaping state behaviour, as well as the power and structural considerations stressed by realists. Combes (2011) contends that China is not a wholly status quo or wholly revisionist power. "Not being one does not mean to suggest that it is wholly the other" (p.6) and there is a huge amount of middle ground between the two.

This thesis argues that China is not an innate status quo power or revisionist in global governance, and China's behaviours or strategies are determined by its varying interests and preferences, which are not innate neither, but affected by material and ideational factors. In some cases or in some fields of global governance where the existing international order may be in conflict with China's interest and preferences, China tends to be more revisionist or revolutionary. On the other hand, where China's basic interest and preferences are maintained, China is more likely a status quo. In this sense, the formation of China's interest and preferences is the key to understand China's behaviour in the international system.

In addition to this scholarly question on China's stance, there are other research conundrums in relation to China in global governance. Wang and Zheng (2007, pp.169-178) comprehensively summarize 10 conundrums that have been widely discussed without consensus answers in academia. They are as follow:

> *"1. Pragmatic Realpolitik: Is China moving from strategic realism to pragmatic Realpolitik in its foreign policy?*
> *2. The UN as the anchor: How important is the UN as a base for developing China's multilateral diplomacy?*
> *3. Good neighbors: How important are good relations with its Asian neighbors for China's development?*
> *4. Status quo power: Is China a status quo power or is it a revisionist power?*
> *5. Democratizing international relations: Why does China put so much emphasis on it?*
> *6. Joining the world: Is China's joining the world guided by a deliberate design or is it dictated by necessity?*
> *7. Creeping leadership: Is China building its leadership role in world affairs by stealth?*

> *8. Scouring for energy: To what extent is China's diplomacy shaped by its search for oil and raw materials?*
> *9. All-directional approach: How inclusive is China's foreign policy, in theory and practice?*
> *10. Soft power: To what extent is China exercising its soft power to project its international image and influence?"*

Although the 10 questions tend to explore China's foreign policy in global governance from different perspectives or in different specific directions, one core question beneath them is: what are driving forces of China's action in international politics? As long as this core question or meta-question is answered, these micro questions can be answered. For this reason, this thesis aims to explore the driving forces of China's foreign policy and behaviours in global governance, taking global financial governance as a case study.

Global Financial Governance and China: Research Puzzles

Global financial governance is a subfield of global governance, along with global health governance, global food governance, global environment governance and many others. In this sense, defining the term of global financial governance requires a clear definition of global governance. Therefore, this section first looks into the conceptualization of global governance and then proposes a working definition of global financial governance drawing on definitions of global governance.

Global governance is variously defined. The definition from the Commission on Global Governance (CGG) has been acknowledged most widely. The Commission (CGG, 1995, p.2) stated that:

> "*Governance is the sum of many ways individuals and institutions, public and private, manage their common affairs. It is a continuing process through which conflicting or diverse interests may be accommodated and co-operative action taken. It includes formal institutions and regimes empowered to enforce*

> *compliance, as well as informal arrangements that people and institutions either have agreed to or perceive to be in their interest*."

This definition is more quoted than others, but is by no means a perfect one without flaws. Overbeek (2005) pointed out three key problems of this definition---lack of analytical or theoretical meaning, depoliticizing tendency and ahistorical feature. In the same year as the appearance of this definition, Finkelstein (1995, p.369) defined global governance simply as "governing, without sovereign authority, relationships that transcend national frontiers" and argued that "what we need is a conceptualization that enables us to penetrate and understand the government-like events that occur in the world of states even in the absence of government". Supporting this simple definition, many scholars, such as Makinda (2001) and O'Brien et al. (2000), contend that the incapability of states in managing global affairs and the absence of global government facilitated global governance led by other non-state actors, such as multilateral organizations, non-governmental organizations (NGOs) and multinational corporations.

In addition to the two incipient definitions, many other ways of defining global governance emerged subsequently. The first way is to treat global governance as an observable phenomenon or a political program (Dingwerth & Pattberg, 2006). In this view, global governance refers to a variety of phenomena, including global social movements, civil society, the changing regulative capacity of state, the activities of international organization, private organizations, public-private networks, transnational rule making and forms of private authority (Dingwerth & Pattberg, 2006, p.189). Rosenau's (1995, p.13) often-quoted definition is from the angle of human activity and social phenomenon. He stated that "global governance is conceived to include systems of rules at all levels of human activity - from the family to the international organization - in which the pursuit of goals through the exercise of control has transnational repercussions". For some other scholars, global governance, as a political concept, "captures a vision of how societies should address the most pressing global problems" that are caused by economic globalization and the resulting loss of national authority (Dingwerth & Pattberg, 2006, p.193). In his review, Spath (2002, p.193) argued, "theoretically, global governance offers an analytical concept to subsume various efforts at the global level to come to terms with this loss of control and to balance the uncontrolled processes of globalization".

The second way is to subsume definitions of global governance into macro, middle and micro levels (Biermann et al., 2009). The macro-level global governance focuses on the theoretical accounts of the overall phenomenon while the micro-level one stresses the empirical studies of distinct institutions to solve particular governance challenges. Standing between the two, Biermann et al. (2009, p.15) focus on the meta-level global governance - global governance architecture, which is defined as "the overarching system of public and private institutions that are valid or active in a given issue area of world politics" and "comprises organization, regimes, and other forms of principles, norms, regulations, and decision-making procedures".

The third way is to discern global governance as globalization of international processes, fragmentation processes or conflict regulation mechanism (Senghaas, 1993). The process of internationalization and globalization has inevitably made worldwide political events like international security and environmental degradation increasingly complex, and thus demands coordinated and concerted policy-making. In this sense, global governance simply refers to policy coordination among states. The fragmentation processes means increasing conflicts caused by clash of irreconcilable interests and marginalization led to by globalization processes. In this view, global governance emphasizes mediation of these increasing conflicts throughout the world. The conflict regulation mechanism is closely and causally related to the fragmentation process, but focuses more on appropriate intervention procedures launches by global actors, such as international private and public organizations.

The last and most common way is to define “global” and “governance” separately. With respect to “global”, there are two understandings. In the first, “global” refers to the extent and inclusiveness of the actor realm, which ranges from state to non-state, North to South, “high” to “low”, local to international and public to private (Whitman, 2003). In this view, Overbeek (2005, p.39) defined “global” as “of planetary dimension”, “world-wide” and “global-spanning”. In the second, “global” means aggregate. Therefore, global governance refers to “activities that also find expression as an aggregate phenomenon” (Whitman, 2003). The “global” appeared in the CGG’s definition mentioned above belongs to this second category. With regard to “governance”, four characteristics of it were clearly presented by Walters (2004). First, governance involves a shift of the analytical focus of political studies from “institutions” to “process” of rule. The essence of governance is the governing mechanisms without recourses to the authority and sanctions of government (Stoker, 1998). The aforementioned definitions from Finkelstein (1995), Makinda (2001) and O’Brien et al. (2000) reveal and stress this feature of governance. Second, governance emphasizes "self-governing networks". Governance is about managing networks, which are presumed to have their own autonomy and materiality. The third feature of governance is its particular narrative of social change while the fourth is the erosion of state sovereignty and eclipse of authority. Drawing on this perspective, Global governance is defined here as a world-spanning rule-making mechanism and network without government-like authority and involving various actors from state to non-state, North to South, local to international and public to private.

In this sense, global financial governance is understood as a global-spanning financial governing mechanism and network without government-like authority and involving various actors from state to non-state, North to South, local to international and public to private. Several points related to this definition should be stressed. First of all, global financial governance is a global-spanning mechanism and network. This mechanism and network is informal without the authority power of sovereign state. It aims to govern global finance by both informal and formal ways. The formal way includes international laws, regulations and rules like Basel accords. The informal way refers to non-binding suggestions and advice, forums, consultation and others. Third, global financial regulators include both public and private actors, mainly international organizations (IOs). The following Chapter Two analyzes in detail the newly reconstituted global financial governance network and its major actors and characteristics.

The definition above provides a framework for analyzing China's role in global financial governance. China's stance toward global financial governance can be observed from the aspects mentioned above - mechanism and network, ways and regulators.

Consequently, research questions emerge. On a global level, what is the new mechanism and network in response to the 2008 global financial crisis? In what ways has the previous flawed global financial governance system been improved? Who are the major actors in the new global financial governance system? With respect to China, what is China's position in this new mechanism and network? What are China's attitudes toward these changes? What is China's stance toward these global regulators?

As to these global-level questions, in the post-2008 global financial crisis era, the global financial governance system has experienced dramatic changes and a comparatively new network system has formed. With respect to these questions related to China, China's extraordinary performance during the crisis by virtue of its unique political and economic systems has elevated its role in the new system. However, China's attitudes toward global financial governance events and/or regulators vary. For example, toward the G8, China is more indifferent; as to the implementation of Basel III and the participation of the G20, China is more cooperative and active; toward global monetary system reform, China is more critical. This leads to a core research question: **Why has China advocated for the status quo in some cases but for modest reforms or even anti-status quo reforms toward other global financial governance institutions or events?** In essence, what is the driving force of China determining its strategies in global financial governance system? To answer this core question and explain the inconsistency of China's strategies in global financial governance, this thesis puts forward a two-stage model which treats interests and preferences as an inner drive and decision-making process as significant intervening factor.

Foreign Policy Analysis Literature: Why a New Model?

FPA has experienced several generations development since the end of World War II. The emergence and development of this subfield was catalyzed by the inability of the conventional IR theory in predicating and explaining profound empirical changes, such as the end of the Cold War (Gaddis 1992/1993; Hudson & Vore, 1995), and addressing the "agent-structure" puzzle underling most social scientific inquiry. Arguably, FPA has significantly contributed to political science in general and IR in particular. First, it connects international politics with domestic ones (Kaarbo, Lantis & Beasley, 2013). Second, it seeks to resolve the agent-structure problematique through "omnipresence of both actors and structures" and analysis on the intimate and reciprocal link between the two factors (Carlsnaes, 2012, p.114) and by "incorporating a more robust concept of agency into IR theory" (Hudson, 2005, p.4). Third, it bridges IR with other fields of political science and more broadly social science, such as comparative politics and psychology. Consequently, both explanandum and explanans of FPA have expanded dramatically. The former mainly emphasizes the purposive nature of foreign policy actions, policy commitments and role of state boundaries (Carlsnaes, 2007). The latter has incorporated respectively or simultaneously numerous factors at multiple levels from various disciplines. The multifactorial, multilevel and multidisciplinary feature of FPA brings difficulties for demarcating the substance and boundaries of this field and clearly summarizing the integrative works synthesizing varied factors (domestic vs. international and material vs. ideational), actors (individual vs. collective), levels (agency vs. structure) and disciplines (intra- vs. inter-disciplines).

A clear demarcation of the substance and boundary of FPA is conducive to theoretical integration of FPA frameworks, which is the true unfulfilled promise of FPA (Hudson, 2007). The existing studies, however, have not convincingly demonstrated a clear-cut skeleton of FPA that would inspire integrative works. Following three paradigmatic works in the 1950s and 1960s, for example, Hudson (2005) categorized FPA works into several generations from three aspects--- comparative foreign policy (CFP), foreign policy decision making and foreign policy context. Works in the three categories adopt different ontological and epistemological perspectives to explain and/or predict national foreign policies. This categorization outlines a clear trajectory of this subfield, but does not significantly contribute to the potential development of integration, for it failed to present explicit dimensions or points of reference for integration. These potential dimensions, which could be factors, actors, levels or disciplines, provide substantial contents and clear directions for potential vertical (within-dimension) and horizontal (across-dimension) theoretical integrations.

Current integrative FPA works mainly focus on vertical integration, which emphasize in-depth study within each dimension. Integrative foreign policy studies in terms of levels of analysis are a good example. In the period right after the World War II, foreign policy was exclusively a reaction to external stimuli (Rosenau, 1966) and foreign policy analysis focused on international level. Since the 1950s and 1960s, the focus has moved to the domestic sources of foreign policy and the interplay of external and internal variables has appeared. More recently, many scholars integrated both external and internal factors, such as Putnam's (1988) two-level games, neoclassical realism

(Schweller, 1998), and domestic-structure approach (Katzenstein, 1976). In addition, many studies attempted theoretical and empirical cross-fertilization of various decision actors, such as decision unites approach (Hermann, 2001), material and ideational factors, such as Alagappa (1998), Glenn (2009), Meyer & Strickmann (2011) and Sørensen (2008), and various disciplines, such as policy analysis and psychology. In contrast, horizontal integration, which refers to synthetic studies across different dimensions, is not equivalently developed as the vertical one. A major reason is that horizontal integration usually involves large numbers of factors from various dimensions, which are difficult to be synthesized logically and parsimoniously.

Similar with Carlsnaes' (2007) demarcation, this section categorizes FPA frameworks from the perspectives of ontology and epistemology/methodology and thus proposes a clear way to summarize the integrative works in FPA studies and a new approach to horizontally integrate the matrix of factors. Fundamentally, ontology of FPA is about the nature of entities or units of analysis, which could be agents (actors of deeds) and/or structures (contexts of actions). Both agents and structures are inescapable in deciphering foreign policies, since "every time we construct, however tentatively, a notion of social, political or economic causality we appeal, whether explicitly or (more likely) implicitly, to ideas about structure and agency" (Hay, 1995, p189). Empirical studies, nonetheless, tend to prioritize one over the other, because of the "agent-structure problem", namely the difficulties to successfully and simultaneously account for the powers of agents and the causal relevance of structural factors (Dessler, 1989). As a result, theories in IR and its FPA subfield are either actor-specific or actor-general. More broadly, "… regarding either agents or structures as ontologically primitive has been a constant and factious characteristics of the history of modern social science…" (Carlsnaes, 1992, p.248). Conventional IR theories are actor-general ones, which approximate state as a unitary actor and prioritize structure over agent. FPA breaks apart this monolithic view and deciphers the "black-boxing" of states by focusing on agents (individuals or groups) that comprise the state (Hudson & Vore, 1995). As such, ontological privilege, which prioritizes either agent or structure, is a crucial criterion to classify relevant studies of foreign policy.

An epistemological/methodological [1] criterion is another crucial one. The epistemological/methodological debates in IR, particularly the behavioural revolution in the 1950s and 1960s and the positivist-interpretivist debate since the middle 1980s, tremendously impacted FPA. The CFP branch pioneered by Rosenau (1966) is an outcome of the former. The latter corresponds to the rational-cognitive bipartition in FPA. In other words, various FPA models focus on either rationality (bounded or not) or cognition. The rational group argues that decision makers choose an option that maximizes utility rationally among a set of alternatives, while cognitive group holds that psychological factors, such as emotion, personality and belief system, capability of cognition of decision-makers and other factors like costs of information gathering, time pressure and organization structure make the rational assumption unrealistic in practice.

The ontological and epistemological/methodological privileges subsume foreign policy related studies into four types: rational/cognitive actor-specific and

[1] "Epistemology and methodology are intimately related: the former involves the philosophy of how we come to know the world and the latter involves the practice" (Trochim and Donnelly, 2006).

rational/cognitive actor-general approaches. The matrix below lists major frameworks of the four types.

<table>
<tr><td colspan="2" rowspan="2">Table 1.1 FPA Matrix</td><td colspan="2">Ontological Privilege</td></tr>
<tr><td>Agent (Actor-specific)</td><td>Structure (Actor-general)</td></tr>
<tr><td rowspan="2">Epistemological/ Methodological Privilege</td><td>Positivist /Rational</td><td>Rational Actor Model; Bounded Rationality and Cybernetic model; Comparative policy analysis; Collective actor (Bureaucratic Politics, Organization behaviour, Organizational process)</td><td>Realism; Neoliberalism; World-system theory; Hegemonic Stability Theory</td></tr>
<tr><td>Interpretative /Cognitive</td><td>Cognitive and psychological approaches; Neuroscience; Hermeneutics; Groupthink; Problem Representation</td><td>Social constructivism; Identity construction; Cultural approaches</td></tr>
</table>

This categorization presents two clear ways for horizontal (cross-dimension) integration of FPA works. One way is epistemological/methodological integration, bridging between both rational and cognitive schools of thoughts. A representative work is Mintz's (2003,2004,2005) poliheuristic theory and "Applied Decision Analysis" model. This theory and model is applied to analyze China's foreign policy, such as James et al. (2005) and Sandal et al. (2011). Another example is Welch's (2005) theory of foreign policy change, which is inspired by organization theory, cognitive and motivational psychology, and prospect theory. The other way is ontological integration, focusing on the linkage and mutual influence between agents and structures, domestic actors and international system as well as subjectivism and objectivism. Integrations of this type, mainly metatheoretical ones, are catalyzed by and in response to the agent-structure problem. Classic metatheoretical works include but are not limited to the structuration theory of Giddens (1986), the transformational model (Dessler, 1989) and the tripartite approach of Carlsnases (1992). On the empirical side, existing FPA works mostly focus on the unidirectional constraints and structuring of structures on agents, largely because the influence of domestic and international environments on policy-makers are far more explicit and earlier to measure than the reverse way. In addition, the intertwinements of the agent-structure relation with the micro-macro level-of-analysis and even rational-cognitive issues make the ontological integration more difficult.

Against this background, for explaining China's policy inconsistency in global financial governance, this thesis establishes a two-stage model, referring to both the ontological and epistemological/methodological integrations.

Chapters Outline

Excluding the introduction and conclusion chapters, the remainder of this thesis consists of six chapters. Chapter Two looks into changes of the global financial governance network in response to the 2008 global financial governance crisis as well as China's role in it. The new system and China's role in it in the post-crisis era have three major characteristics - centripetalism (rather than centrifugalism), elevation (rather than domination) and inconsistency (rather than coherence). Centripetalism means the patched global financial governance network system has more forces to coordinate states and related international organizations. Elevation refers to a relatively more important role of China in the new system, but, by no means, a dominant (or hegemonic) role. China is an indispensable participant rather than a leading power in global financial governance. Inconsistency indicates the differed strategies of China in various global financial governance institutions or toward different events. Based on this new system and considering China's elevated role in it, this thesis focuses on explaining the disparate strategies and stances of China in global financial governance.

Chapter Three establishes a two-stage theoretical model to explain the policy inconsistency. The two-stage model is comprised of the formation of *Guojia Liyi* (interests and preferences of China) (stage I) and the decision-making process (stage II). At the first stage, the structuring effects of both material (international and domestic political economic environment) and ideational factors (interpretation and state ideology) on *Guojia Liyi* may be different in various events or international financial governance institutions. Therefore, China's strategies in these events or institutions based on the *Guojia Liyi* are different, which is the first explanation of the consistency or inconsistency of China's foreign policy in the global financial governance. At the second stage, even if the *Guojia Liyi* formed are same in many events or in different institutions, the final actions are not always in accordance to the *Guojia Liyi* due to the influence of some factors on the specific decision-making process, such as lobbying, institutional conflict, complexity of issues, short-time pressures, emergent event and risk appetite of decision makers, which constitutes the second explanation.

Chapters Four-Seven are case studies analyzing China's attitudes towards or policies in global financial governance institutions or events. First, the G20 and the Financial Stability Board (FSB), as argued in a latter chapter, are the dual-core of the reformed global financial governance system. China was not a member of the Financial Stability Forum (FSF), the precursor of the FSB, until late 2008. In contrast, China has had a long relationship with the G20 since its founding in 1999 and with its predecessor - the G7/8. Therefore, the first case study in Chapter Four analyzes China's *Guojia Liyi* in the G8 and the G20 and consequently explains China's different attitudes towards the two institutions. Second, the global monetary system and financial regulation reform are the most salient fields of global finance governance. Flawed global monetary system and lax global and national financial regulation arguably resulted in the 2008 global financial crisis to a considerable extent. As such, Chapter Five looks into China's reform-minded stance toward the current international monetary system reform by dissecting the formation of China's *Guojia Liyi* in the reform**,** while Chapter Seven inquires into China's responses to the recent wave of global financial regulation reform, particularly the Basel III, employing the two-stage model. Lastly, China's exchange rate policy has long been a controversial topic in global financial governance. Chapter Six studies China's exchange rate policy, referring to both the formation of China's *Guojia Liyi* (Stage I) and the internal policy-making process (Stage II).

Chapter Two: China and Global Financial Governance - Centripetalism, Elevation and Inconsistency

In the post-2008 global financial crisis era, the global financial governance system has experienced dramatic changes and a comparatively new network system came into the fore. Meanwhile, China's extraordinary performance during the crisis by virtue of its unique political and economic systems elevated its role in this new system. Consequently, China, as an emerging power, has played an increasingly important role in global governance in general and global financial governance in particular. Against this backdrop, many research puzzles emerge in related studies, which include but are not limited to the following ones. What changes have occurred in global financial governance responding to the 2008 global financial crisis? What role does China play in the new global financial governance system? What are China's strategies in global financial governance?

The related literatures have delved into these questions, but left these conundrums unconvincingly answered. One consensus regarding to the changes of the global financial governance system against the 2008 global financial crisis is that the system was flawed and has been reformed. The new financial governance system is called "Networked International Financial Governance" (NIFG) and still has three distinct accountability problems -uneven representation of countries, overly technocratic character and the risk of capture by the financial industry (Helleiner & Porter, 2009, p.14). Helleiner (2009) observed that the crisis has not only led to reregulation of international financial markets by the leading Western governments, but unleashed centrifugal pressures that may lead toward a more decentralized and fragmented form of global financial governance over the medium term. Reflecting on this idea and inspired by the network analysis that is introduced to international politics studies by scholars like Sheng (2010) and Hafner-Burton, Kahler & Montgomery (2009), this chapter argues that the recent reforms only patched, but not revolutionized, the previous system. The patched system is a network centered on the G20 and the Financial Stability Board (FSB) and generates centripetal (rather than centrifugal) force to connect the previously fragmented global financial governance system.

China's role in the new network is also hotly debated. A fact is that the position of China in this new system has been enhanced (Helleiner & Kirshner, 2014a). The increase of China's quotas and voting power in International Monetary Fund (IMF) and World Bank (WB) and the incorporation of China into the G20 and the FSB are direct evidence. Disputes lie in two respects. First, is China a leader or rising star in the new global financial governance system? In other words, does China have "power-as-influence" or "power-as-autonomy", which respectively mean "the ability to change others' behavior" and "the capacity to act without restraint, independently from external influence" (Helleiner & Kirshner, 2014a, p. 3; Cohen, 2008)?

Second, what is China's strategy in this new system, a status-quo power or a revisionist? With regard to the first question, Garrett (2010, p.29) answered that "the world will be characterized by a de facto China - US G2 after the financial crisis". On the contrary, Overholt (2010, p.24) pointed out "China's strategy for growth had been fabulously successful but was becoming obsolescent". As a result, China is unlikely to be a leader in global financial governance. Hamilton-Hart (2012) focused more broadly on the Eastern Asian region and argued that despite the comparatively strong positions of this region during the crisis, it remains structurally embedded within the global markets, especially Western markets. This chapter concentrates on the structural position of China in the new global financial governance system and concludes that China is more powerful in this new system, but far from being a leader. The domestic economic achievements of China are the root cause for the structural elevation, while the domestic economic and societal challenges prevent China from being a leader in global financial governance in the short or medium term.

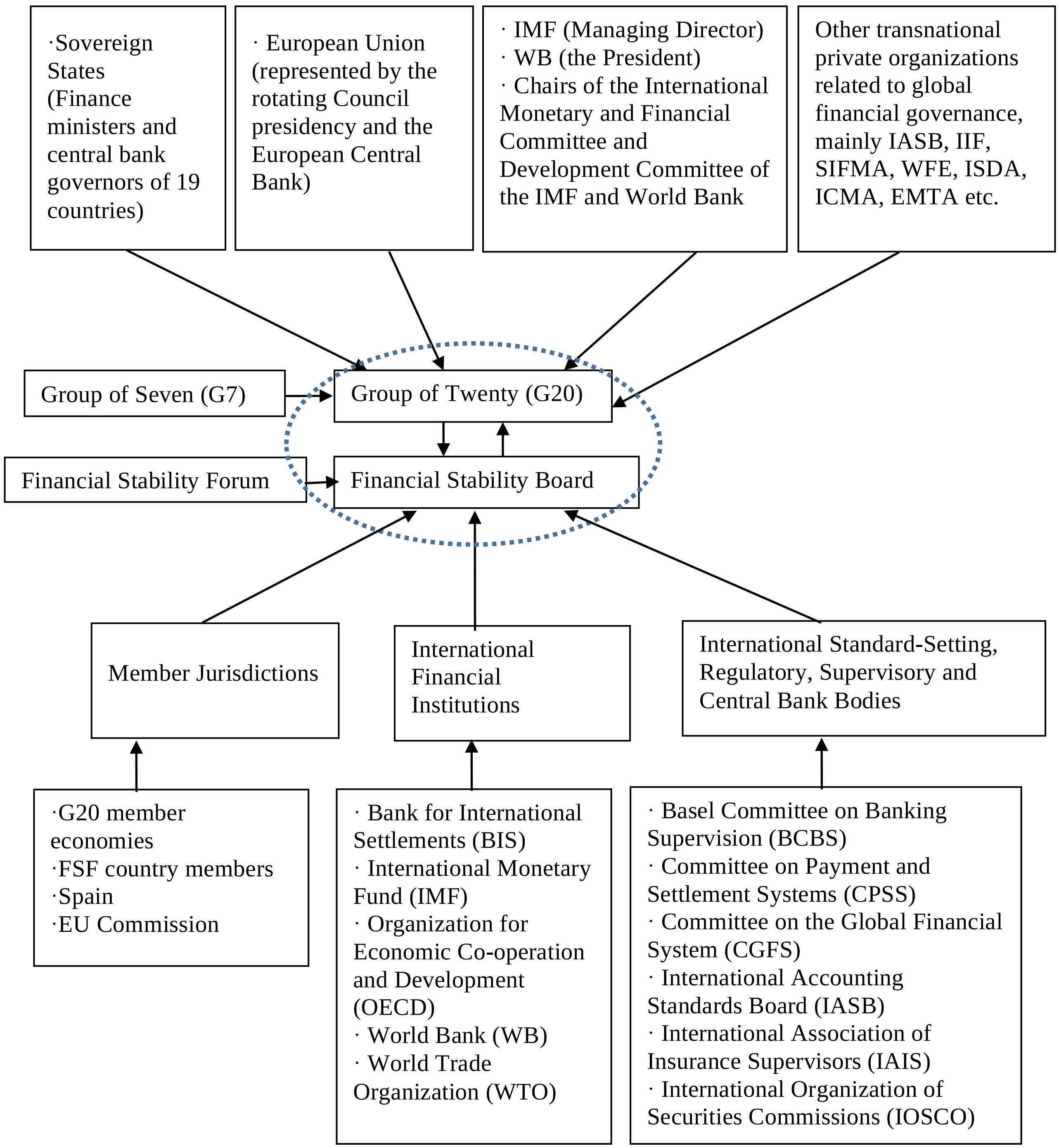
As introduced in the introductory chapter, three views on China's stance in global governance have emerged--- revisionist power, status quo power and pragmatic power lingering between the two. Scholars and even the Chinese officialdom hold different perspectives on China's priorities in international monetary relations (Helleiner & Kirshner, 2014a). By exploring China's specific strategies towards various global financial governance institutions or events, this thesis argues that China is not an innate status quo power or revisionist in global financial governance, and China's behaviours or strategies are determined by its varying interests and preferences, which are also not innate, but are rather affected by internal and external factors. The remainder of this chapter first overviews change related to global financial governance system, outlines a sketch of the newly reconstituted system and analyzes the characteristics of this new system. Then, changes of China's position in the new system are examined, followed by the last section that explores China's diplomacy or strategies in global financial governance.

A Newly-reconstituted Global Financial Governance System

In the wake of the 2008 global financial crisis, the previous global financial governance system has been overhauled and, consequently, a new system has been gradually formed. The previous system was created by the powerful G8 countries in response to the growing volatility in the developing world following the 1997 Asian financial crisis. This architecture mainly comprised of the G20, the Financial Stability Forum (FSF) and the Reports on Observance of Standards and Codes (ROSCs) (Soederberg, 2002, p. 607). Compared to the prior global financial governance system, many changes occurred in response to the 2008 global financial crisis. First, in September 2009, the G20 summit in Pittsburgh permanently upgraded the G20 to a leaders' forum with an annual rotating chairmanship. This powerfully suggests that the G20 substantively supersedes the G8 as the main economic council of wealthy nations. Second, in the G20 London summit in April 2009 the leaders of the G20 agreed to upgrade the FSF to the FSB, whose members includes all G20 countries, FSF members, Spain, and the European Commission (G20, 2009a). The FSB has been established, it is claimed on its official website, to address vulnerabilities and to develop and implement strong regulatory, supervisory and other policies in the interest of financial stability. The third is a flurry of changes in other transnational public and private sector institutions (Porter, 2009) related to global financial governance. Transnational public institutions, such as IMF, WB, Bank of International Settlement (BIS), Basel Committee on Banking

Supervision (BCBS), International Organization of Securities Commissions (IOSCO) and Organization for Economic Co-operation and Development (OECD), have made some changes in response to the current crisis. For example, the IMF made a realignment of quota shares to better reflect the changing relative weights of the IMF's member countries in the global economy. It also plans to double its total quotas and shift more shares to under-represented member countries and dynamic emerging market and developing countries (IMF, 2011). In addition, some transnational private institutions, such as Institute of International Finance (IIF) and International Accounting Standards Board (IASB), also made some important changes. In late 2008, for example, the IASB suspended fair-value accounting in a higher number of banks' holdings because it is "criticized for increasing the kind of pro-cyclicality of the financial regulatory regime" (Helleiner & Pagliari, 2009a, p.281). Generally, Helleiner and Pagliari (2009b) argued there have been three kinds of changes in global financial system before and during the current crisis: an expansion of the perimeter of international regulation, an effort to strengthen the fragmented system, and delegating regulatory and supervisory responsibilities to private market actors.

Chart 2.1 Networked International Financial Governance



Consequently, a new global financial governance system, as illustrated in Chart 2.1, comes into focus. This new system reveals two major new features. First and foremost, it is an informal network. A network, Andrew Sheng (2010, p.3) points out, "describes a collection of nodes and the links between them". In the new global financial regulatory network, as shown in Chart 2.1, the major nodes are national and regional authority, especially sovereign state, international financial institutions like FSB, BIS, WB and IMF etc. and "international standard-setting, regulatory, supervisory and central bank bodies" (IMF, 2010, pp. 24-27), such as BCBS, IASB, IOSCO and so on. The links among the three major participants are reflected through the complex and interlaced membership of the international financial institutions and "international standard-setting bodies and other groupings"[2](IMF, 2010, pp. 24-27). For example, as one of the two cores of the network, the G20 comprises 19 sovereign states, a regional authority (EU) and some international institutions, mainly IMF and WB. Shown in Chart 2.1, the membership of the other core, the FSB, is more complicated, including all G20 members, previous FSF members, some international financial institutions and "international standard-setting bodies and other groupings". For another example, as an important member of the FSB and one of key roles in the network, the Bank for International Settlements (BIS) itself comprises of 56 national and regional central banks or monetary authorities and is the site of many committees like BCBS, International Association of Insurance Supervisors (IAIS), Committee on Payment and Settlement Systems (CPSS), the Committee on the Global Financial System (CCFS), the Joint Forum and FSF (Porter,

[2] "International standard-setting bodies and other groupings" and "international standard-setting, regulatory, supervisory and central bank bodies" are two interchangeable terms used in IMF and FSB's documents.

2009, p.5).

The informality of the network is demonstrated by the lack of formal rules of membership or structure of representation, formal decision-making rules, authority to make, implement, or enforce rules and formal method for resolving disputes (Martinez-Diaz & Woods, 2009, p.1). Although some nodes of the network are not informal per se – such as international institutions like the IMF and the WB – nevertheless the network as a whole is made up of informal links among and between nodes. At least, the two cores of the network, the G20 and the FSB, characterize the informality. Taking the G20 as an example, despite playing a pivotal role in the new network, the G20 has not established formal membership criteria, decision-making rules and enforcement mechanisms. Moreover, the G20 has only been used for agenda-setting and consensus-building, policy coordination, knowledge production and exchange as well as norm-setting and diffusion (Martinez-Diaz & Woods, 2009, p.1).

Second, this new network centers on the G20 and the FSB and generates centripetal, or centralizing, force to coordinate global financial governance. In the new network, the G20 and the FSB have played a particularly important role in developing and promoting the implementation of regulatory financial sector policies and urging international communication and cooperation among national financial authorities, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts (FSB, 2011a). This was especially obvious in mitigating the global financial crisis and bailing out the depressed world economy. The G20 was created to “bring together major advanced and emerging economies to stabilize the global financial market" (G20, 2011) in the wake of the 1997 Asian financial crisis. Since the first head summit of the G20 in 2008 the member states of the G20 have cooperated and come into consensus to fight protectionism, restore economic confidence, reform IMF, eliminate global imbalance, strengthen global financial regulation and create the FSB etc. The G20 also coordinates a flurry of other international organizations in various areas related to global financial governance, such as: IASB in accounting; BIS, BCBS, FSB, IMF and WB in urging cooperation on global financial governance among national and regional central banks; IOSCO and IAIS in statutory regulation of global finance etc. (Germain, 2010, p.140). The G20, as Woods (2010, p.51) pointed out, transfuses blood into multilateralism and "was a shot in the arm not just for coordination among governments but also for existing multilateral institutions".

The FSB, which includes representatives from many countries and IOs, also plays a particularly important coordinating role. The FSB has made great efforts on strengthening international supervision, especially making up the loopholes of global finance, such as the procyclicality of financial sector, the too-big-too-fail issue, lack of risk resolution mechanism, insufficient regulation on derivatives and credit rating agencies, tolerance on off-balance sheet and flawed risk assessment method. The method of doing so is not to directly make or implement specific international rules, but coordinate and call on related IOs. For instance, since the 2008 crisis, the FSB has called for examining the forces that contribute to procyclicality in the financial system and developed options for mitigating it. Specifically, it identified three areas as priorities for policy action, which are the capital regime, bank provisioning practices, and the interaction between valuation and leverage (FSB, 2009). It also formed three working groups to support the formulation of policy recommendations in these areas. Around the three major areas, nation states and various international private and public organizations have taken different actions. In 2010 the BCBS formulated a comprehensive set of proposals (Basel III) on the new CAD ratio to revise the procyclical problem. Many countries or regional entities had planned various tools to mitigate procyclicality. In the US, the *Dodd-Frank Act* includes countercyclical capital requirements. In the EU, the *De Larosière Report* recognized the excessive procyclicality in the Basel framework and proposed to reduce it by several methods. In Spain, banks are required to set aside provisions during boom time according to a formula (Hardouvelis, 2010).

China in Global Financial Governance System: a rising star or a leader?

The analysis of the changes in the global financial governance system, specifically the formation of the new network system, provides a framework for exploring China's new role in global financial governance. The new network, as mentioned above, largely consists of nodes and links among and between institutions and sovereign states. Therefore, observation on China's changes in global finance can be made along these two dimensions - nodes and links among them. Moreover, the changes can also be observed from international and domestic perspectives respectively. The two angles of looking into China's changes in global financial governance are not separated but closely related to each other. As a new node of the network, China's changes in global finance governance include not only the incorporation into the new governance network mainly by strengthening the links between China and other players of the network – that is, other national or regional authorities, international financial institutions and international standard-setting bodies and other groupings – but also China's domestic economic and financial reforms and developments which have qualified China to be a new node of the network.

Internationally

China's New Role in the G20 and the FSB

On the international level, changes in China's global financial governance role can be observed from the incorporation of China as a new node into the cores of the network, namely the G20 and the FSB, and China's changes in other international financial institutions and international standard-setting bodies and other groupings. China has been incorporated into the G20 and the FSB as a new key actor in global financial governance. As pointed out before, in the new network system the G20 and the FSB are two cores. Therefore, China's presence in the two cores is a good indicator of its growing influence in global financial governance. In the wake of the 2008 global financial crisis, the emerging countries like China, Brazil, Russia and India, have gained bigger say in the G20 and consequently in global economic and financial governance. Some scholars even posit that China will become the core power of G20 and, together with the US, the G2 (the US and China) will be the new hegemonic power in global economic and financial governance (Garrett, 2010). However, although China's role in the G20 has been indeed enhanced, it is not strong enough to be a new hegemonic power parallel with the US because of the following reasons. At first glance, the US hegemonic power in the G8 has been diluted by the creation of the G20. But this view "is blurred by the degree of American diplomatic leadership involved in G20 process" (Cooper, 2010, p.745). In fact, the US economic size, military power and the soft powers deriving from its hegemonic currency, scientific innovation and so forth are still unparalleled. Moreover, despite of the current sovereignty debt crisis and lackluster economic recovery of the EU, ignoring this "club" of core wealthy countries is unreasonable and unconvincing.[3]

In addition, the effectiveness of the G20 as one of the two cores of the new network in managing world economic and financial order in the long term has been questioned. By extension, China's leading role in global financial governance through the new leading role in the G20 is also doubted. As Nelson (2010, p.20) argues, the "G20 could be an effective body in times of economic duress, when countries view cooperation as critical, but less effective when the economy is strong and the need for cooperation feels less pressing." To be sure, the G20 has played a key role in coordinating different countries' bailout policies against the global financial crisis and in recovering the world economy. For example, in the Pittsburgh Summit the G20 leaders pledged a fiscal stimulus plan of five trillion dollars between 2010 and 2012, and supported an increase in the IMF and the Multilateral Development Banks (MDBs) funds by 1.1 trillion dollars (G20, 2009b).

Yet it is clear that the G20 is staggering forward in the long-term reform of global financial governance system. In order to transform itself from an "improvised crisis committee" to a "steering committee" the G20 needs to "tilt more explicitly away from its

[3] According to the statistics of IMF, the EU's GDP, which is 16,414,697 million of USD, ranked first in 2009.

concentration on a detailed but technical agenda and towards taking itself far more seriously as the hub of economic global governance" (Cooper, 2010, pp.756-757). Without further reform or improvement the G20 will be only a "temporary sticking plaster" focusing on short-term remedies policy on the world economy recovery rather than a "full organ transplant" (Maxwell, 2009, pp.27-28) aiming at the long-term restructuring of global economic and financial order. China's role in the global financial governance architecture is thus limited in part by the G20's structural limitations.

The FSB was established after the 2009 G20 London Summit as a successor to the FSF. At the Cologne Economic Summit in June 1999, the G8 broadened the Forum to include Hong Kong, Australia, Singapore and the Netherlands. The FSF had no direct connection with China until it was upgraded to the FSB in 2009. In late 2008, the leaders of the G20 called for a larger membership of the FSF and "placing the FSF on stronger institutional ground with an expanded membership to strengthen its effectiveness as a mechanism for national authorities, standard setting bodies and international financial institutions to address vulnerabilities and to develop and implement strong regulatory, supervisory and other policies in the interest of financial stability" (FSB, 2011a). Responding to this call, in 2009 the FSF was broadened and replaced by the FSB, whose members include "member jurisdictions", international financial institutions and "international standard-setting, regulatory, supervisory and central bank bodies" (IMF, 2010, pp.24-27). "The number of representative authorities per Member jurisdiction varies (from one to three) to reflect the size of the national economy, financial market activity and national financial stability arrangements of the corresponding Member jurisdiction" (IMF, 2010, p.4). Not only has China become one of the member jurisdictions of the FSB, but also it has three representative authorities, which are the Ministry of Finance of China (MOF), the People's Bank of China (PBC) and the China Banking Regulatory Commission (CBRC). Others who have three representative authorities are the G8 countries and several other emerging countries, including India, Brazil and Russia. Despite the elevation, it is ungrounded to argue that China, as a newcomer, is or will be a leader in the FSB in the foreseeable future.

China's Role in Other International Organizations

Apart from the addition of China as a new node in the new network by being incorporated into the G20 and the FSB, links between China and other nodes, especially other international financial institutions and international standard-setting bodies and other groupings, have also undergone some changes. The first and foremost one is the enhancement of China's position in the IMF and the WB. These two Bretton Woods institutions have played an indispensable role and are important nodes in the new network by overseeing the international monetary system and promoting the economic development of the world's poorer countries. Since the inception of the current crisis, China's position in the two institutions has become more central.

China's share and right to vote in the IMF and voting power in the WB have been enhanced. On 15 December 2010, the IMF Board of Governors, the Fund's highest decision-making body, approved a package of far-reaching reforms on the Fund's quotas and governance structure (IMF, 2011). According to the reform package, China's IMF share will rise to 6.39% from the current 3.72% and the right to vote from the current

3.65% to 6.07% (Caijing, 2010). China will become the third-strongest member of the Fund in terms of IMF shares after the US and Japan, surpassing Germany, France and the United Kingdom. Although this reform was proposed in 2010, it was delayed as of 2014 because of the US Congress's repeated refusal to ratify it. The continuing economic rise of emerging countries, particularly China, and the pressure from the G20, the IMF and other countries on the US government will turn the proposal into an action inevitably in near future. For instance, in early 2014, the G20 industrialized and emerging economies formally expressed frustration with the ongoing inability of the United States to approve the IMF reform package (Biron, 2014). Moreover, IMF former chief Dominique Strauss-Kahn contended "the Chinese Yuan should be given a greater role within a restructured international monetary system" by adding the Yuan[4] to a basket of currencies that composes the SDRs (Wroughton, 2011). China's position in World Bank has also been enhanced. In April 2010, the World Bank's 186 members decided to increase China's voting power from 2.77 % to 4.42 %. This rate is still behind the US's 15.85% and Japan's 6.84%. Despite the enhancement or potential enhancement of China's position in the two institutions, it is still unconvincing to say China will be a leading role in the two institutions. The US still has veto power in both institutions by holding 16.75% votes in the IMF and 15.85% votes in the WB. China's votes, 6.39% in the IMF after potential reform (currently 3.81%) and 4.42 % in the WB, are still very small and do not empower China enough to be another leading role in the two institutions.

So despite its limited substantive impact on the governance trajectory of the IMF

[4] Chinese currency, also known as Renminbi or RMB.

and the WB, China has gradually become a more important member in other transnational public institutions related to or specialized in global financial governance (although even here Chinese influence is still limited in most of them). For instance, China and the Hong Kong Monetary Authority gained membership in the BIS and its constituent bodies in 1996. As of today, members of BIS comprise the central banks or monetary authorities from 56 countries. Its Board of Directors is the most important decision-making body within the Bank. The Board of Directors presently has 19 members, which include six ex officio directors[5], six members appointed by and had same nationality with each ex officio member, and seven elected directors[6] according to the Statutes of the Bank. Zhou Xiaochuan, head of Central Bank of China, is an elected director of the Board. Despite Zhou's presence, China's influence in the BIS is limited.

It is important to note that since the inception of the current crisis, China has been given more attention in other international bodies located in the BIS. In March 2009, banking supervision authorities from Australia, Brazil, China, India, Mexico, Russia, and South Korea became members of the BCBS, one of the most important international bodies located in the BIS (BIS, 2011a). This body provides a forum for regular cooperation on banking supervisory matters. On 29 July 2009, "the central banks of India and China, besides Australia, Brazil, Mexico, Russia, Saudi Arabia, South Africa and South Korea have accepted the membership of the Committee on Payment and Settlement Systems (CPSS)" (Hindu Business Line, 2009). This committee's Secretariat is hosted by

[5] They are the Governors of the central banks of Belgium, France, Germany, Italy and the United Kingdom and the Chairman of the Board of Governors of the US Federal Reserve System.
[6] They are the Governors of the central banks of Canada, China, Japan, Mexico, the Netherlands, Sweden and Switzerland and the President of the ECB are currently elected members of the Board.

the BIS and aims at strengthening the financial market infrastructure through promoting sound and efficient payment and settlement systems. The Committee on the Global Financial System, another committee located in the BIS, has a mandate to "identify and assess potential sources of stress in global financial markets, to further the understanding of the structural underpinnings of financial markets, and to promote improvements to the functioning and stability of these markets" (BIS, 2011a). Here the PBC is one of the 23 member institutions. Moreover, the CIRC is one of the members of the IAIS, which represents insurance regulators and supervisors of some 190 jurisdictions and whose Secretariat is also hosted by the BIS.

In addition, China or some Chinese regulatory authorities have recently integrated into transnational private or non-governmental financial organizations. For example, In July 2007, a Chinese expert, Zhang Wei-Guo, was appointed as a member of the IASB. The IASB, an independent accounting standard-setter based in London, England, consists of 15 experts from different countries "with an appropriate mix of recent practical experience in setting accounting standards, in preparing, auditing, or using financial reports, and in accounting education" (IASB, 2011). However, 9 of the 15 members are from the G7 countries while only 3 of them are from developing countries[7] (IASB, 2011). Obviously, developing countries are minority of the IASB and China's power in the Board is weak. Yet Zhang's appointment points to growing influence for China in the IASB.

In the IIF, the world's only global association of financial institutions, Chinese

[7] Among the 9 members from G-7 countries, 4 are American, 2 are British, 2 are French and 1 is Japanese. The 3 members form developing countries are Indian, Brazilian and Chinese. The other 3 members are Australian, South African and Swedish.

financial institutions have a significant presence. With 18 members, China ranks the third after the US (52) and the UK (22) (IIF, 2011a). In addition, China's two biggest stock exchanges – Shanghai Stock Exchange and Shenzhen Stock Exchange – are members of the WFE, while many Chinese financial firms are members of the ISDA that has worked to make over-the-counter (OTC) derivatives markets safe and efficient.

The following table summarizes China's changes in the cores of the new network, namely the G20 and the FSB, and in other transnational public and private financial institutions after the crisis. It shows clearly that in many IOs, no significant changes have occurred since the 2008 crisis. In a word, China's structural position in the new global financial governance network has been obviously enhanced, but China is not now and far from being a leader in the near future. Domestic development that will be discussed subsequently is an important reason for the enhancement discussed above, while the domestic problems are major barriers for China to be a leader.

Table 2.1 China's Changes in Major International Financial Organisations

Institutions		Before the Crisis	After the Crisis
Cores of the new network	G20	Ordinary participant of the G20 Finance Ministers and Central Bank Governors' Meetings	Major player of the G20 Leader's Meeting; G2 (the US and China) or G3 (the US, China and EU) is argued as the core power of the G20
	FSB	Not a member of FSF	A member of FSB with three representative authorities--- Ministry of Finance of China, People's Bank of China and China Banking Regulatory Commission
Transnational Public Organizations or Institutions	IMF	A member with 3.72% shares and 3.65% right to vote	The shares and right to vote will be increased to 6.39% and 6.07%; China will become the third-strongest member of the Fund after the US and Japan (Reform is ongoing).
	WB	A member with 2.77% voting power	The voting power was increased to 4.42 %, which is the third biggest behind the US's 15.85% and Japan's 6.84%
	WTO	A member	No significant change
	IOSCO	China Securities Regulatory Commission is a Ordinary Member	No significant change
	BIS	Zhou Xiaochuan is an elected director of the 19 Board Directors.	No significant change in BIS per se, but some in its affiliated bodies below.
	CPSS	Not a member	The central bank of China became a member of it in 2009
	CGFS	People's Bank of China is one of the 23 member institutions	No significant change
	IAIS	China Insurance Regulatory Commission is one of the members	No significant change
Transnational Private Organizations or Institutions	IASB	No Chinese member before 2007	Zhang Wei-Guo was appointed as a member of the 15 Board Members in 2007
	IIF	18 Chinese financial institutions are its members. The number ranks third after U.S (52) and the U.K (22)	No significant change
	WFE	Shanghai Stock Exchange and Shenzhen Stock Exchange are its members	No significant change
	ISDA	Some Chinese firms are its members.	No significant change
	ICMA	Not a member	No significant change

Domestically: Achievements and Challenges

China has taken steps to enact important domestic policy changes both prior and in response to the 2008 global crisis. These measures include both short-term and expedient ones in response to the crisis, like the stimulus package, and long-term and sustainable ones, such as domestic financial reform and ideational shifts in attitudes toward global financial governance (and global governance more generally), the internationalization of the Yuan and the development of China's sovereign wealth funds. They all contribute to China's positive economic performance during the crisis and also enhancing China's position in global financial governance.

China's stimulus package in response to the current crisis sustained China's excellent economic performance during the crisis and thereby enhanced China's position in global financial governance. This stimulus had the effect of minimizing the some of the more harmful impacts of the financial crisis in important domestic sectors, especially the export industry. Although the global recession briefly diminished China's GDP growth compared to 2007 numbers (14.191%), under the "active" fiscal policy and "moderately easy" monetary policy (Xinhua, 2008a), China's consecutive high economic growth in the past decade has been sustained. From 2007 to 2012, China's annual average GDP growth rate is the highest in the world. The economic performance is a key underlying factor favouring China's greater integration into global financial governance networks, shoring up China's position in some international organizations like the IMF and the WB.

China's long-term domestic financial reform as part of China's reform and opening-up policy launched in the late 1970s has gradually completed China's financial system, promoted the development of China's financial sector and, as a result, increased China's influence in global financial market and governance. Specifically, the development of China's financial industry over the past 30 years can be observed from the increasing scale of China's financial industry, the establishment of exchange rate and interest rate regimes as well as the ongoing improvement of financial surveillance systems. According to a Global Times report (2011), as of October 2010 the total assets of China's financial industry, including banking, securities, insurance and funds, reached 101.65 trillion Yuan ($15.32 trillion US). The total assets of the banking sector exceeded 92 trillion Yuan ($14.32 trillion US), 1.47 times higher than at the beginning of the 11th Five-Year Plan (2006-2010). By the end of October 2010, the assets of 106 securities companies exceeded 2.24 trillion Yuan ($337.71 billion US), and the assets of 62 assets management companies exceeded 2.51 trillion Yuan ($378.41 billion US), 6.3 times and 4.32 times higher than at the beginning of the 11th Five-Year Plan (2006), respectively. Moreover, the total assets of Chinese insurance companies reached 4.9 trillion Yuan ($738.73 billion US) at the end of November 2010, 2.2 times higher than at the beginning of the 11th Five Year Plan. Arguably, the increasing scale in these financial industries propels China's influence in the global financial market.

The institutional completion of China's economic system has contributed largely to these impressive economic figures. In the past 30 years, China's exchange rate (ER) and interest rate (IR) regimes have been reformed and improved step by step. Currently, China has established a managed floating exchange rate regime based on market demand and supply with reference to a basket of currencies, and has actively been establishing a multi-level and flexible interest rate regime that centers on the central bank's benchmark interest rate and can effectively reflect the capital supply and demand. Despite much criticism of China's ER and IR regimes, especially from some Neoliberal states, China's macro economy equipped with the two regimes performed stably, strongly and even surprisingly well. In addition, as the transfer of the regulatory authority on security and insurance from the PBC to China Securities Regulatory Commission (CSRC) and the CIRC, and the establishment of the CBRC in 2003, a financial regulatory system has been formed, in which CBRC, CSRC and CIRC work in coordination, each body having its own clearly defined responsibilities respectively on banking, security and insurance.

Clearly, China's attitude to global governance has undergone dramatic changes since the founding of China in 1949. These changes dovetailed with the development of China's diplomatic strategy, which has evolved from the self-imposed isolation in Mao's era (1949-1976) to the recent active and multilateral participation. The deepening of China's involvement into processes and systems of globalization, the emergence and exacerbation of many transnational problems, such as global climate change, global environment pollution, transnational proliferation of communicable diseases and, of course, global financial turbulence, as well as the incremental dependence of China's economy on world market together have made China realize the necessity of participating in global governance. In the past decades, China actively participated in various international organizations. By 2003 China had become a member of 298 international organizations and Chinese organizations had become members of 2,659 transnational organizations (Wang & Rosenau, 2009, p.22). According to the classification and data from Union of International Association (UIA), by 2003 China's participation rates in the A, B and C types[8] of international organizations that, taken together, constitute global conventional international organization, were respectively 67.57%, 73.66% and 50.74% (Wang, 2006a). In recent years, China has gradually formed its own vision of global governance under the concept of "harmonious world", which consists of four principles: "democratization of international relations", "justice and common prosperity", "diversity and tolerance" and "peaceful resolution of international conflicts" (Wang & Rosenau, 2009, p. 17).

The gradual internationalization of RMB in last decades is another critical factor in enhancing China's international position. According to data from State Administration of Foreign Exchange of China, the annual cross-border flow of RMB is about 100 billion Yuan and the overseas stock of RMB is about 20 billion Yuan. The total Chinese RMB supply (M2) is about 2 trillion Yuan, which means that the overseas RMB stock occupies about 1% of the total supply of RMB. Thus, the RMB has been, to some extent, widely accepted by surrounding countries or regions and the internationalization of RMB is in a progressive stage (China Financial Net, 2009). According to global transaction services organization SWIFT (Society for Worldwide Interbank Financial Telecommunication), China's yuan has become the second-most used currency in trade finance since October 2013 and the seventh most-used world payments currency since January 2014 (Reuters, 2013 and 2014b).

Arguably, these domestic changes constitute a firm basis for China being a more

[8] The A, B and C types are Federations of International Organizations, Universal Membership Organizations and Intercontinental Membership Organizations.

influential actor in global financial governance. Fundamentally, more substantive claims to leadership in global financial governance needs to be supported by a more stable and developed domestic environment. In post-crisis period, China still faces some domestic problems, such as the negative impacts of the crisis on China's economy, especially on the trade export, employment and currency value stability, in addition to the irrational economic structure (high export dependency) and financial system (banking dominance). These impediments stymy China's leadership in global financial governance. To be specific, three major challenges that China is facing in the post-crisis era are: maintaining economic growth, irrationality of the industrial structure, and exchange rate policy.

First, in the post-crisis era when the world market becomes gloomy, maintaining economic growth is a challenge to China. In 2008 as the US Subprime Mortgage Crisis escalated to global financial crisis and then spilled over from financial sector to the real economy, China's picture was mixed. On the one hand, "China could decouple from a recession in the West and it could be immune from financial turmoil by its 'closed' capital account and insulated banking sector primarily relying on deposits and not exposed to risky Western financial instruments" (Schmidt, 2009, p. 1). On the other hand, China is an emerging economy with high foreign trade dependence on the major economies, especially on the US and the EU. Therefore, when the financial crisis cuts import demand from China's major trading partners, China's intention to maintain sustainable and fast economic growth has been challenged.

Second, the irrationality of industrial structure is one of the biggest challenges and obstacles to the sustainable development of China's economy in the next decades. The irrationality mainly reveals the high foreign trade dependency ratio and the imbalance among the primary, second and tertiary industry. The negative impact of the irrational industrial structure is never only confined to the high trade dependence, but also casually related to the comparatively low productivity and profit rate, the instability of employment and market, as well as the relative high pollution on environment etc. These negative consequences challenge China's economy and urge a rational structure adjustment.

Third, another crucible for China is how to handle the so-called "international currency war"[9]. The crucial point in the international currency war for China is whether China's currency is undervalued and should be appreciated. China falls into a dilemma. On the one hand, the appreciation of RMB will increase the spending power and improve the living standard of Chinese, decrease the foreign debt to some extent, propel the adjustment of industrial structure and, at the same time, will be helpful for the China's investment abroad as well as for enhancing the confidence of foreign investors on China's economy. On the other hand, steep appreciation of RMB will setback China's economy in other aspects. In particular, the appreciation will negatively impact China's exports, which now underpin China's economy, and consequently will cause enormous unemployment in the short run. In addition, given the appreciation of RMB, the foreign reserves of China, which are mainly US dollar- denominated assets, will devalue.

[9] Brazilian Finance Minister Guido Mantega's words that "we're in the midst of an international currency war" have brought the conception---international currency war, and the debate on countries' foreign exchange policies to public attention worldwide in 2010.

China in Global Financial Governance: Inconsistency of Strategies

As far as global financial governance is concerned, as reviewed above, China is seemingly becoming increasingly important following the eruption of the 2008 global financial crisis. However, from China's perspective, are all the institutions equally important? In other words, what are China's strategies towards the various types of global financial governance institutions, such as the informal networks G8 and G20, the conventional Bretton Woods institutions like the IMF and non-governmental global financial governance institutions, such as the IASB? Generally, China's attitudes towards the various institutions or different events within certain institutions differ and can be also categorized into three types: a reform-minded status quo, revisionist or indifferent power.

China participates in the global financial governance, at times, as a revisionist, which seeks to change the existing system. The two cases reviewed here, in which China played or is playing a revisionist role, are the G8 and the IMF. In the G8, China is increasingly confident but cautious and reformatory. After refusing twice the invitation of the G8 in 1999 and 2000, China finally started to contact it in 2003 through participating in side meeting at the G8 summit in Evian, France. The following comment in *China Daily*, which is the major English newspaper of the Chinese government, reveals China's view on the G8 (Ruan, 2006):

> *"On the one hand, the group is trying to have a bigger say in international affairs, with its agenda extending from exclusively economic matters to international politics and security. On the other hand, however, the G8, bringing together just eight countries, is not representative enough. As a result, its prestige has dropped."*

Chin (2008) clearly explained the caution and confidence of China toward the G8. "The caution is a response to what Chinese leaders see as the basic ontology of world order that China is facing" (p.85), while the confidence derives from the growing systemic importance based on its increasing economic weight. To be specific, China treats the G8 as an organ dominated by the major Western countries, especially the US that is still the sole superpower for the time being and in near future. As a result, the issues discussed in the G8 are mainly related to maintaining these major countries' benefits rather than those of developing countries'.

Generally, China's attitude to the IMF is also reformational. In the wake of the 2008 crisis, as reviewed before, China's position in the Fund has been enhanced in terms of its quotas and voting power. Nonetheless, the elevation has not appeased China and other developing countries. China's basic diplomacy in the IMF is to urge it to reform. In 2009 G20 London Summit, President Hu Jintao clearly put forward a reform proposal for IMF: first, the IMF should strengthen surveillance of the macro-economic policies of major countries; second, the IMF should reform its governance structure; third, the IMF should actively aim to improve the international monetary system by reforming the mechanism for issuing and regulating reserve currencies and by promoting the rationalization and diversification of international monetary system (Zhou, 2010). Zhang (2011) argues that China will act more like a balancer in the IMF, which, on the one hand, represents and reflects the interests of the developing countries and, on the other hand, has shown great presence in the reform of the IMF architecture. Furthermore, he holds that China has two strategic goals in participating in the reform of the IMF and international financial system: one is to assure stable external economic settings for its domestic sustainable development, while the other is to "promote its own capacity-building in contributing to global economic governance for the sake of a better systematic framework on strong, balanced and sustainable growth of the world economy" (p.2).

In addition to being a revisionist power, in more cases, China is a reform-minded status quo power in global financial governance. The examples reviewed here include China's strategy toward the G20 and China's implementation of Basel III and IFRS accounting standard. China's dissatisfaction with the G8 partly explains the more active and positive attitude of China to the G20. Since 1999, China has actively participated in all G20 meetings and made contributions to the reform of international financial architecture and global economic developments (Huang, 2011). From China's perspective, Huang (2011) thinks participating in the G20 actively provides a chance to participate in global coordination, a chance to adapt to and learn global governance, a chance to represent the Chinese position and build China's external image and a way to facilitate the adjustment of the domestic economic structure. Chinese scholars Wang and Li (2012) explain that the active attitude of China to the G20 lies in four reasons: economically, China needs a dynamic, stable and development-oriented international economic system; from an international order perspective, China needs a platform to reform the existing international order in its own favour; in terms of values, China needs an international institution that is in accordance with China in basic values towards international relations; from the perspective of dealing with global issues, China also needs a broader stage.

The appearance and elevation of the G20 in global governance meets these needs of China and, consequently, the G20, compared to the G8, is more in China's interest. However, it does not mean that China is a perfect member of the G20 and the G20 is a flawless international institution for China. In fact, "there are limits to the amount of faith that Beijing has actually invested in the G20 Leaders process" (Chin, 2010, p.116). For example, China Government has diplomatically supported the "Group of 155" process initiated by the non-G20 states in the UN and led by UN secretary General Ban Ki Moon. Chinese officials even question the legitimacy of the G20 for the over-representation of European states and under-representation of Southern countries and regions (Chin, 2010). Moreover, prominent Chinese scholar Ren Xiao's (2012) research shows that China is a reform-minded status quo power, after delving into the issues of international monetary reform, reform of the international financial institutions, international financial regulation, the future of the dollar, and internationalization of renminbi. Specifically, on one hand, "China has actively participated in the G20's deliberations and actions, put forward its suggestions, sought expanded share and voting power in the IFIs in correspondence with its rising status, and promoted the internationalization of the Renminbi" (p.30). On the other hand, China also espouses necessary changes for a "new international political and economic order" and pushing international order to change in the direction of becoming more just and reasonable. The mainstream view, as Wang and Li (2012) observed, holds that the G20 is the premier forum for international economic cooperation, but is still one of the alternatives with an obscure future. Therefore, China actively participates in the G20, but does not put all eggs in one basket.

China's implementation of Basel III and adaptation of the IFRS with some minor adjustments in reference to China's specific situation are other examples of a reform-minded status quo power. In response to the 2007-09 financial crisis, in December 2010, the Basel Committee on Banking Supervision (BCBS) published Basel III, a comprehensive set of reforms to raise the resilience of banks, supplementing Basel II and 2.5 in a number of dimensions. Against this background, on 3 May 2011 the CBRC published its *Guidelines for Implementing New Regulatory Standards in the PRC Banking Industry*, which is China's own version of Basel III (Sekine, 2011). On December 7, 2012 the CBRC published detailed timetable for implementation of new capital rules under the Basel III framework. The schedule requires all commercial banks to begin adhering to the rules from January 1 2013 and have a transition period of six years (Cushnie, 2013). According to the *Progress Report on Basel III Implementation* issued by the BCBS, China, along with other 7 countries, has done best in terms of the adoption of Basel III as of end September 2012 (BCBS, 2012). In addition, China, specifically the Ministry of Finance, announced the introduction of new Chinese Accounting Standards in February 2006. Although the new standards do not comply with International Financial Reporting Standards (IFRS), they do adopt the principles contained in the IFRS and are considered substantially convergent with the IFRS (ICAS, 2010).

Finally, toward some other global financial governance institutions or events, especially toward most transnational private institutions, China often plays an indifferent role. Among these institutions listed in Table 2.1 except for IASB, China or Chinese members in other institutions, such as the WFE, the ISDA and the ICMA, is inactive and indifferent. The indifference lies in two aspects. First, Chinese members did not actively struggle for more influence in these institutions. Second, as a result of the inactive attitudes, after the 2008 crisis, China's status in these institutions has not been significantly elevated as shown in the Table 2.1.

Conclusion

In sum, three words are appropriate to describe the new global financial governance network and China in the new system - centripetalism (rather than centrifugalism), elevation (rather than domination) and inconsistency (rather than coherence). Centripetalism means the patched global financial governance network system has more centripetal forces to coordinate states and related international organizations. The new network centered on the G20 and the FSB connects the previously fragmented nodes (mainly sovereign states and IOs) and coordinates them in governing global finance. This new network is more effective to prevent and solve global financial problems, which are mainly ascribed to the high interdependence of global finance. Elevation refers to a relatively more important role of China in the new system, but, by no means, a dominant (or hegemonic) role. The domestic situation explains, to a large extent, the elevation of China in global financial governance. Meanwhile, the domestic political economic challenges also account for the short-term or medium-term impossibility of being a leader in global financial governance for China. Inconsistency indicates the differed strategies of China in various global financial governance institutions or toward different events.

The description leads to several research questions: What are the driving forces of China's action or strategies in global financial governance? How are the different strategies or attitudes of China in global financial governance explained in reference to IR and International Political Economy (IPE) theory? The remainder of this thesis aims to explore and answer these questions.

Chapter Three: A Two-Stage Theoretical Model

The previous chapter delved into changes of the global financial governance system and China's enhanced position in the new system and, finally, put forward a research puzzle: why has China advocated for the status quo in some cases, but for modest reforms or even anti-status quo reforms in others in global financial governance? Existing literatures touched upon this question to various degrees. A recent example is Helleiner and Kirshner's (2014b) edited book *The Great Wall of Money: Power and Politics in China's International Monetary Relations*, which, as the editors claimed, reveals "how China's priorities and decisions will be shaped by political influence stemming from the domestic, state, and external level". However, this book seemingly lacks a unified analytical framework and contributors highlighted different factors in analyzing various international monetary issues, such as key government officials, domestic pressures like lobbying, ideational frames, divisions among Chinese officials etc. In contrast, this chapter attempts to establish an analytical framework called a two-stage model to disentangle the various factors as surveyed in the previous section about foreign policy analysis literatures.

Structurally, this chapter first provides an overview of the basic logic of and major factors in the two-stage model. Then it looks into the formation of interests and preferences in mainstream IR literature and Chinese studies and puts forward a new concept *Guojia Liyi* to explain the formation of China's interests and preferences. The third section explores the decision-making process and argues that six major factors may influence the specific policy-making process. The fourth section elaborates how the two-stage model integrating the formation of interests and preferences and the decision-making process explains the inconsistency of China's policy in global financial governance.

A Two-Stage Model: An Overview

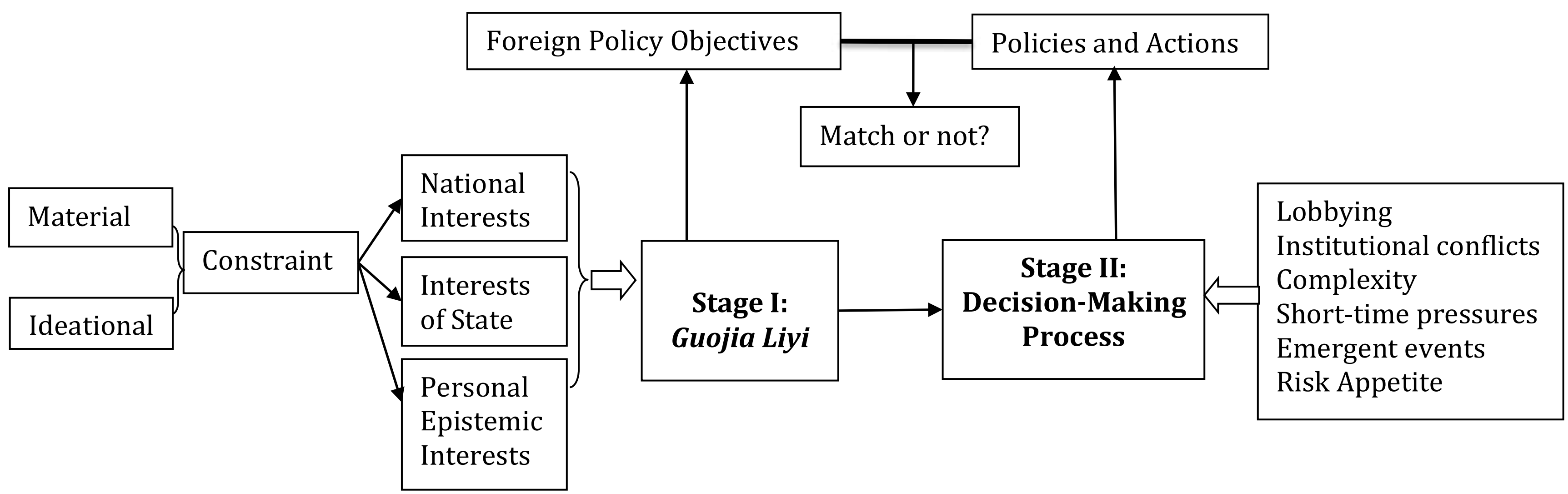
The two-stage model, as the name indicates, consists of two related stages - Stage I Formation of *Guojia Liyi*[10] and Stage II Decision-making Process. The Chart 3.1 below illustrates the basic logic of this model. Hypothetically, *Guojia Liyi* is the fundamental driving force of national policies and state behaviors. The medium or long-term national policy objectives are usually based on and reflect *Guojia Liyi*. *Guojia Liyi* is constituted by personal epistemic interest, interest of state and national interest. In different time periods and/or different cases, the three constituents of *Guojia Liyi* may play different roles during national policymaking in global financial governance. The three constituents are constrained by both material and ideational factors. Material factors mainly refer to domestic and international political and economic factors, while ideational factors include principally state ideology and interpretation. Under the constraints of both material and ideational factors, the *Guojia Liyi* constituted by personal epistemic interest, interest of state and national interest determine China's stances and policies in global financial governance in the long run.

Though the *Guojia Liyi* formed at the first stage is an inner drive of national policies in the long run, many other factors may influence the specific decision-making

[10] A Chinese term for interests and preference of a state. A latter section elaborates what is *Guojia Liyi* and how it is different from national interest.

process in the short term These include lobbying of interest groups, institutional agreements or conflicts, complexity of issues, short-term pressures from IOs or other countries, emergent events and risk appetite of decision makers. When some or all of these factors bound the rationality of decision-makers, the final decisions and actions would be in discord with the *Guojia Liyi* and the corresponding foreign policy objectives. On the contrary, when there is no significant influencing factor that bounds decision-makers, the final decisions will reflect the *Guojia Liyi* and the corresponding foreign policy objectives. The rationality here refers to decision-makers' capability of recognizing and complying with the *Guojia Liyi*. One possibility is that these factors hinder decision-makers' ability of realizing the *Guojia Liyi*. In other words, in a specific policy context, decision-makers do not understand or misunderstand what policies benefit the country. The other possibility is that even if decision-makers understand the preferences and interests of this country, the decision-making is constrained and deviated by these factors. The two stages together explain the inconsistency of China's attitudes and policies in global financial governance. The following sections will elaborate the two stages in tandem.

Chart 3.1 Theoretical Framework



Stage I: Formation of Interests and Preferences

National Interest

National Interest in the Western IR Literature

"National interest" is one of the most important and fundamental terms in IR theory and, further, in foreign policy analysis (FPA). Its origin and development can be traced from Rousseau's conception of the "general will" and the earlier doctrine of "raison d'état" associated with Machiavelli (Burchill, 2005). Its importance lies in the following three aspects. First, it is usually treated as an internal motivation of state behaviour and, consequently, is a touchstone for various IR theories. Second, it enunciates the foreign policy objectives to be pursued by policy-makers, and thus provides a basic rule of conduct for them. Third, "it functions as rhetorical device through which the legitimacy of and political support for state action are generated" (Weldes, 1996, p.276). This importance spawned vast studies on this term within different schools of IR theories, mainly (Neo) Realism, (Neo) Liberalism, Constructivism and Marxism, and, as a result, endless debates and disputes on conceptualizing this term among these theoretical approaches.

Classical or conventional realists define national interest in terms of power. In Pham's (2008, pp.257-258) words, "every political action is seen as directed toward keeping, increasing, or demonstrating power" in the classical realists' framework. This definition ultimately roots in a view of human nature, which assumes an innate desire for power. Therefore, states led by human beings have a limitless lust for power (Morgenthau, 1948). The desire for power is regarded as the principal driving force of state behaviour. In this sense, national interest is subjective. Morgenthau (1977) points out that national interest is an objective datum that is imposed upon all men applying their national faculties to the conduct of foreign policy, rather than the whim of a man or the partisanship of party. Power of states and a struggle for power between nation-states can be assessed and measured by military, economic and cultural capability, which are objective realities. The objectivity of national interest doesn't lead to stability in any sense. On the contrary, the national interest defined in terms of power is not "fixed once and for all" (Morgenthau, 1951, p.8), but changes over time. As Morgenthau (2005, p.12) remarked "while the realist indeed believes that interest is the perennial standard by which political action must be judged and directed, the contemporary connection between interest and the nation state is a product of history, and is therefore bound to disappear in the course of history". In short, classical realists' definition of national interests, as Burchill (2005) observed, is problematic and raises more questions than it answers. Among many others, one problem is that "it was neither entirely objective nor subjective, variable nor invariable" (p. 61).

Unlike classical realism, structural realism or neo-realism defines the national interest as a product of the anarchic international system. Simply, national interest is shaped by anarchy. Jackson and Sorensen (2003, pp.87-88) compared classical and structural realism's understanding of national interests by comparing the two pioneer scholars, Morgenthau and Waltz, in the two schools of thought:

> "*Morgenthau believes that state leaders are duty bound to conduct their foreign policies by reference to the guidelines laid down by the national interest, and they may be condemned for failing to do that. Waltz's neorealist theory hypothesizes that they will always do that more or less automatically. Morgenthau thus sees*

> *states as organizations guided by leaders whose foreign policies are successful or unsuccessful, depending on the astuteness and wisdom of their decision. Waltz sees states as structures that respond to the impersonal constraints and dictates of the international system."*

Based on comparison above, several points are raised. First, the neo-realist definition of national interest is less subjective. Neo-realists claim that national interest is a systemic given rather than a by-product of human nature. Therefore, decision makers have limited discretion in defining national interest, but passively adopt it, because it derives from the anarchic international system. In this sense, definition of national interest is hardly influenced by human subjectivity. Second, the neo-realist definition of national interest is less changeable. For any type of country, neo-realists argue, the primary foreign policy objective is to survive in the anarchic international system. This objective is unaffected by any domestic changes. The anarchical condition of the international system is a permanent, or at least long-term, situation barring the disappearance of sovereign states or the appearance of a world government. Therefore, the national interest in a neo-realist's mind is less changeable than that of a classical realist. Third, classical and structural realism's assumptions on national interest have been criticized. A common assumption of classical and structural realism is that states are unitary actors in international politics. This assumption leads to crucial questions related to the definition of national interest---whose interests do the national interests represent? Who represents national interests in dealing with specific international and domestic issues? The answers of both classical and structural realism to the two questions are: state and state government. State is simply constituted by the citizens of certain region, while the state government always represents its citizens. These assumptions have been questioned by scholars: the former ignores a number of realities, such as stateless nations, refugees and exiles, while the latter overlooks the fact that "the national interest may be a vital prism for national leaders who want to couch their decisions in terms which will appear to benefit all of their constituents, but they rarely show a preparedness to address these important questions which go the very heart of policy formation" (Burchill, 2005, p. 51).

Liberal thought in IR originates in the Enlightenment and focuses on issues of achieving peace and cooperation. Three major variants of liberal theory have been developed in IR liberalism - democratic peace theory, commercial peace theory and institutional peace theory (Geis & Wagner, 2008). Democratic peace theory states wars among democracies are impossible or at least less likely. Therefore, domestic democratic political regimes are conducive to world peace. Commercial peace theory stresses the automatic harmonization of individual and states' interests and calls for free trade and further globalization. Institutional peace theory, against realism, argues that cooperation can be sustained in anarchy, that absolute gains are more important than relative gains and that long-term interests should be pursued over short-time interests. Generally, the national interest of IR liberalism is to pursue peace and absolute gains in the anarchic international system, such as through democratization, cooperation and globalization. For IR liberals, "states represent some subsets of domestic society, on the basis of whose interest state officials define state preferences and act purposively in world politics" (Moravcsik, 1997, p.518). The national interest in IR liberals' minds can be specified as objective foreign policy goals, such as democratization, minimal state and free trade. Subjective interests "are invariably captured by dominant groups, and therefore frustrate the community's objective interest in market-based solutions to economic challenges" (Burchill, 2005, p.150). In this sense, liberals agree upon the objective goals of foreign policy, but are suspicious of subjective claims of particular groups. Finally, the national interest is not fixed, but "functionally differentiated" through pursuing "particular interpretations and combinations of security, welfare, and sovereignty preferred by powerful domestic groups enfranchised by representative institutions and practices" (Moravcsik, 1997, pp.519-520).

Unlike Realism and Liberalism, Marxism defines national interest as the preferences of the dominant class or ruling class, which sets society's political policy by controlling the central economic and political institutions of a nation-state. For Marxists, states and related political powers are merely the instrument of one class for oppressing another. In this sense, the so-called national interest is only the interest of the dominant class. In capitalist countries, the dominant class is the bourgeoisie and the national interest is used to conceal class division in capitalist society (Burchill, 2005). Marxists focus more on the economic and material aspects and view the international system as an integrated capitalist system in pursuit of capital accumulation, which can be treated as the most basic and important interest of capitalists and which changes over time. Finally, as Burchill (2005, p.103) concluded, "the disproportionate influence of ruling groups and their ability to extract benefits from state policy is an subjective, class-based assessment".

For most constructivists, national interest is an important social construction, which emerges out of a process of representation through which state officials make sense of their international context (Weldes, 1996). In this sense, the national interest is constructed by dominant groups in society for securing particular identities. Although Wendt (1999, p.199) defined national interest as “the objective interests of state-society complexes, consisting of four needs: physical survival, autonomy, economic well-being, and collective self-esteem”, constructivists claim that national interests is not objective but inter-subjective beliefs that are shared among people. The national interest is not given prior to social interaction, but “endogenous to so interaction, as a consequence of identity acquisition, as learnt through process of communication, reflection on experience, and role enactment” (Reus-Smit, 2001, p.219). Because the social interaction changes over time, the national interest is not fixed but variable in constructivist’s mind. The following Table 3.1 summarizes basic ideas of IR theoretical thoughts on national interest.

<table>
<tr><th colspan="7">Table 3.1 National Interests in Mainstream IR Theory and Chinese Study</th></tr>
<tr><td colspan="3">Schools</td><td>Stability/ Volatility</td><td>Objectivity/ Subjectivity</td><td>Representation (Who's interests)</td><td>Basic Conception or definition</td></tr>
<tr><td rowspan="5">IR Theory</td><td rowspan="2">Realism</td><td>Classical</td><td>Neither entirely variable nor invariable</td><td>Neither entirely objective nor subjective</td><td>State as a unitary actor</td><td>Power</td></tr>
<tr><td>Structural</td><td>Less changeable</td><td>Less subjective</td><td>State as a unitary actor</td><td>Product of the structure of the anarchic international system</td></tr>
<tr><td colspan="2">Liberalism</td><td>Changeable</td><td>Objective</td><td>Some subsets of domestic society</td><td>Pursuing peace and absolute gains in anarchic international system, e.g. through democratization, cooperation and globalization</td></tr>
<tr><td colspan="2">Constructivism</td><td>Changeable</td><td>Inter-subjective</td><td>Dominant groups in society</td><td>Social construction which emerges out of a process of representation</td></tr>
<tr><td colspan="2">Marxism</td><td>Changeable</td><td>Subjective</td><td>Ruling class</td><td>Capital accumulation</td></tr>
<tr><td colspan="3">Chinese studies</td><td>Stable + Changeable</td><td>Objective + Subjective</td><td>All the people of a nation state</td><td>Common material and spiritual needs of all the people of a nation state</td></tr>
</table>

National Interest in Chinese Study

The open-up reform of China in past decades has not only promoted China's economic modernization and globalization, but also urged integration of the conventional Chinese IR thinking with the Western IR theories. Specifically, Chinese theorizing on national interests draws on the mainstream IR theories and also maintains the conventional wisdom, such as Confucianism and the golden mean. Generally, Chinese studies on national interest can be observed from four aspects: debate between "national" and "state" interests, characteristics, determinants and typology of national interest.

The pioneer Chinese scholars studying national interest paid more attention to differentiating "national" and "state" interests. In Chinese language, "*Guojia Liyi*" (interests and preferences of China) contains at least two meanings - interest of the state and national interest. Interest of the state refers to the interest of or represented by the government, while national interest means the interests of China as a nation state in international politics (Yan, 1996). The difference derives from the difference between "state" and "nation". The former is the "artificial" or "conventional" apparatus of government, while the latter is a "national" or "organic" community of men (Carr, 1945, p.39). Yan (1996), as one of the earliest Chinese scholars who systemically analyzed national interest, claims that the state is a tool of the ruling class and thus interest of the state represents only the interest of ruling elite, which is in conflict with the interests of other groups. Therefore, he argues that national interest, which is defined as "common material and spiritual need of all the people of a nation state" (Yan, 1996, p.10; Gupta, 2012, p.806), should be treated as the internal motivation of China's foreign policy and behaviour. This differentiation has been widely accepted in Chinese academia and by Chinese officials. However, this differentiation and conceptualization have more rhetorical functions than analytical ones. Solely treating national interest defined as common material and spiritual need of all the Chinese people as the internal motivation of the Chinese state is no more than a legitimization strategy of the Chinese communist party, and hardly contributes to understanding China's policies and behaviours.

Characteristics of national interest have been vastly explored in Chinese literature, drawing on the dialectical philosophy thought and the traditional idea of the golden mean.

Generally, the characteristics of China's national interest can be summarized into the following three aspects. First, it characterizes both objective and subjective. The objectivity derives from the objective existence of the specific content of the national interest, such as security, economic profit and cultural interest, and the concrete state behaviours and specific foreign policies for achieving these national interests. The subjectivity refers to how recognizing the national interest and the related ways to achieve the interest and the specific foreign policy-making processes are usually subjective (Wang, 2006b). Second, it changes over time but with certain stability. The subjectivity mentioned above consequently leads to changes in the national interest. In addition, the specific national interest is determined by internal and external factors, which are not static and will be explored further later on. Therefore, the national interest of China is not invariable. Meanwhile, the national interest also reveals some stability. Drawing on realism, some Chinese scholars treat survival as the most important interest of the national state and argue that this interest will not change for long. Furthermore, some factors that determine national interests are given and not easy to change in the short term, such as geological position and size, population and natural resources.

Third, the national interest of China features both national and class characters. Differing from Yan (1996) who argued that the national interest of China has no class character but only national character, mainstream Chinese studies conclude that the national interest still has class character. This idea draws on Marxism, which points out that the state is merely the instrument of one class for oppressing another. Although the national interest is defined as the interest all Chinese people, the interest, in both domestic and international realm, has to be achieved or defended by the state or government with class character. In this sense, the national interest of China has class character.

Formation or determinants of national interest is another field that was looked into in Chinese IR. The most common way is to categorize the factors that determine China's national interests into two types - invariables and variables (Wang, 2002 ; Gao, 2009). Invariables include mainly geologic environment, population, natural resources, religion, history, national hard power, etc. Variables contain internal and external factors. Internal variables mainly refer to the mode of production and domestic political regime, while the external variables include mainly but are not limited to the international political economic environment, the international system and norms and inter-state relations among major states. In addition, some scholars explain the formation of China's national interest in different ways. Zhou (2003), for example, explicates the formation of the national interest from personal, national and international dimensions. But the national dimension in this formation blurs the boundary of the Chinese nation and state that Yan (1996) attempted to distinguish. Yan (1996) summarized four factors that influence the formation of the national interest -international environment, comprehensive national strength, technology and cognition. These studies fail to clearly differentiate the intension and extension of this concept from its influencing factors. In other words, they did not convincingly spell out the specific contents of the national interest and, more importantly, its origin and formation.

There are many typologies of the national interest in Chinese literature. According to content of interest, the national interest contains political, security, economic and cultural interests. In terms of duration of interest, the national interest can be divided into long-term, medium-term, and short-term interests. Based on importance, the national interest consists of core and marginal interests. In addition, Wang (2003) concludes that the national interest of China is composed of three main interests: development interests, sovereignty interests and responsibility interests. Among these typologies, the Chinese government and officials often use the core-marginal division and identify the *Hexin Guojia Liyi* (core national interest) of China. Dai Bingguo, Chinese State Councilor, for instance, stated during the US–China Strategic Economic Dialogue in July 2009 that China's core national interests are to safeguard China's fundamental systems and national security, to maintain national sovereignty and territorial integrity and to ensure sustained and stable development of its economy and society (Xinhua, 2009; Gupta, 2012).

Guojia Liyi

Conventional mainstream IR theories treat national interests as the internal motivation of state behaviours. A dispute lies in the definition of national interests, such as regarding the emphasis power of realists, social construction of constructivists or capital accumulation of Marxists. These system-level definitions tend to simplify this term and the motivation of state behaviours and, consequently, risk losing details and leverage in analyzing specific cases and overlooking origin and the formation of the driving force of national policies. Therefore, a Chinese term *Guojia Liyi* is employed here to generalize the driving forces behind national policy and behaviours. In Chinese language, *Guojia* (国家) has multiple meanings, referring to a country, a nation state or a sovereign state. Country and sovereign state are usually interchangeably used to define a region that is legally identified as a distinct entity in political geography, while a nation state is a state whose political legitimacy derives from serving for a nation that is a community of human beings with same ethnicity. *Liyi* (利益) means interests, which, lexically, refer to one's own benefit or advantage and preferences of selecting of someone or something over another or others. Therefore, *Guojia Liyi* (国家利益) lexically refers to state or/and nation's recognition of its benefit or advantage, which could be economic, political and cultural, and its criteria for leaning to one action or decision over another.

The major reason for using the Chinese concept *Guojia Liyi* rather than national interests or interests of the state is that *Guojia Liyi* literally contains national interests and interests of the state, which both are the substratum of China's foreign policy making. As explicated before, interests of the state refer to the interests of or represented by the government, while national interests mean the interests of China as a nation state in international politics (Yan, 1996). In addition to the two aspects, *Guojia Liyi*, I argue, still contains a personal dimension, particularly personal epistemic interests of great people, such as Mao Zedong and Deng Xiaoping, key policy elites and even ordinary people. Therefore, *Guojia Liyi* is comprised of three constituent aspects - national interests, interests of the state and personal epistemic interests. Pursuing or/and maintaining *Guojia Liyi* is the driving force of China's foreign policy and corresponding state behaviour in international politics.

Three Constituents of Guojia Liyi

National interest is a crucial aspect of *Guojia Liyi*. This national interest is not the one in Western IR theory, but draws on Chinese studies. In Chinese literature, national interests are collective and "common material and spiritual need of all the people of a nation state" (Yan, 1996, p.10; Gupta, 2012, p.806), such as national security and development in material terms and respect and recognition from the international community in spiritual terms. It depicts the interests of the Chinese nation. National interests are determined mainly by some invariables or variables that rarely change, such as history, religion, culture, geographical position, population and ethnicity, and, consequently, are more stable and objective in the short or medium term. The "great rejuvenation of the Chinese nation" is treated as one of the core national interests of modern China. This interest roots in Chinese history and the national experience, especially the "century of national humiliation" that began with the First Opium War (1839-1842) and lasted through the end of the Sino-Japanese War in 1945 (Zheng, 2013). In history, China, the "Middle Kingdom", was one of the most influential and powerful regions in the world. Therefore, citizens of China feel a strong sense of closeness and are proud of their ancient achievements. "After suffering a humiliating decline in national strength and status, the Chinese people are unwavering in their commitment to return China to its natural state of glory" (Zheng, 2013). Since the new China in 1949, this interest has been the core interest of Chinese nation. Recently, the new leader of China, Xi Jinping, put forward the "Chinese Dream", which is also a renewed expression of the rejuvenation of Chinese nation. The collective interests can be transformed into national policies and behaviours mainly through influencing voters and/or policy elites. Voters express their wills through democratic mechanisms, such as inclusive deliberation and universal suffrage, while policy elites can directly influence the decision-making process.

As discussed below, this aspect of policy formation is developing but remains incomplete in contemporary China.

Interests of the state, in a narrow sense, equate with the interests of the government and the ruling political party. In China's one-party political system, the interests of the state, to a considerable extent, are the interests of Communist Party of China (CPC). The fundamental interest of any ruling party is to maintain its political power. For CPC, its major task is to maintain a stable political system in China. The ways to do so are various, including political system reform, anti-corruption, limited democratization, and, most importantly, economic development. Compared to national interests, interests of the state are relatively short-term and changeable. The Chinese government usually remakes or adjusts its policy objectives that directly reflect the interest of the state every five years through the five-year plans, which are a series of social and economic development initiatives shaped by the CPC. In the long run, national interests significantly influence interests of the state. The former is usually one of the legitimization strategies of the latter. In other words, the core interest of the state - political stability – can only be achieved when national interests are satisfied or seriously considered in the long run.

Finally, personal epistemic interests mainly refer to epistemic interests of great people (or extremely powerful political leaders), epistemic community elites or individual voters. Epistemic interests are distinct from personal self-interests. The former is mostly normative and relates to "normative and principled beliefs", "causal belief", "notions of validity" and a policy enterprise (Haas, 1992, p.3). Briefly, epistemic interests are belief or faith in particular forms of knowledge or specific truths (Hass, 1992), such as views about what development way is best for China, what type of financial regulation is most effective or what exchange rate policy is best suited for the Chinese economy. In contrast, personal self-interests refer to needs or desires of the self, such as seeking to become rich through corruption.

Personal epistemic interests can help to define national interests and interests of the state and, consequently, suggest "a nonsystemic origin" for *Guojia Liyi*, to use Haas's (1992, p.4) words. "The process of elucidating the cause-and-effect relationships of problems can in fact lead to the redefinition of preconceived interests or to the identification of new interests", as Haas (1992, p.15) pointed out. These personal epistemic interests redefine (contribute to or undermine) this country's interests and preferences in different ways. Great people' views or actions may directly guide or disrupt national policy-making during a certain period of time. For example, from 1950s to mid 1970s, Mao Zedong, the founding father of the new China, had personally determined political and security interests of the state as being of utmost importance according to his judgment of the world situation. Unlike Mao, Deng Xiaoping, the second-generation leader of China, considered economic development as the core national interest. Epistemic community elites' views are usually turned into national policies through their leverage in key government agencies. "An epistemic community is a network of professionals with recognized expertise and competence in a particular domain and an authoritative claim to policy-relevant knowledge within that domain or issue-area" (Haas, 1992, p.3). Chinese epistemic community elites mainly include leading scholars, leaders of official think tanks, political leaders and government decision-makers. Lastly, voters' views are reflected through mainly democratic mechanisms. Arguably, in a perfectly democratic country, the *Guojia Liyi* represents the collective interests of voters, while in a completely authoritarian state epistemic interests of dictators or the group interest of a ruling party becomes *Guojia Liyi*. As a state that lies between a democracy and a complete dictatorship, China's interests and preferences are formed through a combination of the three aspects – national interests, interests of the state and personal epistemic interests.

The three interests have different weights in constituting *Guojia Liyi* under different conditions. Personal epistemic interests tend to have high leverage under the following four conditions:

First, once great people emerge, their epistemic interests or personal understanding of interests of the state and national interests will be the major part of *Guojia Liyi*, in light of their personal charisma and dominating political influence. In contemporary China, great people no longer exist after Deng Xiaoping's administration. The great people personal decision-making mechanism has been replaced by a fledgling collective decision-making mechanism. Nonetheless, the great people's ideological legacy, particularly Deng Xiaoping's development theory, still has huge influence on contemporary China.

Second, when "the increasingly complex and technical nature of the ever-widening rang of issues" brings mounting uncertainties to the interests and preferences of a country, epistemic communities become popular and important in light of its recognized expertise and competence (Haas, 1992, p.12). In addition, complexity of policy issues also influences the short-term policymaking, as discussed in the second stage.

Third, when the government decision-making mechanism is deficient or inefficient, epistemic interests of government decision makers more likely become a core constituent of *Guojia Liyi* and are reflected in domestic and international policies through a personal decision-making system. The decision-making mechanism of the Chinese government evolves from personal decision-making, collective decision-making to the latest “consensus decision-making” (Wang & Fan, 2013). The gradual completion of people's congress system and the establishment of the collective decision-making principle have seemingly improved China's decision-making mechanism to be more democratic. As a result, the power of individual politicians in decision-making has been weakened to some extent. They, however, still maintain decreasing but significant influence on policy-making, mainly because in a one-party-ruled government, complete democratic decision-making is less likely, and political power is concentrated on party elites for maintaining the authoritarian regime of this single party.

Fourth, when a democratic mechanism is completed, voters' common personal epistemic interests may become *Guojia Liyi* through their democratic rights. Although China has been treated as an authoritarian state solely controlled by the CPC, the development of representative democracy in China is not completely sterile. Some argued that China already holds more elections than any other nation in the world (Hill, 2011). Under the *Organic Law of the Village Committees*, some 600 million village voters in China's approximately 1 million villages hold elections every three years for local village committees (Hill, 2011). However, as far as the democratic rights concerned, China's democratic mechanism is far from being completed and people's interests play a very limited role in *Guojia Liyi*. In contrast, the interests of epistemic leaders, which include great people, political leaders, government decision-makers and other epistemic community elites, play a bigger role in forming *Guojia Liyi*.

The interests of the state tend to be the main part of *Guojia Liyi* when a government has a unified and consistent identity and ideology and strong leverage in society and the economy. A unified and consistent identity and ideology is more likely to form consensus on government goals in the medium or long term, while a strong government's leverage in society and the economy ensures realization of these goals. Briefly, clear government goals and strong government capacity together make the interests of the government reflected in *Guojia Liyi* and consequent national policies. The Chinese government has insisted on a socialist developing state identity and a state-led development ideology. Strong state capacity and intervention has long been a characteristic of China's economic development. As such, the Chinese government's interests have been a crucial part of China's *Guojia Liyi*.

Lastly, national interest must be an indispensable part of *Guojia Liyi* in the long run. As mentioned before, the Chinese government, like any other government in the world, claims to represent its people in the effort to consolidate its political power. Since the founding of the new China in 1949, the CPC has placed great emphasis on the purpose of building the Party to serve the people. At the turn of the 21st century, this task was more explicitly enunciated in the "Three Represents". There has long been a debate on the extent to which serving and representing the Chinese people is rhetoric and a legitimization strategy or a guiding principle of the communist party. However, one common argument is if the people's basic interests cannot be satisfied in the long run, political stability and legitimacy of the communist government will be threatened. In the short or medium term, personal epistemic interests or interests of the state may violate or outweigh national interests, because they are more concrete and tangible than the loosely-organized collective interests of the Chinese people due to the underdevelopment of the democratic mechanism and the dearth of a full-fledged civil society.

The three constituents may coincide or be in conflict. National interests, as defined above, are usually collective and long-term interest of a nation, while interests of the state represented by the government and ruling party are medium-term. Personal epistemic interests are comparatively most changeable and often short-term. The three interests can be in harmony or in conflict. The economic development of China, for example, conforms to the interests of Chinese nation, government and ruling party and key epistemic leaders of China. Economic development is an imperative for rejuvenating Chinese nation, an effective way for fortifying the political power of the CPC and a consensus of epistemic leaders. At times, however, these interests are in conflict. For example, in the Great Proletarian Cultural Revolution (also known as the Cultural Revolution) from 1966 through 1976, Mao Zedong and the CPC led by him launched a series of movements to enforce, as claimed, communism in China by eliminating capitalist tradition and cultural elements from Chinese society. The Cultural Revolution was set into motion according to Mao Zedong's understanding of the situation of China and the world but at the cost of the national interest, for it paralyzed China politically, economically and socially. Therefore, in different periods, the constitution of national interest, interest of the state and personal epistemic interest in *Guojia Liyi* may be different according to harmony (or conflict) and specific power distribution among the three constituents, which are under the influence of both material and ideational factors.

Material and Ideational Factors or Constraints

The explanation of formation of *Guojia Liyi* draws on both Western mainstream political theory, particularly IR theories, and Chinese studies on national interest. First, mainstream IR theories mostly concentrate on interests, which are treated as internal driving forces of state actions, as shown in Table 3.1. The interests are mostly structural and system-level, although in some rational choice approaches they can involve individual self-interest. In contrast, *Guojia Liyi* here considers all the personal, state and national interests and is a combination of the three respects as enunciated above. This combination provides a richer explanatory account for explaining China's policy inconsistency in global financial governance. Second, mainstream IR theory studies formation of interest by separately investigating material and ideational factors. Some scholars (Alagappa，1998; Glenn，2009; Meyer & Strickmann，2011; Sørensen，2008) attempted theoretical and empirical cross-fertilization between the two forces in detailed foreign policy analysis. These literatures mainly focus on the interaction or mutual-constitution of the two factors. Here material and ideational factors are treated as two relatively independent variables, which structure the formation of *Guojia Liyi* by influencing its three constituents. Third, material factors are not confined to systemic pressures but also include domestic process. Conventional realists focus exclusively on systemic anarchy. Neoclassical realists seek to include domestic factors in empirical analysis, such as state's bureaucratic apparatus, the perceptions and misperceptions of policymakers, interest groups and elite consensus (Clenn, 2009). Drawing on this neoclassical turn, this model stresses both the international structure and domestic process. Lastly, Chinese literatures distinguish national interests from interests of the state and analyze both variables and invariables that influence formation of national interests and interests of the state. The material and ideational factors here include both variable and invariable elements. The following section introduces the major material and ideational factors and their influences on the formation of *Guojia Liyi*.

Material factors mainly refer to domestic and international political and economic factors. International political and economic factors mainly include the international system, the international economic situation and the power distribution of states in international politics (or a country's status in international politics), while domestic political economic factor means domestic economic environment, mode of production, political regime and comprehensive national strength. The shaping effects of material factors on *Guojia Liyi* and, consequently, state behaviours are influencing all three of its constituents. First, the international and domestic political economic environment affects the view of epistemic leaders on certain events, which can be transformed into national policy through different ways as mentioned before. As human beings, epistemic leaders' views and actions are influenced and constrained by the social environment in which they live. For instance, key economic policy makers' views have been under the impacts of the changing international and domestic economic situation, particularly in a highly globalized world. This explains why the subprime mortgage crisis in the US immediately aroused policy reactions worldwide.

Second, the domestic situation provides a fundamental basis for, and therefore is, a determinant of the government's interests, while the international environment imposes constraints on these interests. In regard to domestic issues, it is evident that domestic economic and political factors are considered primarily, while international factors only exert limited influences. In contrast, policy making related to foreign issues have experienced significant changes in the past several decades in terms of the levels of analysis formulated by Kenneth Waltz - the first image (at the level of human nature), the second image (at the state level) and the third image (at the international level). In the period right after the World War II, foreign policy was "exclusively a reaction to external stimuli" (Rosenau, 1966) and foreign policy analysis focused on the third image. Since the 1950s and 1960s, the focus has moved to the domestic sources of foreign policy and the interplay of external and internal variables has appeared in foreign policy analysis. As a result, many domestic level variables, such as public opinion and domestic institutions, state-level variables focusing on state power and geopolitical position, and system-level variables like the distribution of capabilities have been introduced in analyzing foreign policies (Alons, 2007). Although in some domestic issues with high international spillover effects, like exchange rate policy, and most foreign issues, international political and economic factors have generated huge influence, the domestic sources of *Guojia Liyi* are decisive.

Third, in the long run, changes in the domestic and international environments will prompt the adjustment of the vested national interests. As discussed before, the current national interest is a result of historical events, national experiences and foreign relations of China in the past more than half century. Therefore, what is happening today, such as globalization, the global financial crisis and domestic economic growth, may result in some adjustment of China's national interests in certain future. Briefly, as the changes of domestic and international environment in the long run, national interests will be adjusted correspondingly and gradually. However, in the short term, as analyzed before, national interests are relatively stable.

Ideational factors, deriving from constructivism, broadly refer to but are not limited to ideas, interpretations, norms, culture, ideology and identity. One crucial problem is that there has not been a clear-cut and acknowledged conception and boundaries of ideational factors. Consequently, scholars have used various terms to describe and represent ideational factors. The connections between these different ideational factors have been not clearly demonstrated. For different scholars facing various problems, ideational factors may differ. For example, in Berman's (2001) article about how and why ideational variables matter, "idea" is treated as the only or at least most important ideational variable. Ross (2009) implied culture, which was defined as shared meaning and meaning-making, has the same implication with ideas to a considerable extent. For scholars studying the formation and evolution of economic policy, economic ideas are the most crucial factors (Jacobson, 1995; Blyth, 1997). In the political culture literature, culture becomes self-evidently the most important ideational factor. Here two major ideational factors, state ideology and interpretation, are employed as two major factors influencing the formation of *Guojia Liyi*.

State ideology, drawn on Hamilton's (1987, p.39) definition of ideology, refers to a system of collectively held normative and reputedly factual ideas and beliefs and attitudes advocating a particular pattern of international and social relationships and arrangements. According to this definition, the state ideology of modern China has at least four key constituents - Socialism with Chinese characteristics, nationalism in the specific form of rejuvenating Chinese nation, state identity and development ideology. The theory of Socialism with Chinese characteristics put forward in the 12th National Congress of the CPC by great man Deng Xiaoping is the most important content of modern Chinese state ideology. It differs from the Mao's radical socialism and is "a product of the integration of the basic tenets of Marxism with Chinese realities and the primary stage of socialism in China" (Wu, 2008b, p.46). This official ideology intends to utilize capitalism (capital and market) in modernizing the socialist China under the leadership of the Communist Party (Wu, 2008b). This theoretical breakthrough has paved the way for developing a market economy in the socialist China and, consequently, has driven China's economic growth in past decades.

Nationalism is another crucial aspect of Chinese state ideology. Chinese nationalism is a mixture of state and popular nationalism (Wang, 2008). State nationalism roots in the "the official cultivation of a well-behaved 'patriotism' and national sovereignty instrumentalized by the Chinese party-state as an ersatz ideology" (Holbig and Gilley, 2010, p.402). In contrast, popular nationalism mainly results from "the uncertainties produced by the pluralisation and marketization of social life, ruptures in the process of socialization and the building of personal identities, mounting pressures in the fields of education and employment, and the ensuing sensibility toward nationalistic myths" (Holbig and Gilley, 2010, p.402). Nationalism mainly refers to Chinese state nationalism in this thesis. Rejuvenating the Chinese nation proposed officially in the 15th Congress of the CPC and the "Chinese Dream" put forward by Xi Jinping are two direct reflections of Chinese state nationalism. The self-identity as a developing country that is and will be for a long time in the primary stage of socialism is the third important component of the modern Chinese state ideology. This judgment made in the 13th National Congress of the CPC has prioritized development and provided the Chinese government with flexibility in making economic policies.

Lastly, the unique development ideology is also a crucial aspect of the Chinese state ideology. Roughly before the 1997 Asian financial crisis, China's development way was widely described as a Developmental State (DS) (Johnson, 1982), which characterizes efficient and managerial-talent-staffed elite state bureaucracy, a powerful and competent political system and state intervention in the economy (Stubbs, 2009). Since the 1997 Asian financial crisis, the DS model has been criticized widely and there has been a debate on whether China is still a developmental state. In the 16th National Congress of CPC the Scientific Outlook on Development was proposed. This new development ideology champions people's interests and advocates for comprehensive, coordinated and sustainable development (Chinese Government, 2012). However, China's model of development has not yet been radically changed and still embodies the basic characteristics of the DS (Knight, 2014).

The modern Chinese state ideology influences the formation of *Guojia Liyi* in specific cases through affecting the ideological system of Chinese people and epistemic leaders and, consequently, national interests, interests of the state and personal epistemic interest. As to the personal dimension, the state ideology provides a thinking pattern for epistemic leaders (great people, political leaders, government decision-makers and other epistemic community elites) in the medium term. The Socialism with Chinese characteristics, for instance, has brought a new idea to epistemic leaders that market economy is not equal to capitalism and can also be cultivated in socialist China. With respect to the interests of the state, the state ideology forms the identity of the government and provides a guideline for the government's action in the medium term. The fundamental interests of the Chinese government are to maintain political stability, sustain economic development and enhance international status. These basic interests derive from the state ideology discussed above. The Socialism with Chinese characteristic liberated China from the endless social ideological debates in the Mao's generation, has paved the way for political and economic development. The Scientific Outlook on Development has made sustainable development come to the fore. Chinese nationalism in the specific forms of the rejuvenation of Chinese nation and the Chinese Dream has urged the Chinese government to pursue higher international position and reputation. In respect to national interests, in the long run, the state ideology and the consequent state identity may prompt the adjustment of the vested national interests. In the Mao's generation, China was self-identified as orthodox socialism. The national interests under the huge influence of the great man Mao Zedong were to survive the intangible and tangible wars against capitalism. Deng identified China as socialism with Chinese Characteristics. Under the impact of this new state ideology, the national interest of China became economic development, rather than social ideological triumph.

Chinese state ideology, for example, significantly influenced the "no devaluation" policy in the 1997 Asian financial crisis, which makes China praised by international community. In the wake of the 1997 Asian financial crisis, China put forward a new identity - "a responsible great nation". This new identity is associated with Chinese nationalism, particularly rejuvenating Chinese nation in modern time. The "no devaluation" policy was made based on this ideology and the consequent new identity. To restore the ancient China's glory and status in the international community, economic development and international reputation and recognition are equally important. In addition, political ideology, as a key component of state ideology, also influenced the "no devaluation" policy. Although it had been globalized and integrated into world economy, China had unswervingly insisted its socialist way in reality or at least in rhetoric. The eruption of the 1997 Asian financial crisis coincides with the return of Hong Kong to China from the UK. Although China adopted a "one country, two systems" policy and retains the capitalist economic and political system in Hong Kong, financial and economic collapse in Hong Kong, which prospered under the UK's capitalist administration for a long period, right after the transfer of its sovereignty to socialist China was unacceptable for Chinese leaders. A "no devaluation" policy, the then Chinese leaders believed, was conducive to securing the Hong Kong's Linked Exchange Rate System and, consequently, maintains the stability and prosperity of Hong Kong' s economy. Chapter Six delves into China's exchange rate policy specifically.

Interpretation mainly refers to epistemic leaders and government's understandings of the domestic and international factors under the influence of the state ideology. Constructivism holds that intersubjective understanding among social actors determines each actor's identities and interests, which will influence social actors' interpretation of the situation that they are facing (Wendt, 1992). When making decisions and taking actions, social actors not only consider their own interests, but also interpret the situation. Finally, the mutual interpretations and final actions of social actors based on strategic calculations will reciprocally influence the intersubjective understanding (Wendt, 1992). Drawing on the Constructivist view, interpretation is considered as an important factor that influences the formation of *Guojia Liyi* by affecting decision makers' understanding and, consequently, the judgment of the government on specific events or institutions in global financial governance.

Interpretation is an inevitable path in which the material factors and the state ideology influence personal epistemic interests and interests of the state represented by the government. As to personal epistemic interests, the material factors and state ideology may change understanding and preferences of epistemic leaders, which are expressed and transformed into *Guojia Liyi* through different ways, as mentioned before. On the state level, the identity and ideology of the government and the internal cause and external constraints together form the judgment of the government during certain period of time.

In the short or medium term, national interests are largely stable and, the personal and collective (government) understanding of national interests is also stable.

For example, the Chinese government and epistemic leaders' interpretation of the G8 decisively influences China's revisionist strategy toward it. China treats the G8 as an organ dominated by the major Western countries. As a result, the issues discussed in the G8 are mainly related to maintaining these major countries' benefits rather than developing countries'. In addition, Chinese leaders worry that a fully-fledged G8 may marginalize the UN. As a permanent member state of the UN Security Council, China would suffer a lot from the marginalization of the UN. Therefore, in 2002, the Foreign Ministry spokesperson Zhu Bangzao declared that China has no intention to join G8 and emphasized that the UN and its Security Council have an irreplaceable role in international affairs (Xinhua, 2000). Besides, some scholars (Chin, 2008, p.89) even observed the possibility that "China's view of the G8 has also been conditioned by the G7's decision in 1989 to condemn and sanction China for the Tiananmen Tragedy". Chapter Four looks into China's different attitudes toward the G8 and the G20.

The following *Guojia Liyi* Formation Matrix (Table 3.2) illustrates clearly the structuring effects of the types of factors - material and ideational factors (state ideology and interpretation) on *Guojia Liyi* through influencing the three constituents--- personal epistemic interests, interests of the state and national interests. Several hypotheses are made.

Hypothesis one: *Guojia Liyi*, which is comprised of personal epistemic interests, interests of the state and national interests, is the driving force of China's policy in the global financial governance system. *Guojia Liyi* is constituted by the short-term changeable personal epistemic interests, the medium-term and relatively stable government judgment and the long-term and less-likely changeable national interests.

Hypothesis two: Both material and ideational factors have significant influences on the formation of *Guojia Liyi*. To be specific, domestic and international political economic environment, state ideology and interpretation are three major structuring factors that determine the formation of *Guojia Liyi* through influencing some or all of its three constituents.

Hypothesis three: The three constituents have different weights in *Guojia Liyi* under different situations. When great people emerge, the democratic mechanism is highly developed, particular policy areas become highly complex, technical and uncertain or government decision-making mechanism is deficit or inefficient, the personal epistemic interests of great people, voters, epistemic communities elites or government decision makers will be respectively and largely reflected in *Guojia Liyi* and the consequent national policies; When government has a unified and consistent identity and ideology and strong leverage in society and economy, interests of the state represented by the government will be largely shown in *Guojia Liyi;* The basic national interests have been an important part of *Guojia Liyi* in the medium or long term. However, in the short term, it may be replaced by the strong personal epistemic interests or state interests under the previous two situations.

Table 3.2 Guojia Liyi Formation Matrix				
Constraints		Three Constituents of *Guojia Liyi* (Interests and Preference of China)		
		Personal Epistemic Interests	Interests of the state	National Interests
Material	Domestic and International	Affects both key policy makers and people's views on certain events in the medium term.	Domestic situation provides a fundamental basis of and is a determinant of government's interests, while the international environment constrains the interests.	In the long run, the changes of domestic and international environment will prompt the adjustment of the vested national interests.
Ideational	State Ideology	Provides a thinking pattern for policy-makers in the medium term.	Forms the identity of the government and provides a guideline for the government's action in the medium term.	In the long run, the state ideology and the consequent state identity may prompt the adjustment of the vested national interests.
	Interpretation	The influence of the above two factors will finally turn into the understanding of great people, key policy elites and/or people.	The identity and ideology of the government and the internal cause and external constraints together form the judgment of the government during certain period of time.	In the short or medium term, national interests are largely stable and the personal and collective understanding of national interests is also stable.
Guojia Liyi *Guojia Liyi* is influenced by the short-term changeable personal epistemic interests, the medium-term and relatively stable government judgment and the long-term and less-likely changeable national interests. The three factors have different weights in the *Guojia Liyi* under different situations.				

Stage II: Decision-Making Process

China's Policy-Making Mechanism

To understand China's policy in global financial governance one must first explore China's foreign policy-making mechanism in general and economic policy-making mechanism in particular. Chart 3.2 lists major Chinese foreign policy actors from core to periphery. The major participants can be classified into four levels in terms of their power of influencing China's foreign policy-making. First, the Central Politburo

Standing Committee of the Communist Party of China (PSC) acts as the de facto most powerful decision-making body in China. The current PSC took office in the 18th National Congress of the CPC in November 2012, consisting of seven members led by Xi Jinping [11] and Li Keqiang[12]. Second, closely around the PSC are several bodies that are directly accountable to the PCS, including Foreign Affairs Leading Small Group (FALSG), Financial and Economic Affairs leading Small Group (FEALSG), Policy Research Office (PR Office), International Department, State Council and People's Liberation Army (PLA). The FALSG, also known as the National Security LSG, is presumed as the most critical foreign policy-making body under the PCS (Jakobson & Knox, 2010). It was chaired by Hu Jintao until March 2013 when the first plenary session of National People's Congress of China elected Xi Jinping as China's new President. Under Hu's administration, the FALSG includes major senior members of China's leadership[13]. After the power transition from Hu to Xi, the power structure and members of the FALSG was also changed[14]. Unlike the FALSG, the FEALSG exclusively focuses on economic policies, currently chaired by Prime Minister Li Keqiang. The PR office,

[11] Xi is current General Secretary of the Communist Party of China, the President of the People's Republic of China, and the Chairman of the Central Military Commission.

[12] Li is current Premier of the People's Republic of China and party secretary of the State Council.

[13] Under Hu's administration, the FALSG members mainly include but not limited to Hu Jintao, Xi Jinping, State Councilor Dai Bingguo, International Department head Wang Jiarui, Publicity Department head Liu Yunshan, Foreign Minister Yang Jiechi, Minister of Commerce Chen Deming, Minister of Defense Liang Guanglie and Minister of State Security Geng Huichang.

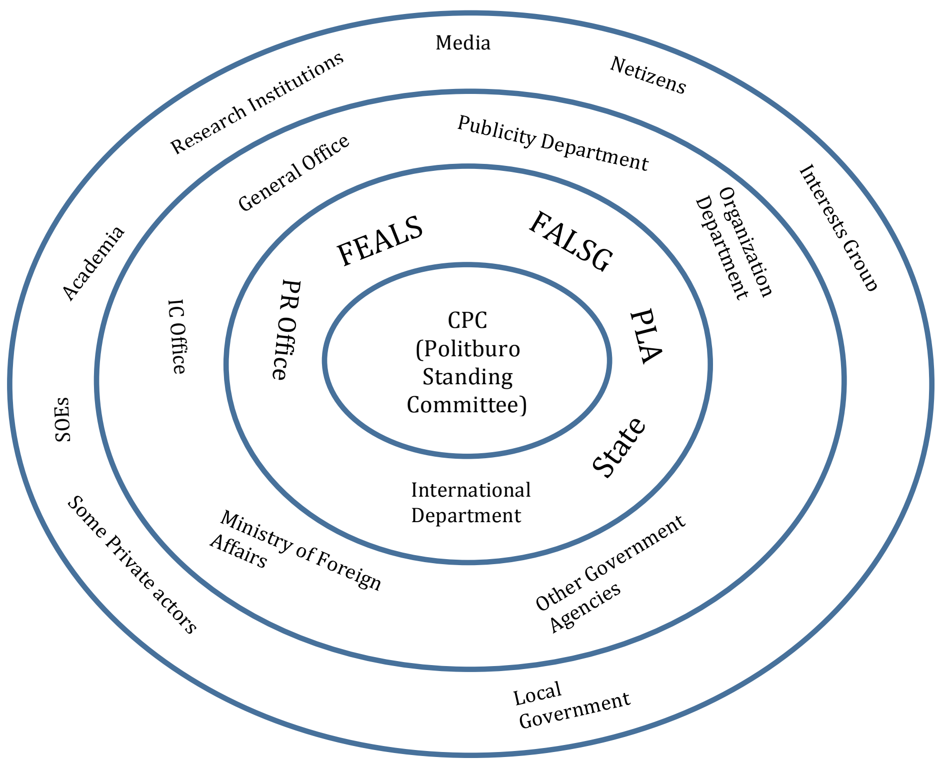
[14] The current FALSG members include Xi Jinping, Li Yuanchao (vice president), Yang Jiechi (state councilor), Liu Qibao (head of Publicity Department), Wang Jiarui (head of International Department), Wang Yi (foreign minister), Chang Wanquan (minister of defense), Guo Shengkun (minister of public security), Geng Huichang (minister of state security), Gao Hucheng (minister of commerce), Zhang Zhijun (Taiwan Work Office of the CPC Central Committee director), Wang Guangya (Hong Kong and Macao Affairs Office of the State Council director), Wang Cheng (International Communication Office of the CPC CC director and Information Office of the State Council director) and Qiu Yuanping (Overseas Chinese Affairs Office of the State Council Director).

headed by Wang Huning, is designed to provide advice and drafts policy documents to major decision-makers, while the International Department, formerly the International Liaison Department, is in charge of conducting foreign relations with other political parties. In addition, State Council and the PLA are also two key actors in China's foreign policy-making. The former, headed by Premier Li Keqiang, is the highest body in the Chinese Government and represents China in inter-state relations, while the latter "shares authority with government and commercial entities on decisions pertaining to arms control and non-proliferation—spheres with direct foreign policy implications over which the PLA formerly exercised nearly unquestioned authority" (Jakobson & Knox, 2010, p.13).

The third level comprises several bodies that play instrumental and auxiliary roles in the foreign policy-making and implementing. Specifically, the General office chaired by Li Zhanshu is responsible for providing administrative and logistical support to the Politburo. The Publicity Department (headed by Liu Qibao) and International Communication Office (headed by Wang Jiarui) are tasked with respectively shaping domestic public perceptions and improving international community's understandings of China's foreign policy (Jakobson & Knox, 2010). Ministry of Foreign Affairs and other Government agencies also play important roles in China's foreign policy. The Ministry of Foreign Affairs, as claimed in the office website, is mainly responsible for implementing the state's diplomatic principles and policies and related laws and regulations. Other government agencies are crucial in making and implementing foreign policies in specific fields. For example, Ministry of Finance, Ministry of Commerce and People's Bank of

China (PBC) are especially important in making and implementing China's foreign economic policies. The fourth and most marginal level is mainly comprised of media, netizens, research institutions and academia, various interest groups, sate-own enterprise (SOEs) and local government. In the highly centralized power structure of China, these marginal actors have limited influence on China's foreign policy.

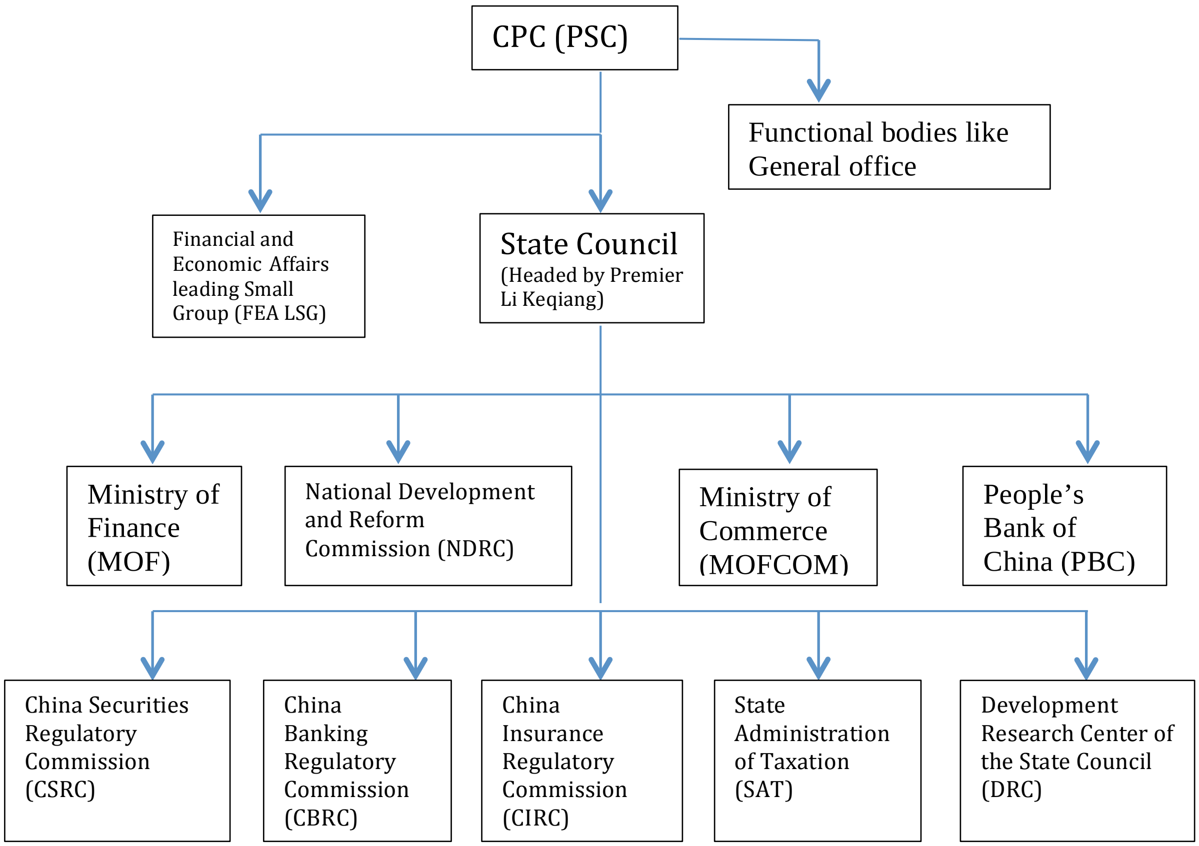
Chart 3.2 China's Foreign Policy-making Actors



China's strategy and behaviour in global financial governance is more specifically related to China's foreign economic policy-making. Chart 3.3 illustrates major actors in making foreign economic policies and the power structure, which is part of the whole foreign policy-making structure analyzed above. The CPC, especially the PSC, is still standing at the center of China's foreign economic policy-making, supported by some functional units like the General Office that provides administrative and logistical support. Another body that is directly accountable to the CPC and crucial in making foreign economic policy is the FEALSG as mentioned before. State Council and its subordinate agencies, such as Ministry of Finance, Ministry of Commerce, National Development and Reform Commission and People's Bank of China, play irreplaceable roles in making and implementing foreign economic policy. In addition to these government departments, some bodies, which are also directly accountable to State Council and take more specific responsibility in economic governance, have important economic policy input. They include China Securities Regulatory Commission, China Banking Regulatory Commission, China Insurance Regulatory Commission, State Administration of Taxation and Development Research Center of the State Council.

Although the organizational structures of China's foreign policy making in general and foreign economic policy making in particular are clear as mentioned above, the specific policy-making process and factors that may influence these policies in certain ways are still opaque because of the inaccessible information caused by the elusive power relations and domestic political system with Chinese characteristics. The Stage II of the two-stage model focuses on the specific policy-making process, particularly the policy-making environment.

Chart 3.3 China's Foreign Economic Policy-making



Decision-making Environment

Unlike mainstream IR theories that mostly treat the state as a unitary unit of analysis, the two-stage model considers both the state (government) and the individual (policy-makers). Once the *Guojia Liyi* is formed, the next question is how decision-makers will make specific policies based on it. Foreign Policy Analysis (FPA), as reviewed before, explores various decision-making models, which include mainly rational actor model (e.g. the expected utility and game-theoretic models) and bounded rationality (e.g. the cybernetic model, bureaucratic politics, organizational politics, prospect theory and poliheuristic theory) (Mintz & DeRouen, 2010). The rational actor model assumes that decision makers are capable of ranking preferences based on their rationality and of choosing the best alternative among many options in terms of their preference. The bounded rationality model argues political leaders are boundedly rational and "adaptive within the constraints imposed both by the external situation and the capacities of the decision maker" (Simon, 1985, p.294). The bureaucratic politics model stresses the political competition among various bureaucracies, while the organizational politics model focuses on how a decision is made within a specific agency (Graham & Philip, 1971). Prospect theory, as a leading psychological theory of decision-making emphasizes psychology of decision-makers, which are risk-averse with respect to gains and risk-acceptant with respect to losses (Kahneman & Tversky, 1979).

These models mentioned above focus on either rationality (bounded or not) or cognition. The rational group simply argues that decision makers choose an option that maximizes utility rationally among a set of alternatives, while cognitive group holds that psychological factors, such as emotion, personality and belief system, capability of cognition of decision-makers and other factors like costs of information gathering, time pressure and organization structure make the rational assumption unrealistic in practice. In contrast, Mintz (2005) combined the cognitive and rational models to form a "poliheuristic decision model". Espousing the combination, I argue that both cognitive and rational approaches are explanatorily powerful in analyzing state policies and behaviours. The conventional bounded rationality holds that rationality of individuals in decision-making is limited by insufficient and asymmetric information, limitation of cognitive capacity and the finite amount of time. Thus, decision-makers are usually satisficers who seek a satisfactory decision rather than an optimal one. However, within the limited foreign policies and action alternatives, decision-makers still tend to choose the optimal one. This leads to another question: under what conditions does rationality, cognition or any combination of the two have more leverage in explaining China's policy making?

Probing this question will lead to the second major explanation of China's inconsistency of strategies in the global financial governance. Once the *Guojia Liyi* is formed, the decision-makers may or may not make every decision strictly in accordance with its interests and preferences. The rational model assumes decision makers will obey the interests and preferences without any exception, while cognitive model holds that rationality of decision makers is bounded by many factors like limitation of cognitive capacity and others. I argue under some conditions in which the bounds on rationality do not exist or act weakly, decision makers tend to be rational and the rational model is more explanatorily powerful. Under conditions in which the bounds on rationality are significant, the cognitive model has more leverage. When decision makers are rational or capable of being rational, their decisions will be in accordance with the *Guojia Liyi* and the foreign policy objectives built on interests and preferences; when decision makers' rationality is bounded, their decisions will be, to some extent, in discord with the *Guojia Liyi*, and state strategies and behaviours based on these decisions will deviate from the existed foreign policy objectives. However, a pivotal question is what are these conditions ?

Six variables are considered as important factors influencing the process of decision-making to be rational or cognitive, drawing on the relevant literatures mentioned above. These factors include, as shown in Table 3.3, lobbying of interest groups, institutional agreements or conflicts, complexity of issues in point, short-term pressures from IOs or other countries, emergent events and the risk appetite of decision makers. Table 3.3 summarizes the effects of these factors on the process of decision-making. Briefly, if decision-makers are facing an emergent and complicated issue, toward which there are conflicting views among related agencies and between China and other countries or IOs and on which key decision makers have low risk appetite, the final decision on this issue is highly likely to be cognitive, rather than rational.

China's currency policy, one of the most hotly debated subjects in the recent international monetary history (Mitchell & Hawkins, 2012), provides a good example. Due to its externalities to international society, China's exchange regime has been highly watched by the global financial governance system. Generally, China's exchange rate policy is made based on China's *Guojia Liyi*, which is to promote and maintain economic development by establishing and improving the socialist market economic system in China and enabling the market to fully play its role in resource allocation (Xinhua, 2003). Meanwhile, the specific exchange rate policy-making process has been influenced by many factors as shown in the following Table 3.4. The Chapter Six analyzes these factors in detail.

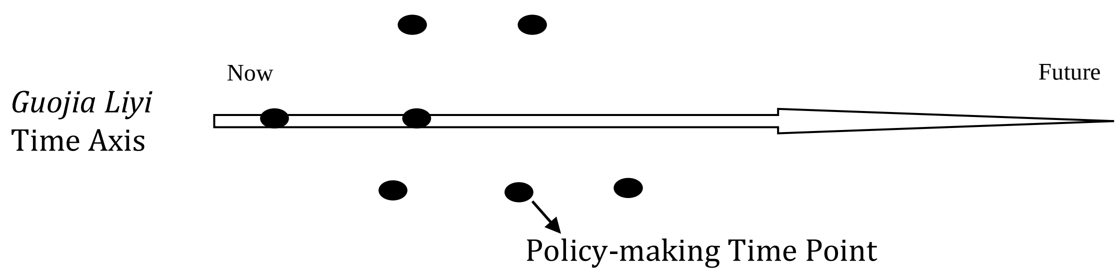
Table 3.3 Factors Influencing the Process of Decision-making	
Factors	**Influence**
Lobbying of Interests Group	The harder the lobbying is, the less rational the decision will be.
Institutional agreement or conflicts	The decision tends to be more rational based on the "*Guojia Liyi*" if there is more likely an institutional agreement among agencies. Vice versa.
Complexity of issues in point	The more complex the issue is, the more cognitive the decision will likely be.
Short-time pressures from IOs and countries	The more external pressures from IOs or other countries will lead more cognitive decisions. Vice versa.
Emergent events	Emergent events always require immediate response in short time and unconventional measures to deal with. Therefore, the more emergent the event is, the more cognitive the decision will likely be.
Risk appetite of decision makers	The higher the amount of risk that decision makers are willing to take in order to meet their vested epistemic interests is, the less possibility that these factors above may change decision-makers' views and/or decisions. Vice versa

Table 3.4 Factors Influencing the Process of Exchange Policy-making	
Factors	**Influence**
Lobbying of Interests Group	The export sectors have lobbied against the currency reform and consequent RMB appreciation through direct and indirect ways.
Institutional agreement or conflicts	There are institutional conflicts, especially between People's Bank of China (PBC) and Ministry of Commerce (MOFCOM). The former is a strong backer and initiator of China's currency reform, while the latter opposes, concerning the competitiveness of China's export sector would be weakened.
Complexity of issues in point	The specific ways to reform and the externalities of the currency reform may be complex. The extent of the complexity may be different according to the macro-economic condition in different periods.
Short-time pressures from IOs and countries	China's exchange rate policy and value of RMB have faced huge external pressures in the past decade and more.
Emergent events	Some emergent events in global and domestic economy may change the exchange rate policy. The 1997 and 2008 global financial crises are two good examples.
Risk appetite of decision makers	Key policy elites, especially in the PBC, such as Zhou Xiaochuan and Yi Gang, have unswerving personal recognition advocating a more flexible exchange rate system in China and are relatively willing to take the potential risks of exchange reform.

Distinction between the two stages is theoretically clear but may be empirically blurred. As showed in the Chart 3.1, some material and ideational factors influence the formation of *Guojia Liyi,* while six major intervening factors influence the specific decision-making process. In reality, these material and ideational factors and intervening factors are inextricably linked. One the one hand, these material and ideational factors may influence or in essence overlap with the intervening factors. On the other hand, the intervening factors that influence specific decision-making may also generate influence on formation of *Guojia Liyi*. For solving these puzzles, time should be considered as an independent variable.

The two stages are in time sequence and have different time scopes. The formation of *Guojia Liyi* provides decision-makers basic criteria for making policies and taking actions. Therefore, the Stage I is usually formed prior to the Stage II. In extreme cases where epistemic interests of dictators or key policy elites in certain domains play a decisive part of *Guojia Liyi*, the *Guojia Liyi* may be formed during the process of making policies or decisions. In terms of time scopes of the two stages, the first one is much wider than the second. Duration of particular *Guojia Liyi* in certain policy areas varies from case to case. China's *Guojia Liyi* is usually re-identified and/or adjusted every five years through the Five-Year Plan. Some *Guojia Liyi* lasted for decades while some changed over time more frequently, depending on the (in)variability of the material and ideational factors discussed above. In contrast, when a particular type of policy or decision is required, policy/decision making is a short-term process in most cases, as shown in the Chart 3.4. Therefore, time becomes a crucial criterion to distinguish the material and ideational factors that influence formation of *Guojia Liyi* from the intervening factors that influence specific policymaking. The former have a medium/long-term influence on certain broad policy areas, while the latter have a relatively short-term influence on specific policy issues.

Chart 3.4 The Time Scope of *Guojia Liyi* and Policy-making



Conclusion: Explaining the Policy Inconsistency

The two-stage model explains the inconsistency of China's policy across various institutions or events in global financial governance by the following two hypotheses. First, the *Guojia Liyi* of China in various institutions or events may be different, because of the different structuring material and ideational factors and the consequent different leverage of the three constituents. The structuring effects of these factors on *Guojia Liyi* are not equivalent invariably, mostly because these factors are changing to different extents. The leverage of personal epistemic interests, interests of the state and national interests under the influence of the two groups of factors differ under different situations as analyzed before. Therefore, China's specific interests and preferences (or *Guojia Liyi*) may be different in various events or global financial governance institutions. As the previous examples indicated, China's different strategies toward the G8 and the G20 and in the post-2008 crisis financial reforms and the 1997 Asian financial crisis are due to the different *Guojia Liyi* formed by different factor(s), such as interpretation in the G8 and the G20's cases, state ideology in the "no devaluation" policy and political economic factors in the post-crisis financial reforms.

The second hypothesis is that given the ascertained *Guojia Liyi*, under some specific situations, the decisions are not always rational and in accordance to these interests and preferences. As showed in Chart 3.4, some decisions are in line with the medium or long-term *Guojia Liyi,* while some others are not. Decision-makers follow *Guojia Liyi* where rationality is not bounded or constrained, but are influenced away from *Guojia Liyi* when rationality is bounded or constrained. In some global financial governance institutions or events, decision makers are capable of being rational because of fewer bounds on the rationality, while in some others, the rationality is bounded by lobbying of interest groups, complexity of the issue, decision-makers' cognition and others. Therefore, even if the medium- or long-term interests and preferences are the same, the short-term or even one-off decision and strategy may be different due to the specific conditions for making a decision. In this sense, the inconsistency of China's strategies in global financial governance is explained.

For example, as mentioned before, reforming China's exchange rate system has conformed to China's *Guojia Liyi*, which can be briefly understood as construction of socialist market economy and prosperity of the Socialism with Chinese characteristics. This *Guojia Liyi* guides the long-term objective of completing China's market-oriented exchange rate mechanism. However, in the short or medium term, China's exchange rate policy has not always obeyed this *Guojia Liyi*. As shown in Table 3.5, China's exchange rate policy in past decade experienced three periods, which are 2005 reform (2005-2008), 2008 stagnation (2008-2010) and 2010 relaunch (since 2010). In the first and third periods, the exchange rate policies are in accordance with the *Guojia Liyi*. China acted and is acting, comparatively, as a status-quo power in global financial governance, actively seeking to complete its exchange rate system under the surveillance of major global financial governance institutions, particularly the IMF. In the second period, China's exchange rate policy temporarily deviated from the long-term *Guojia Liyi* and became revisionist in global financial governance system. The major reason for the different exchange rate policies in the three periods is the disparate influences of the factors listed in Table 3.4 on the policy-making process. Briefly, as shown in Table 3.5, in the first and third period, these factors have mostly weak influence on the decision-making process and thus the decisions are more based on the *Guojia Liyi*. In the second period, these factors exerted relatively strong influence on the decision-making process and the decision became more cognitive rather than rational conforming to the *Guojia Liyi*. The Chapter Six delves into these factors more specifically.

Table 3.5 Summary of Factors Influencing the Exchange Policy-Making

Factors	2005 Reform	2008 Stagnation	2010 Relaunch
Lobbying	Weak	Strong	Weak
Institutional conflicts	Weak	Strong	Weak
Complexity of issues in point	Low	High	Low
Short-time pressures from IOs and countries	High	Low	High
Emergent events	No	Yes	No
Risk appetite of decision makers	High	Low	High

Chapter Four: From G8 to G20 - Changing *Guojia Liyi* of China

Despite many disputes related to the 2008 global financial crisis, such as causes of the crisis and how to reform the flawed global financial governance system, at least one consensus has been reached: emerging countries have become indispensable in global financial governance and the world economy in the post-crisis era. As the biggest emerging economy, China has become more active in global financial governance, especially in some key global financial governance institutions like the G20. This attitude is in sharp contrast to China's attitude towards the G8, the initiator and precursor of the G20. Many Chinese and Western scholars respectively analyzed China's revisionist attitude towards the G8 (Cao, 2003; Chin, 2008; Lv, 2006) and status-quo-power stance to the G20 (Chin, 2010; Huang, 2011; Yu, 2005). Few of them, however, compared the two attitudes and put forward a framework to explain the discrepancy. Against this research gap, this chapter aims to explain China's different foreign strategies in the G8 and the G20 drawing on the theoretical framework put forward before, particularly the Stage I formation of *Guojia Liyi.*

China in the G8: A Revisionist Power

During the Cold War period, the G8[15] and China were separated by political ideology and were indifferent to each other. China defined the G8 as a club of rich nations without any significant influence on China's development, while the G8 led by the US treated China as a socialist heretic. In the post-cold war era and before the

[15] Before the accession of Russia in 1997, the group appeared as the G7. This thesis uniformly uses the G8.

inauguration of the G20 in 1999 against the backdrop of the 1997 Asian financial crisis, the G8 played a crucial role in the global economic governance and cooperation and started to pay attention to China. On the one hand, it treated China as a potential danger to the world and encouraged reform and disarmament of China. On the other hand, it attempted to intervene with China's internal affairs, such as with regard to political reform, human rights and the South China Sea issue (Chen, 2009). Even after the birth of the G20 Financial Ministers and Central Bank Governors and until the upgrade of the G20 to a leaders' forum in September 2009 Pittsburgh summit, the G8's role in governing world economy and solving global issues was still evident.

Recently, the G8 (G7+Russia) has changed its attitude by seeking cooperation and communication with China. This dramatic turn lies in, to a large extent, the 1997 Asian financial crisis. China's acknowledged performance in this crisis made the G8 realize, among many other things, that China has become incrementally important for stabilizing world economy and settling global issues. The G8, especially the US, for example, think that world anti-terrorism co-operation without China's participation is unimaginable (Lv, 2006). Therefore, following the 1997 Asian financial crisis, the G8 extended invitations to China respectively in 1999, 2000 and 2002. It was only in 2003 that China's president Hu Jintao participated in the side meetings at the G8 summit in Evian, France. In 2005, a dialogue mechanism between the G8 members and five emerging countries called the G8+5 was formed. This informal mechanism was further institutionalized in the 33rd G8 summit as the "Heiligendamm Process" in 2007. Subsequently, some G8 members, particularly Russia, France and the UK, called on enlarging the G8 by incorporating emerging countries like China. For example, in a foreign policy statement, French president Sarkozy espoused that China, India, Brazil, South Africa and Mexico should be members of the G8, saying "the G8 can't meet for two days and the G13 for just two hours. That doesn't seem fitting, given the power of these five emerging countries" (Times of India, 2007). In contrast, Japan and the US oppose China's accession, while Germany, Italy and Canada's views have been changing with the alternation of ruling parties in these countries (Chen, 2008). From China's perspective, despite the G8's important role in settling many international issues, such as climate change, energy cooperation and international development, China has not been motivated to join. China has even questioned the legitimacy of the G8, acting as a revisionist power. This stance is driven by China's relevant *Guojia Liyi*, which is summarized here as maintaining China's economic development and enhancing China's international status without violating China's ideology and identity. According to the two-stage model, this strategy of China toward the G8 and the fundamental *Guojia Liyi* are influenced by material and ideational factors through influencing some or all the three constituents - personal epistemic interests, interests of the state and national interests. To be specific, the material factors mainly refer to domestic and international political economic environment, while the ideational factors are state ideology and interpretation.

Political Economic Environment

The domestic and international environment that China has been facing influenced the formation of China's *Guojia Liyi* and consequent strategy toward the G8 by impacting personal epistemic interests of key policy elites, interest of the government and national interests. The domestic situation mainly refers to the high-speed domestic economic development and consequent growing systemic importance in world economy, while the international situation, to a large extent, refers to the 1997 and 2008 global financial crisis and the weak performance of the G8 in these crises as well as in world anti-terrorism, which discredited the G8 as a core mechanism in global governance. The influences of the domestic and international situation on the formation of *Guojia Liyi* of China in the G8 mainly include the following several aspects.

Frist, the legitimacy and reputation crisis of the G8 makes China's policy elites more indifferent to this group, while the domestic economic development has brought them more confidence to steer clear of the G8 in pursuing sustainable development and international status. The G8 has been facing a legitimacy crisis, particularly in the recent decade. The annual recurrence of widespread protests against the G8 meetings is an explicit indication of the legitimacy crisis. In essence, the legitimacy crisis primarily stems from the perceived show-event character and a lack of tangible outputs (Gronau et al., 2009). In addition, excluding or failing to include the second-largest economy China per se is self-defeating for the G8 (Butler, 2013). The legitimacy deficit of the G8 largely influences Chinese scholars and policy elites' perspectives on it. Many Chinese scholars argue the era of the G8 has come to the end, replaced by the G20 (Li & Zhang, 2011; Zhang, 2012a; Cui & Xin, 2011). Although the G20 was initiated by the G8 and the two institutions maintain dialogues, the vice-president of the China Institute for Contemporary International Relations (CICIR) Wang Zaibang (2006c) observed that the dialogue between the G20 and the G8 neither change the fact that the G8 summits have become a target of ridicule, nor solve the vital problems influencing the future and destiny of the G8. In contrast to the legitimacy crisis of the G8, China has gained higher international reputation and status in light of its better performance in 1997 and 2008 financial crisis. Consequently, Chinese leaders firmly believe that without the G8 China still can play a role in global governance (Lv, 2006). Recently, Russia's take-over of the Crimea and the consequent sanction of other G8 members on their colleague further made the club of leading industrialized economies defunct. As German Chancellor Angela Merkel said in public that, "as long as there is no political environment for such an important political format as the G8, like at the moment, the G8 doesn't exist anymore, neither the summit nor the format as such" (Torry, 2014).

Second and more importantly, maintaining an informal relation with the discredited the G8 would not impede the Chinese government achieving sustainable development and higher international status, whilst to be a formal member of it may cost the Chinese government too much. Closely related to the personal understandings analyzed above, the domestic and international environment, to a considerable extent, influenced the Chinese government's benefit and cost analysis. Internationally, Russia's accession to the G8 sets China a negative example, while the rising G20 provides China a good alternative. Russia's contact with the G7 can be traced back to the early 1990s by participating in some sessions with the G7 leaders during their summits. In 1997 Russia formally joined the group. The initial purpose of the addition of Russia was to encourage it to become a free market liberal democracy with a commitment to the international processes and norms that the G7 considered acceptable (Smith, 2011). Nonetheless, as the agenda of the G8 has expanded from economic and financial issues to a broader range of topics from geopolitical issues to environment, the differences between Russia and the original seven have been widened. Arguably, Russia was only a marginal power in the G8. Before the eruption of 2008 financial crisis, other members of the G8 had criticized Russia for its disqualification as a G8 member in terms of economic scale, human rights standard, democratic level and international cooperation on certain critical issues (Zhang, 2014). Recently, in direct response to Russia's annexation of Crimea, Russia's membership in the G8 was suspended.

Russia's experience in the G8 is China's lesson. Domestically, China also has substantial differences with other G8 members in many aspects like social ideology and development paradigm, which will be looked into later. These differences make China, as they do Russia, an anomalous power to this group. On the contrary, the G20 provides a better platform for China to participate into global governance and, therefore, pursue higher international status, which will be analyzed in the later section. To sum, the following comment from the *China Daily*, a major English newspaper of the Chinese Government, reveals the view of the Chinese government on the G8 (Ruan, 2006):

> *"On the one hand, the group is trying to have a bigger say in international affairs, with its agenda extending from exclusively economic matters to international politics and security. On the other hand, however, the G8, bringing together just eight countries, is not representative enough. As a result, its prestige has dropped."*

Third, given the international and domestic political economic environment, keeping an informal relation with the G8 does not violate China's long-term national interest, which is to rejuvenate Chinese nation and realize "Chinese Dream". The goals of rejuvenating Chinese nation and realizing Chinese dream are development of economy, society and culture and the enhancement of Chinese nation's international position. A crucial step is to sustain China's economic development. In the long run, the domestic and international policies of China are based on the long-term national interests. Given the domestic and international factors, joining the G8 may bring negative influences on China's development by mainly influencing its development identity and ideology, which will be analyzed subsequently.

State Ideology

Chinese state ideology, as enunciated in the theoretical chapter, contains four key aspects – Socialism with Chinese characteristics, nationalism in the specific form of rejuvenating Chinese nation, state identity and development ideology. The four aspects all influence the formation of China's *Guojia Liyi* towards the G8 and the consequent domestic and international policies to different degrees and in different ways. First, China identifies itself as a developing and socialist country. China's political leaders have insisted Socialism with Chinese characteristics for several generations since Deng's administration to the latest inauguration of Xi. As Xi, new President of China, said recently:

> *"Socialism with Chinese characteristics is the underlying achievement gained by the Party and the people through long time of practices, and is the banner under which the Party and the people unite themselves, strive and win. This banner should be held high and adhered to in the country's efforts to build a moderately prosperous society in all respects, advance the socialist modernization and realize the great rejuvenation of the Chinese nation. "* (Xinhua, 2012)

Joining the G8, which is considered as a club of capitalist countries, may affect negatively the Socialism with Chinese characteristics, the official state ideology of China. In addition, the idea of joining the G8, as Chin (2008) argued, was seen as running counter to the former leader Deng Xiaoping's view of never seeking a leadership position in world affair (*Juebu Dangtou*). From the view of the Chinese government, as a developing country, joining the rich club will aggravate the burden and obligation of China in global governance, which may drag down China's development; as a socialist country, China thinks that the old unfair and irrational international political and economic order, or in Chin's (2008) term "the basic ontology of world order", has not been changed fundamentally (Jiang, 2002) with several Western capitalist countries, especially the US, still dominate the world economy. Moreover, the G8 pattern violates China's idea of the democratization of international relations, which holds that every county, poor or rich, big or small, has equal right in international community (Cao, 2003). From the angle of national interests, maintaining China's self-identity as a socialist developing country is more advantageous for rejuvenating Chinese nation in international society. Joining the G8 would, to some extent, violate the principle of being socialist developing country in the short and even medium term.

Second, China's development ideology differs from the mainstream neoliberalism held by most G8 members. China's unique development paradigm has been extolled for creating China's economic miracle in the past decades. However, the nature of China's paradigm has long been a contested question. One group contends that China is a Developmental State (Johnson, 1982), which contains efficient and managerial-talent-staffed elite state bureaucracy; a political system in which the bureaucracy is powerful and competent to take initiative and operate effectively; state intervention in the economy; a pilot organization that "controls industrial policy through its influence over planning, the energy sector, domestic production, international trade, finance and government funds" (Stubbs, 2009, p.2). Another group argues that the Chinese state has deviated from the conventional DS model and formed its own development way, which is "regulatory state" (Yang, 2004), "entrepreneurial developmental state" (Blecher & Shue, 1996) or "dual developmental state" (Ming, 2000). Despite these various views, one consensus is that China's development way is different from or even competing with the neoliberalism or the Washington Consensus propagated by the G8. In detail, there are at least four contentions between the two models, which are the disparity in the relations between economic growth and national security, conflicts between economic nationalism and liberalization, deregulation and privatization, difference between strong state and bureaucracy and strong market, and contentions between weak and strong society. The inconvertibility of China's currency RMB and the call of the G8 for coordinating member states' exchange rates are a tableau of the conflict of the two development models. In economic dimension, an important strategy of the G8 is to coordinate the member countries' exchange rates. In this sense, the inconvertibility of RMB is a barrier for China to join the G8 (Cao, 2003).

The unique development ideology and the consequent economic achievement make major policy elites and the Chinese government hesitate or even inimical to the neoliberal ideas. Joining the G8 may bring two scenarios to China, either maintaining the independence of the development and social ideology but being marginalized or being assimilated by the neoliberalism. Both are not acceptable for Chinese policy elites and government. From the national state perspective, the Chinese way is treated as an effective way to realize rejuvenating Chinese nation and Chinese dream. However, joining the G8 may violate the Chinese way and consequently the economic development. Consequently, the domestic and international environment and the state ideology analyzed above together formed the interpretation of Chinese policy elites and government.

Interpretation

Interpretation mainly refers to epistemic leaders and the government's understandings of the domestic and international environment structured by the state ideology. Chinese leaders' interpretation of the G8 influences China's strategy toward the G8 to certain extent. To be specific, China treats the G8 as an organ dominated by the major Western countries, especially the US that is still the sole superpower for the time being and in near future. As a result, the issues discussed in the G8 are mainly related to maintaining these major countries' benefits rather than developing countries'. Therefore, it was only a "forum of the rich countries and not a global regime with legitimacy of enforcement that is recognized by the sovereign governments of the rest of the world" (Yu, 2005, p.9). In addition, Chinese leaders worry that a fully-fledged G8 may marginalize the UN. As a permanent member state of the UN Security Council, China would suffer from the marginalization of the UN. Therefore, in 2002, the Foreign Ministry spokesperson Zhu Bangzao declared that China has no intention to join the G8 and emphasized that the UN and its Security Council have an irreplaceable role in international affairs (Xinhua, 2000). Besides, some scholars (Chin, 2006, p.89; Cao,

2003) even observed the possibility that "China's view of the G8 has also been conditioned by the G7's decision in 1989 to condemn and sanction China for the Tiananmen Tragedy". In addition, as mentioned above, the Chinese government interprets that joining the G8 will aggravate the burden and obligation of China in global governance by changing China's identity from a developing to a developed country and will violate China's Socialism with Chinese characteristics by being imposed by the neoliberalism.

The above factors of domestic and international environment, state ideology and interpretation together form China's *Guojia Liyi* in the G8, which can be briefly summed as maintaining China's economic development and enhancing China's international status without violating China's ideology. The specific strategy of China toward the G8 based on this *Guojia Liyi* is to keep a proper distance with this informal mechanism.

China in the G20: A Status-Quo Power

In 1999, following the Asian financial crisis, the G20 Finance Ministers and Central Bank Governors (the G20) was formally established at the G8 Finance Ministers' meeting for cooperation and consultation on matters pertaining to the international financial system. Following the exacerbation of the subprime mortgage crisis to a global financial crisis, the G20 was upgraded to permanent leaders' forum in Pittsburgh Summit in September 2009. Responding to the global financial crisis, the leaders' forum aims to incorporate the emerging countries, especially the BRIC, to combat the crisis in a coordinated manner. Towards both the G20 Finance Minister and Central Bank Governors' meeting born in the 1997 financial crisis and the latest version of the leaders' forum upgraded in response to 2008 global financial crisis, China has struck a different attitude compared to its stance to the G8. The difference is revealed through the following several aspects. First, China is an excellent member of the G20, attending actively all the G20 meetings and discussions at different levels. As the former Governor of PBC Dai Xianglong (2008) remarked, "as one of the founding members of the G20, China has not only witnessed the development of the G20, but also participated in the discussion of various issues, with a view to promoting the realization of its mission".

Second, China has not only participated in all the G20 meetings and advocated the G20's proposals, suggestions or/and requirements, but has actively expressed its perspectives. In 2005, as the chair of the G20, China hosted a series of the G20 meetings under the theme of *Global Cooperation: Promoting Balanced and Orderly World Economic Development*, which, as the *2005 G20 Communiqué* said, "discussed a wide variety of critical global economic issues and reconfirmed our (the G20) shared vision and responsibility for achieving balanced and sustainable growth" (G20, 2005, p.1). In addition, China often expressed its view on many issues discussed in the G20 agenda, such as international monetary system reform, strengthening international financial regulation and reforming international financial governance institutions. In the first G20 Summit in Washington in November 2008, for example, President Hu laid out China's fundamental position and proposals to reform the old international financial system, which, in his view, should be conducted in a comprehensive, balanced, incremental and result-oriented manner (Hu, 2008a).

Last but not least, China has become an important player, even a core power, of the G20. From the G8 to the G20, more countries, especially key emerging-market countries, have been included in the core of global economic discussion and governance. Meanwhile, changes also occurred in the core power of the G20. Some think the US is still the single core power of the G20. As analyzed in Chapter 2, at first glance, the US is likely the biggest loser for its hegemonic power in the G7/ G8 has been diluted by the creation of the G20. This view, however, as Cooper (2010, p.745) argued, "is blurred by the degree of American diplomatic leadership involved in the G20 process". Cooper added that President George W. Bush and President Barack Obama have both acted as effective convener of the G20. In addition to the diplomatic leadership, the US's economic size, military power and soft powers deriving from the hegemonic currency, scientific innovation and so forth are still unparalleled. Even so, the further integration of the EU and the fast-growing emerging countries have challenged the US-guided hegemonic structure, and the US is no longer the single hegemon as it was in the Bretton Woods Meeting or even in the G8. Therefore, some argue that the US and China will be the core powers of the G20. The huge Sino-US economic imbalance, which characterizes the tremendous trade surplus and foreign reserve of China and the enormous trade deficit and highly debt-driven economy of the US, is blamed as the main cause of the 2008 global financial crisis and, consequently, empowers the two countries the world economy. At the same time, the relative sluggish economy recovery of the EU and Japan due to the European sovereign debt crisis and Japan's long-term economy gloom since the late of 1980s, also contributes to the formation of the new core power of the G20 - G2 (US and

China). As Garrett (2010, p.29 and 38) argued, “the world will be characterized by a de facto China–US G2 after the financial crisis” and “China and the US have also decided that their de facto G2 should be firmly nested in a multilateral G20 that will sit on top of but not replace the existing institutions of global economic governance”.

In contrast, some argue that the G3 (US, EU and China) will play the core roles in the G20 in the foreseeable future. The issue in stake here is not whether G2 or G3 will be the core powers of the G20, but the status of China in this informal mechanism. Evidently, the economic miracle in the past decades, the outstanding performance in both 1997 Asian financial crisis and the 2008 global financial crisis and the active and multilateral foreign policy have together led to the enhancement of China’s status in global governance in general and in the G20 in particular. In the G20 China is more active, acting as a status-quo power.

China’s *Guojia Liyi* determines its attitude to the G20. In the specific case of the G20, China’s *Guojia Liyi* can be also interpreted from the three aspects. First, securing the vested economic benefits and to gain more ones are one of China’s basic interests. Second, maintaining political stability and development through participating in global governance and accelerating domestic reform is another basic interest of China. Third, to be recognized by international community and rejuvenating Chinese nation is an important interest of China. As the hypotheses claimed before, the specific *Guojia Liyi* of China in the G20 is determined by material (domestic and international environment) and ideational factors (state ideology and interpretation). The channels through which the three factors influence *Guojia Liyi* are the three constituents - personal epistemic interests, interests of the state and national interests.

Political Economic Environment

The international environment, particularly the 1997 Asian financial crisis and the 2008 global financial crisis, is a crucial factor of determining China's attitude to the G20. With respect to the personal dimension of the *Guojia Liyi,* the two crises have made China's political leaders focus more on the global governance and the role of the emerging G20 in global financial governance. As to the interests of the state, the recurrent financial and economic crises at both regional and international levels threatened China's vested economic benefits. International trade is a good example. During crisis time, trade protectionism would rise to protect domestic industries. Since the 2008 global financial crisis, the G20 governments have introduced more trade barriers according to the monitoring report by the WTO (2011). As an export-oriented country, the impact of trade protection on China's economy is severe. In the G20 summits, anti-protectionism and stabilizing international trade have always been important topics. The G20 has urged the establishment of a new "development-oriented" global trade mechanism and the development of "Doha Round" of the WTO. In addition, in terms of global finance, the 2008 financial crisis exposed the shortcomings of the global financial system and its surveillance. As a mechanism born against financial crises, the G20's prior task is to fix the flawed international financial system through mainly coordinating major countries' views and actions. China, as the biggest emerging country, has to be incorporated into the coordinating mechanism. As Chin (2010, p.106) argued, "the global financial crisis has caused the major emerging countries to re-engage 'inside' the main institutional system, even as they continue to pursue new forms of international cooperation beyond the G summits". Finally, the two crises indicate that in a highly globalized world Chinese nation's resuscitation cannot be achieved without integrating into the world and solving the international issues.

The domestic political economic environment, which can be briefly described as economic development and restructuring, is another crucial factor in forming China's *Guojia Liyi* and the corresponding state policy in the G20. Domestic economic development gives Chinese political leaders more confidence in international society. In the early 1990s, facing the economic sanctions imposed by the West due to the Tiananmen incident, Deng Xiaoping articulated a series of principles in handling China's foreign relations, which include but not limited to *"taoguang yanghui"* (conceal capabilities and avoid the limelight) and *"yousuo zuowei"* (strive to make achievements). After nearly two decades' development under the guidance of mainly the former principle, the domestic economic growth and political stability urge Chinese leaders to strive to make achievements in international community. The emergence of the G20 provided a chance to do so. From the government's perspective, as mentioned before, the economic achievements verify the adaptability of state-led development way in China and also provide confidence for China's government to participate into global governance, despite the criticism of major Western countries on many policies under this unique model, such as exchange rate policy.

From the perspective of national interests, participating into the G20 is a way to urge economic restructuring and prompt China's sustainable development, and, consequently, accelerate the rejuvenation of Chinese nation. China has put more emphasis on economic structure adjustment, especially from an export-led pattern to demand-led pattern. However, domestic vested-interest groups have impeded the process. The G20 framework provides China an external strength to drive the adjustment (Huang, 2011). Specifically, in the G20 Summits one of the most important agendas is to solve the global imbalance, especially between the US and China, which is criticized for partly causing the 2008 global financial crisis. One crucial factor contributing to the global imbalance is the irrational economic structure of China, in which economic growth immoderately depends on labour-intensive export industry. Therefore, the G20's determination and efforts in solving the global imbalance problem becomes China's strong external drive to adjust domestic economic structure.

State Ideology

State ideology also plays a significant role in determining China's interests and strategy in the G20. First of all, unlike in the G8 case analyzed before, the G20 is no longer a propagator of Washington Consensus, but an informal mechanism for coordinating member countries' policies, paying less attention to member countries' political ideologies and economic models. Therefore, the Socialism with Chinese characteristics insisted by Chinese leaders since Deng Xiaoping is less likely to be deviated by joining the G20. In addition, as analyzed above, supporting and joining the G20 also matches China's basic diplomatic strategy set by Deng Xiaoping - "*tuoguang* *yanghui"* and *"yousuo zuowei"* (keeping a low profile and taking a proactive role when feasible) (Huang, 2011). To be a responsible developing country has long been China's self-orientation at least since the middle 1990s. In the wake of the 1997 Asian financial crisis, China put forward the new identity - "a responsible great nation" in international community. As Wang Yizhou, the former deputy director in Institute of World Economics and Politics (IWEP), Chinese Academy of Social Sciences (CASS), remarked, the financial crisis in the 1990s is a turning point for China to change from an country indifferent to international affairs to a responsible great country that plays a role in solving international issues taking account of both its own and other country's interests (Zhao, 2007). Participating in the G20 is, to some extent, the result of and reflects China's new identity - to be a responsible great nation. More importantly, the G20 is a place where China can be still treated as a developing or emerging country and can represent vast developing countries' interests, which has been China's foreign strategy. For example, in the 2008 Washington Summit of Financial Markets and World Economy, President of China Hu Jintao (2008b) called on the G20 to help developing countries maintain financial stability and economic growth, saying:

> *"We must be fully aware that the current financial crisis has not only dealt a heavy blow to the financial markets in developed countries but also affected developing countries to varying degrees, and its impact is likely to grow. The economies of developing countries are at a low level and lack structural diversity. Their financial systems are not strong enough to withstand risks. When coping with the financial crisis, the international community should pay particular attention to the damage of the crisis on developing countries, especially the least developed countries (LDCs), and do all it can to minimize the damage."*

Furthermore, China even calls on the G20 to draw on developing nations' experience in solving some economic issues. Chinese former vice Foreign Minister Cui Tiankai said that "it's important for the G20 nations to draw on the experience of developing countries on economic issues and get rid of outdated theories" (China Daily, 2010). At last, actively participating in the G20 conforms to China's national interests. China's enhanced position in the G20 and in global financial governance system is an important step to rejuvenate Chinese nation, which is the backbone of Chinese Nationalism.

Interpretation

Interpretation of Chinese policy elites and the government structured by Chinese state ideology on the domestic and international environment influences significantly China's interests and strategy in the G20. Although the G20 has been questioned for its legitimacy and effectiveness in global financial governance for the huge gap among its core powers[16] (Nelson, 2010), exclusiveness of membership (Payne, 2010) and lack of enforcement mechanism, the G20 has been interpreted by Chinese leaders as a "gift". The former member of the Monetary Affairs Committee of the Chinese central bank Yu Yongding (2005), for example, remarked that the emergence of the G20 was "a timely gift for a Chinese government that wishes to have closer cooperation with the G7/8 but does not want to be part of it for the time being". Chinese leaders are more highly exposed in international politics because of the active participation in the G20 and global financial governance. Although there is no direct evidence that pursuing the personal international reputation is a reason for China's active participation in the G20, the enhanced international popularity of key Chinese policy elites indeed attributes to China's active role in the G20 and global financial governance.

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[16] Nelson (2010) summarized the divergence of G3 (China, EU and US) on the causes of the 2008 global financial crisis and policy objectives.

Governor of China's central bank Zhou Xiaochuan is a good example. As Governor of China's central bank, Zhou participated in most of the G20 Finance Ministers and Central Bank meetings leading China's delegation and often attended the G20 Summits as an important member of China's delegation. In these G20 meetings Zhou contributed many important ideas to solve the issues related to global financial governance, on behalf of China's central bank or/and the Chinese government or in his own name. The contributions earned a high international popularity for this Chinese economist. Zhou was named as the Person of the Year by Time Magazine in 2009 and the world's best central banker by the international finance magazine *Euromoney* in 2011.

From the view of the Chinese government, the G20 is a way to adjust domestic economic structure and a chance to participate in global coordination, to adapt to and learn global governance (Huang, 2011). As a nation state, China treats the G20 as a chance to build China's external image and finally, as mentioned before, as a way to rejuvenate Chinese nation in international community.

Conclusion: Verifying the Hypotheses

The two-stage model put forward in the theoretical chapter contains formation of *Guojia Liyi* (Stage I) and decision-making process (Stage II). This model explains the inconsistency of China's policy across various institutions or events in the global financial governance through two hypotheses. The first one is that the *Guojia Liyi* of China in various institutions or events may be different, because of the different structuring effects of material and ideational factors and the consequent different leverages of personal epistemic interests, interests of the state and national interests in forming the *Guojia Liyi.* The second one is that given the ascertained *Guojia Liyi*, under some specific situations, the decisions are not always rational and in accordance to these interests and preferences due to the changing short-term decision-making environment. This chapter focused on verifying the first hypothesis and comes into the following conclusions.

First, *Guojia Liyi* drives China's strategies and attitudes towards the G8 and the G20. As analyzed above, China's *Guojia Liyi* in the G8 and the G20 are slightly different. In the former, China has strived to maintain its economic development and enhance its international status without violating its ideology. In the latter, China's *Guojia Liyi* is to secure the vested economic benefits and to gain more, maintain political stability and development through participating in global governance and accelerating domestic reform and finally be recognized by international community and rejuvenate Chinese nation. The major difference of the two *Guojia Liyi* is that the former pays particular emphasis on maintaining state ideology, whilst the latter focuses more on economic benefit and international status of China. This difference results in China's different stances in the G8 and the G20 – revisionist in the former and status quo power in the latter, and derives from the different contents of the three constituents - personal epistemic interests, interests of the state and national interests, which are influenced by material and ideational factors.

Second, material (domestic and international political economic environment) and ideational factors (state ideology and interpretation) determine the formation of China's *Guojia Liyi* in the G8 and the G20. The analyses on China's *Guojia Liyi* in the G8 and the G20 above verified the determining effects of these factors on the formation of China's interests and preferences in the two institutions. Table 4.1 summarizes China *Guojia Liyi* in the G8 and the G20 and the three influencing factors. Due to the different structuring effects of the three factors, China's *Guojia Liyi* and the consequent state strategies in the G8 and the G20 are different, as mentioned before. Some factors that influenced China's *Guojia Liyi* in the G8 and the G20 are the same, such as domestic economic development, 1997 Asian financial crisis and China's self-identity as a developing country, while some are different, such as domestic pressure for economic structure adjustment in the G20's case, China's development ideology in the G8's case and, more importantly, the different interpretation of the two institutions.

Third, the structuring effects of the material and ideational factors on *Guojia Liyi* are through influencing some or all the three constituents of it. These factors summarized in Table 4.1 determine China's *Guojia Liyi* in the G8 and the G20 by similarly or differently influencing the personal epistemic interests of key policy elites, interests of the state and/or national interests. Refining the above analysis, Tables 4.2 and 4.3 demonstrate clearly the influence of these factors on the three constituents in forming China's *Guojia Liyi* in the G8 and the G20.

Table 4.1 *Guojia Liyi* and the Influencing Factors the G8 and the G20

	Guojia Liyi of China	Influencing Factors			
		Material Factors		Ideational Factors	
		Domestic	International	State Ideology	Interpretation
G8	Maintaining China's economic development and enhancing China's international status without violating China's ideology	The domestic economic development and consequent growing systemic importance in world economy; Domestic barriers like inconvertibility of RMB.	The 1997Asian financial crisis and the week performance of G8 in it and in world anti-terrorism.	Socialism with Chinese characteristics; development ideology and identity.	China treats the G8 as an organ dominated by the major Western countries. China's social and development ideology may be influenced negatively by the G8.
G20	1. Securing the vested economic benefits and gain more; 2. Maintaining political stability and development through participating in global governance and accelerating domestic reform; 3. To be recognized by international community and rejuvenating Chinese nation.	Domestic economic development; Domestic economic structure adjustment	The 1997 Asian and 2008 global financial crises highlighted the importance of strengthening global financial governance	A responsible country; A developing country; Nationalism	The G20 is a chance to participate in global coordination, to adapt to and learn global governance, to represent the Chinese position and build China's external image, and a way to facilitate the adjustment of the domestic economic structure.

Table 4.2 Formation Matrix of China's Guojia Liyi in the G8				
		Personal Epistemic Interests	Interests of the state	National Interests
Material Factor	International	Policy elites may become indifferent to the G8 because of its legitimacy and reputation crisis.	Maintaining an informal relation with the discredited G8 would not impede the Chinese government achieving sustainable development and higher international status, whilst to be a formal member of it may cost the Chinese government too much.	Weak correlation
	Domestic	The key Chinese policy elites become more confident to refuse the invitation of the G8 because of the domestic development.	China has substantial differences with other G8 members in many aspects like social ideology and development paradigm, which may increase the cost of joining the G8.	The domestic economic development indicates that restoring China's international status can be achieved without joining the G8.
Ideational Factor	State Ideology	Chinese leaders insist on the socialist way with Chinese characteristics that was set by the precursors more than half century ago.	China self-identify as a socialist developing country; Conflict between China's development model and the Washington Consensus.	Currently, maintaining China's self-identity as a socialist developing country is more advantageous for rejuvenating Chinese nation.
	Interpretation	Key policy elites interpret the G8 as an organ dominated by the major Western countries.	Joining the G8 will aggravate the burden and obligation of China in global governance by re-identifying China from a developing to a developed country and will violate China's Socialism with Chinese characteristics by being imposed by the neoliberalism.	Weak correlation

Table 4.3 Formation Matrix of China's *Guojia Liyi* in the G20

		Personal Epistemic Interests	Interests of the state	National Interests
Material Factor	International	The two crises have made political leaders pay more attention to the emerging G20.	Pursuing international cooperation to solve international issues is a good way to maintain China's vested interests and political stability.	The two crises indicate that in a highly-globalized world China's resuscitation cannot be achieved without integrating into the world.
	Domestic	Chinese leaders are more confident to *'yousuo zuowei'* (strive to make achievements) in international society based on domestic economic development.	The excellent domestic performance also gives the Chinese state more confidence to pursue international reputation and status in the G20.	Participating in the G20 is a way to urge domestic economic adjustment, which is important for China's sustainable development.
Ideational Factor	State Ideology	Joining the G20 matches China's basic diplomatic strategy set by Deng Xiaoping- "*tuoguang yanghui*" and "*yousuo zuowei*" (keeping a low profile and taking a proactive role when feasible).	Participating in the G20 is, to some extent, the result of and reflects China's new identity---to be a responsible great nation, and also maintains the old identity as a developing state.	China's enhanced position in the G20 and in global financial governance system is an important step to rejuvenate Chinese nation, which is a key constituent of Chinese nationalism.
	Interpretation	Political leaders of China treated the G20 as a gift and a chance to enhance their international reputation.	The government of China considers the G20 a way to adjust domestic economic structure and a chance to participate in global coordination, to adapt to and learn global governance.	For Chinese nation, the G20 is a chance to enhance China's position and build China's external image.

Two points in respect to the formation matrixes should be noted here. Firstly, national interests are determined mainly by some invariables or less-likely changing variables, such as history, religion, culture, geographical position, population and ethnicity, and, consequently, are more stable and objective in the short or medium term. Therefore, the structure effects of the ideational and material factors on personal epistemic interests and interests of the state are more effective and evident. Secondly, interpretation, among the influencing factors, is an inevitable path in which the influence of political economic environment and state ideology on *Guojia Liyi* is transmitted. In other words, the structuring effects of political economic environment and state ideology are finally reified as the understanding of policy elites and government. With respect to the G8 and the G20, the interpretations are different. The former is interpreted as an organ dominated by the major Western countries and that joining it will aggravate the burden and obligation of China in global governance by re-identifying China from a developing to a developed country and will violate China's Socialism with Chinese characteristics by being imposed by the neoliberalism. On the contrary, the latter is understood as a gift for Chinese politicians and the Chinese government to enhance international status, a way to adjust domestic economic structure and a chance to participate in global coordination, to adapt to and learn global governance.

Fourth, in the G8 and G20's cases, interests of the state and national interests have higher leverage in the *Guojia Liyi* than the personal epistemic interests. The previous hypothesis holds that the three constituents have different weights in *Guojia Liyi* under different situations. When great people emerge, the democratic mechanism is highly developed, particular policy areas become highly complex, technical and uncertain or government decision-making mechanism is deficit or inefficient, the personal epistemic interests of great people, voters, epistemic communities elites or government decision makers will be respectively and largely reflected in *Guojia Liyi* and the consequent national policies. Since the middle 1990s after great man Deng Xiaoping's administration, collective decision-making has been established as basic principle of the Chinese government. There are no more great people like Mao Zedong and Deng Xiaoping in contemporary China. Even though the ideas of these great people, particularly Deng's Socialism with Chinese characteristics, still have huge impacts on today's China, personal epistemic interests of great people can no longer determine China's *Guojia Liyi*. Meanwhile, the democratic mechanism is far from being completed in China. Epistemic interests of voters are usually ignored or can only marginally influence national policies. Although the inter-state relations involved in the G8 and G20 are complex, the two institutions are not highly technical. Therefore, identification of China's *Guojia Liyi* in the two institutions may benefit from but not rely on the personal epistemic interests of related epistemic community elites. The Chinese government decision-making mechanism has long been improving, although the personal views of key policy elites still play important role in making final decisions. Therefore, overall, personal epistemic interests' influences on China's *Guojia Liyi* are becoming weak but still evident in some cases like the G8 and the G20.

In contrast, the interests of the state play a larger part in China's *Guojia Liyi* towards the two institutions, largely because the Chinese government has a unified and consistent identity and ideology, which tend to bring consensus goals for the Chinese government in making domestic and international policies. The most important goals among many are maintaining political legitimacy of the Communist Party of China. The ways to achieve this goal include mainly economic development and stability and enhancement of international status. In the benefit and cost analyses of the Chinese government on their strategies toward the two institutions, the major reason for keeping the G8 away is that joining it may impede China's economic development by negatively impacting China's development identity and ideology, while the major consideration for actively participating into the G20 is that it is a chance to participate in global governance but does not focus on its member countries' development identity and ideology. Finally, the basic national interests, such as rejuvenating Chinese nation, have always been an important part of *Guojia Liyi* in the medium or long term.

To sum, the framework of analysis put forward in the theoretical chapter explains clearly China's strategies in the G8 and the G20. Evidently, it is not only confined to the G8 and the G20, but broadly applicable to analyze China's state strategies or policies in many other global financial governance institutions or events, such as China's attitudes to the IMF and the global financial (governance) system reform in response to the 2008 global financial crisis.

Chapter Five: International Monetary System Reform and China's Choice: Formation of *Guojia Liyi*

Causes of the Crisis and China's Response

Students in several disciplines, especially in economics and political economy, have widely explored the causes of the 2008 global financial crisis, stressing various aspects. Specifically, economists focus on national and international economic and financial factors, while political economists emphasize political factors employing different political economic theories, mainly Realism, Neoliberalism, Marxism and Constructivism. The national economic and financial factors mainly refer to the flawed macro-economic development paradigm (Palley, 2011), the regulatory arbitrage (Acharya & Richardson, 2009) and the monetary policy failure of the US (Wagner, 2010; Carmassi, Gros & Micossi, 2009). The international economic and financial factors include but are not limited to the global imbalance between the West and the East, especially between the US and China, and the flawed international financial governance system, so-called "new financial architecture" (Crotty, 2009). In addition, some scholars focus on the global inequality between developed and developing countries (Lysandrou, 2011).

Along with economists' various explanations, political economists have also dissected the 2008 crisis drawing on different and sometimes competing theoretical frameworks. Neoliberals, who espouse international cooperation and globalization, attribute the crisis to the internal flaws of financial sector, such as procyclicality and other systemic risks, rather than to the economic system that characterizes the neoliberal values of economic liberalization and integration. Against Neoliberalism, Realists criticize the preponderance of Neoliberal ideas for causing a domino effect among states and hence a global crisis. Unlike mainstream political economy theories, Marxism, as a critical theory, has developed its own framework for explaining economic crisis. In Marxists' view, capitalist economic system is driven by unstable, anarchic and self-destructive forces and, consequently, inherently crisis-prone (Easterling, 2003). More specifically, Marxist studies on the 2008 global financial crisis focus on factors like global inequality (Lysandrou, 2011), the organic composition of capital and the falling rate of profit (Rasmus, 2008), overcapacity, financialization and others.

In contrast, Constructivist propounds that material interests, while central to these theories mentioned above, are insufficient to explain economic crisis, and emphasizes ideational factors, including identities, ideas and culture. It is the structuring effect of idea on behaviour that empowers the Neoliberal thought, consequently makes the worldwide neoliberal economic integration and liberalization possible and finally resulted in the financial and economic crisis. Widmaier (2014, p.233), for example, traced "the evolution of values, ideas, and policies across three crises—the Bretton Woods-era inflation and currency crises of the 1960s, the South Korean and Long Term Capital Management crises of the 1990s, and the global financial crisis" and explored how these ideational factors "shape constructions of crises and paradigmatic debate".

To sum, these various causes can be briefly summarized into three major aspects: the flawed global financial monetary system and consequent macro-imbalance, the US domestic policy failure, and the international financial regulation failure. These factors are three stages in the process of running up to the crisis and absence of any one of them would have prevented the calamity. The flawed global financial monetary system injected vast liquidity into the US market. Then the US domestic monetary policy failure and financial regulation laxity accelerated the formation and bust of the speculative bubble by encouraging a credit boom in the securitized US mortgage market. When the bubble finally burst, the global financial regulation system was incapable of controlling or even reducing the contagion effects from the US to other countries and from financial sector to real economy. In the post-crisis era, major countries and IOs have launched a series of reforms to patch these loopholes. As an important actor in international community in light of its excellent economic performance, China has actively participated in these reforms, particularly reforms on the international monetary system (IMS) and the international financial regulation. However, China's stance on the ongoing reforms related to the two aspects differs. Toward the IMS reform, China proposed its own agenda and attempts to be a rule-maker, while to the international financial regulation reform, China is more likely a rule-taker actively accepting the reform suggestions and proposals made by major international financial governance institutions. Employing the two-stage model, this chapter analyzes China's stance on the IMS reform and explains the formation of China's *Guojia Liyi*, while a chapter will look into China's strategy in the international financial regulation reform.

The first section reviews the major proposals of reforming IMS. The second section looks into China's ideas and actions on reforming the IMS. The third section analyzes China's *Guojia Liyi* in the IMS reform and material and ideational structuring factors. The fourth section explicates how these factors influence the formation of *Guojia Liyi* through impacting its three constituents.

International Monetary System Reform

Many proposals on reforming the IMS following the 2008 global financial crisis have been put forward by governments, inter-governmental bodies, academics or non-governmental institutions. One type of proposal is to revive the old system, in which countries pegged their currencies to gold or the US dollar and the IMF and WB were tasked to stabilize exchange rates and served as a lender of last resort. The ex-head of the WB Robert Zoellick advocates that gold play a stabilizing role in the exchange, and the new system "should also consider employing gold as an international reference point of market expectations about inflation, deflation and future currency values" (Zoellick, 2010). Stiglitz and some European states leaders called for restoring the Bretton Woods system. Stiglitz thinks that "this is a Bretton Woods moment where we ought to face up to not just the immediacy of the money (issues) but use this as an occasion to make some of the changes that we have needed for a long time and recognized" (Bases, 2008). French former President Nicolas Sarkozy, British former Prime Minister Gordon Brown and Italian former finance minister Giulio Tremonti all pleaded for a new Bretton Woods system following the eruption of the 2008 global financial crisis (Info - Prod Research <Middle East>, 2010; Winnett, 2008; Dinmore, 2008).

Another type of proposal is to create a new international currency to replace the US dollar's role as a global reserve currency and new institutions to govern the new currency. This view mainly stems from some emerging countries that are struggling for bigger say in the global economy. These states, such as China, call for changing the current international economic order because, in their perspectives, it benefits the developed countries at the expense of developing countries' benefits and rights. For example, Zhou Xiaochuan, governor of the People's Bank of China, suggests the IMF upgrade the SDRs to a super-sovereign reserve currency that would supersede the role of the US dollar. He thinks that creating an international reserve currency not pegged to any sovereign state currency with the ability to maintain long-term stability of the currency value would avoid the inherent flaws of current global financial system (Zhou, 2009). In addition, McKinsey Global Institute (2009, p.38) calls for solving the "clear drawbacks" of the SDRs through the private sector issuing its own synthetic SDR instruments. It argues "there is no fundamental reason why SDRs cannot become a more significant part of the global exchange rate system in the future" (p.38).

The UN's proposal of reforming the present IMS calls for a "truly global reserve currency" (UN Commission, 2009, p.115) and a multilateral framework for real exchange rates management (UNCTAD, 2009, p.128). The proposal for establishing or consolidating a truly global reserve currency is against the option of a multi-currency reserve system. Recognizing that the basic advantage of a multi-polar reserve world is that it provides room for diversification, the Commission (2009, p.114) stresses its cost of "adding an additional element of instability: the exchange rate volatility among currencies used as reserve assets". The truly global reserve currency could be the SDRs or a new currency called "International Currency Certificates (ICCs)". The responsibility for issuing and managing the currency could lie with the IMF or a new institution, such as a "global Reserve Bank" (p.115). In addition, in view of the variability of exchange rates, UNCTAD (2009, p.128) argues that "an internationally agreed exchange-rate system based on the principle of constant and sustainable real exchange rates of all countries would go a long way towards reducing the scope for speculative capital flows, which generate volatility in the international financial system and distort the pattern of exchange rates".

A more ambitious project is to establish a world currency. A world currency, as Robert Modell (2012) defined, is not a single world currency, but a currency system in which each country would produce its own unit that exchanges at par with the world unit. The former Chair of the US Federal Reserve Paul Volcker said "a global economy requires a global currency" (Bonpasse, 2006, p.264). This dictum has been quoted repeatedly by the advocates of a world currency. Although the economic benefits of a world currency are enormous, the political barriers are insurmountable in the foreseeable future.

None of these proposals have been accepted by international financial policymakers. Instead, the on-going reforms of the IMS led by the G20 aim to strengthen and patch the existing system, a multi-reserve currency system centered on the US dollar. The 2010 G20 Seoul Summit called for building a more stable and resilient international monetary system and "asked the IMF to deepen its work on all aspects of the international monetary system, including capital flow volatility" (G20, 2010, p.6). By and large, the G20's agenda for the IMS reform included five elements: surveillance of the international economic and financial system, the management of global capital flows, reserve asset and reserve currencies, the global financial safety nets (the international lender-of-last-resort mechanism), and international monetary system governance (Truman, 2011). All these efforts have not changed the essence of the previous IMS at all. The fundamental structure of the world economy has been dramatically changed in the past several decades. The IMS, however, is adjusting slowly and does not reflect these changes (Bocchi, 2013).

China's Ideas and Actions in Reforming the IMS

The Chinese government is more intent on reforming the flawed domestic and international monetary system in the post-2008 crisis era. Since 1996 when China's currency (RMB, renminbi or yuan) became convertible under current accounts, the process of China's currency reform has been slowed down by a government leadership worried about the potential risks of hasty and fast RMB internationalization. The 2008 global financial crisis made the problems of the IMS come into the fore. The insufficient post-crisis response of the IMS to the world economy changes has cuased China to put forward its own proposal of reforming the IMS and to accelerate its currency reform with the purpose of contributing to the radical reform of the IMS. In the 2008 Washington Summit and the 2009 London Summit, the former Chinese President Hu Jintao emphasized the necessity and urgency of reforming the IMS and put forward four principles for creating a "fair, just and inclusive" international monetary system - comprehensive, balanced, incremental and result-oriented (Xinhua, 2008b). Under the guidance of these principles, China has launched a three-tier reform, which contains international, regional and domestic measures. Internationally, China proposed a super sovereign currency as a major world reserve currency. At the regional level, China is more willing to cooperate with Asian countries and even establish an Eastern Asian currency region. Domestically, many measures have been implemented to accelerate the RMB internationalization.

A super sovereign reserve currency is argued to be able to remain stable in the long run and remove the inherent deficiencies caused by using credit-based national currencies (Zhou, 2009). In 2009, Zhou Xiaochuan, governor of the People's Bank of China, called for establishing a super sovereign reserve currency to replace the US dollar. Although this proposal was put forward as a personal academic idea, it actually represents the Chinese government's intention given the irreplaceable role of Zhou in China's currency policy. Zhou's idea is not original, but has long been proposed, as he himself indicated. However, compared to the premature "Bancor" Keynes introduced in the 1940s and the immature SDR created by the IMF in 1969, this rehashed idea may work at this unique juncture. Zhou's super sovereign reserve currency proposal reveals the wide dissatisfaction of the developing world and major emerging countries with the current IMS. Moreover, this proposal points out again the major flaw of the existing IMS incisively, the Triffin Dilemma, and argues that this flaw has brought inherent vulnerabilities and systemic risks to world economy more severely than ever before in a highly-globalized world. Nonetheless, as Zhou realized, it may take a long time to reestablish a new and widely accepted reserve currency with a stable valuation benchmark. Scholars even think there is not a strong internal motivation for substantively reforming the dollar-centered international monetary system and the reform motivation from the rapid economic growth of emerging countries will only lead to the gradual and tardy change of the IMS (Wang, 2010). Therefore, in the short and medium term, the regional and domestic measures are more reasonable and realistic for China.

Regionally and theoretically, establishing an Asian common currency like Euro is conducive to stabilizing China and Asian economy. Back in the late 1990s after the Asian financial crisis, studies promoting Asian currency cooperation and establishing an Asian common currency attached much attention. Since then, many projects have been proposed and some have achieved certain progress. The major projects include Asian Monetary Fund, ASEAN+3 financial cooperation and Asian common currency. The Asian Monetary Fund proposal, proposed by Japanese financial authorities, was effectively dead, without China's support and in the face of the grave US opposition (Lipscy, 2003). In the context of the 1997 Asian financial crisis, the ASEAN (Association of Southeast Asian Nations) + 3(China, Japan and the Republic of Korea) financial cooperation has been strengthened. In 2000, the ASEAN+3 launched the Chiang Mai Initiative, a multilateral currency swap arrangement. In 2009 in hopes of establishing a foreign exchange reserves pool to prevent next financial crisis, the ASEAN + 3 countries signed the Chiang Mai Initiative Multilateralization (CMIM), proposed by the Chinese government in 2003.

However, these Asian financial cooperation efforts are, to some extent, superficial and far from being productive. During the 2008 global financial crisis, the CMIM contributed nearly nothing to rescuing countries with foreign exchange liquidity problems. The in-depth financial cooperation in the Asian area and even establishing an

Asian common currency face many barriers and difficulties, such as the competition among major currencies for the dominant position in Asian financial cooperation, the unbalanced development and conflicts of interests among Asian countries and the variety of political system, religion and culture. Considering these barriers and the consequent infeasibility of effective regional currency cooperation in the short or medium term, the Chinese government focuses more on the domestic currency policy adjustment in the post-2008 crisis area, particularly RMB internationalization.

After the 2008 global financial crisis, the Chinese government put RMB internationalization on the top of its agenda. As chairman of the National Council for Social Security Funding (NCSSF) and the former governor of the People's Bank of China Dai Xianglong points out, RMB internationalization must proceed with three goals in tandem: international settlement currency, international investment currency and global reserve currency (Caixin, 2012). Many specific measures and policies have been made to realize the first two functions of RMB. Since December 2008, China has signed six currency swap agreements with Indonesia, South Korea, Hong Kong, Malaysia, Belarus, and Argentina worth a total of 650 billion yuan ($95 billion). The purpose of these swap is to "enable importers in other countries to obtain renminbi to pay for yuan-invoiced Chinese exports, and secondarily to provide an emergency source of liquidity in the event that private channels of finance dry up" (Kroeber, 2013, p.8). In addition, many other key measures listed in the following Table 5.1 were taken to make RMB a more qualified international settlement currency. These measures have effectively increased RMB cross-border settlement. In 2012, cross-border trade denominated in renminbi leapt by 41%.

Cross-border trade settlements rose to 2.94 trillion yuan ($472 billion) in 2012 from 2.08 trillion yuan in 2011. In the first three quarters of 2013 RMB cross-border trade settlement reached 3.16 trillion, among which RMB settlement in cross-border trade in goods and cross-border trade in services and other current accounts respectively amounted to 2.07 trillion and 1.09 trillion (PBC, 2013a).

Table 5.1 RMB Cross-border Settlement Measures

Time	Measures
April 8, 2009	China's State Council announced that it would allow exporters in selected mainland cities (Shanghai, Guangzhou, Shenzhen, Zhuhai, and Dongguan) to settle cross-border trade in yuan.
May 18, 2009	China and Brazil announced plans to settle the trade between the two countries with their own currencies---RMB and real, bypassing the use of the US dollar.
June 1, 2009	China launched a new multilateral net settlement system to conduct net settlement services for 21 Chinese and foreign market makers for yuan trading with the dollar, euro, yen, pound, and Hong Kong dollar.
July 1, 2009	The PBC and the five other regulatory authorities, the Ministry of Finance, the Ministry of Commerce, the General Administration of Customs, the State Administration of Taxation and the China Banking Regulatory Commission jointly issued the "Implementing Rules of the Administrative Measures for Piloting Cross-border Trade Settlement in RMB" to formally launch the cross-border RMB trade settlement pilot scheme.
June 22, 2010	Trial places of China's cross-border trade settlement in yuan have been expanded to 20 provinces (autonomous regions), and the markets of cross-border trade can be all over the world.
January 6, 2011	The PBC issued Administrative Measures for the Pilot RMB Settlement of Outward Direct Investment.
August 2011	The Notice on Expansion of the List of Regions for Cross-border RMB Settlement was announced. It extended the coverage of cross-border RMB trade settlement to all provinces and municipalities in the Mainland.
September 2011	The PBC issued Circular to Clarify Relevant Issues in connection with Cross-border RMB business.
April 2, 2012	The Hong Kong Monetary Authority issued Renminbi (RMB) Position Squaring with the RMB Clearing Bank for Trade-related Conversions.
March 2012	The Notice Concerning Issues on Administration of Enterprises Engaging in RMB Trade Settlements for Merchandise Exports was released. It stated that all enterprises with import-export rights are allowed to settle merchandise exports in RMB.

The Chinese government has also made great effort to promote RMB as an international investment currency and develop RMB offshore market. The Table 5.2 below summarizes the key steps of RMB offshore market evolution. So far, four offshore centres have been established in Hong Kong, Singapore, Taiwan and London. Relatively, RMB has been becoming a more important investment currency. As the Table 5.3 indicated, taking the offshore RMB bond market as example, from 2007 to 2013, both the size of issue and total size of offshore RMB bonds increased tremendously. This increase indicates that more international and domestic investors have accepted RMB. However, the development is still limited. One of the biggest barriers is the inconvertibility of RMB in capital account. The Chinese government may further liberalize RMB capital account in 2015 (Yang, 2012). Once the capital account is open, RMB will be one of the attractive investment currencies in the world and may even be competent to challenge the dominant position of US dollar in the long run.

Table 5.2 RMB Oversea Investment and Offshore Market [17]	
Time	Measures
June 2007	People's Bank of China (PBC) and National Development and Reform Commission (NDRC) jointly issued *The Interim Measures for the Administration of the Issuance of RMB Bonds in Hong Kong Special Administrative Region by Financial Institutions Within the Territory of China*.
July 2007	China Development Bank became the first issuer in CNY-denominated bond, with an amount of RMB5 billion and a term of 2 years.
December 2008	General Office of the State Council issued Several Opinions on Providing Financial Support for Economic Development, allowing corporations and financial institutions with substantial business in China to issue CNY bonds in Hong Kong.
Feb 2010	Hong Kong Monetary Authority (HKMA) issued *Elucidation of Supervisory Principles and Operational Arrangements Regarding Renminbi Business in Hong Kong.*
January 2011	PBC and SAFE jointly formulated and issued *Measures for Administration of Pilot RMB Settlement for Overseas Direct Investment.*
October 2011	MOFCOM published the *Circular on Relevant Issues on Cross-border RMB Direct Investment*; PBC issued the *Administrative Measures on RMB Settlement for Foreign Direct Investment.*
December 2012	RMB clearing bank appointed in Taiwan.
February 2013	RMB clearing bank appointed in Singapore.

Table 5.3 Offshore RMB Bond Market

Year	No. of Issues	Total Size (CNH, Millions)
2007	5	10,000
2008	10	22,000
2009	15	30,000
2010	47	62,000
2011	409	224,000
2012	798	378,000
2013 *	1008	481,000

* Up to April
Source: Bloomberg, as of Apr. 2013

[17] Source: Liu, Chenggang (2011) CNH Market--A Burgeoning Offshore RMB Market. Bank of China. Available at: http://www.asifma.org/uploadedFiles/Resources/CSS-LiuChenggang-BOC-CNH-Market--ABurgeoningOffshoreRMB-Market.pdf

Bank of China (Hong Kong) (2012) Prospects for RMB Business Development. Available at: http://www.bochk.com/ir/pdf/presentation_2012-02-18_e.pdf

The first two steps, settlement and investment currency, are necessary but insufficient conditions for the third and final objective of Chinese RMB - global reserve currency. To make RMB an international reserve currency is China's major policy objective in the future. The current RMB internationalization measures aim to creat preconditions and building substratum for achieving this long-term objective. Although the Chinese government has not publicized any specific reform agenda or roadmap, the market is full of prediction. For example, the HSBC (2013) estimated that in 2015 30% of China foreign trade will be settled in RMB and onshore daily forex volume will reach USD 1trn, making RMB the third-most global traded currency after the euro and the US dollar; in 2017 RMB will be fully convertible, while in 2020 Shanghai will be a global financial center. Britain's Chancellor of the Exchequer George Osborne thinks that RMB will "become almost as familiar as the dollar" within his lifetime (Jones, 2013).

However, there are more voices that argue RMB is not ready and will not be a reserve currency in the short term. Responding to Osborn's view, Jones (2013) wrote RMB might become a reserve currency, for "throughout the history of the global financial system, the monies of countries that play major roles in global trade have tended to become reserve currencies". However, it may take a very long time after many barriers, such as capital account inconvertibility, have been successfully removed. Wong (2012) points out "it took the US dollar 50 years to establish itself as a key reserve currency and will be difficult for other currencies to replace its dominance, even the renminbi". Yet, the Chinese government's objective and effort are very clear and steady - elevating RMB to be a settlement currency, an investment currency and finally a global reserve currency.

The following section will explore the formation of this objective and the driving forces behind it.

Guojia Liyi **in Reforming the IMS and Influencing Factors**

As emphasized in the previous chapters, *Guojia Liyi* is the core driving force of the Chinese government's international action and the substratum of China's foreign objectives. *Guojia Liyi* is never invariable and has changed during the course of history. Based on the above review on China's currency policy and strategy of reforming the IMS, China's *Guojia Liyi* can be summed as reforming the dollar-dominated IMS and enhancing RMB's international presence - elevating RMB to be a settlement currency, an investment currency and, finally and gradually, a global reserve currency. Both material and ideational factors structure the formation of China' *Guojia Liyi*. Material factors mainly refer to domestic development and problems, while ideational factors include state ideology and interpretation. The following sections delve into these factors.

Domestic Development and Problems

Domestic development and problems is a key factor determining China's foreign policy or strategies. China's stance in reforming the IMS is, to a considerable extent, determined by its domestic development and problems. On the one hand, the extraordinary economic performance of China in the past decades, especially during the 2008 global financial crisis, and the development of China financial system have provided some general conditions for reforming the IMS and internationalizing the RMB. Elevation of a currency in international economy requires many domestic conditions. These conditions mainly include but are not limited to economic size, financial strength, financial market development, political and military power, stability and predictability of a currency's intrinsic value, the availability of broad transactional networks, low-inflation credibility, a reasonable interest rate and exchange rate and full convertibility (Frankel, 1999; Michalopoulos, 2006; Gao & Yu, 2009). China's development in the past decades has met some of these conditions, mainly economic size, financial strength and political and military power. As to the economic size, it is clearly demonstrated by the data of major international organizations like World Bank and soundly evidenced by vast literatures from every aspect. The opening-up policy in the late 1970s started China's economic miracle. Even when the world economy was hit by the 2008 global financial crisis, Chinese economy still maintained 9.26% growth by average from 2008 to 2012 according to World Bank's statistics. According to the World Economic Outlook database and measuring by gross domestic product using purchasing power parity (PPPs) the IMF estimates that China has overtaken the US to become the world's largest economy. The tremendous economic growth has consequently brought great financial strength and political and military power. The more than $3.5 trillion (until Jun 2013) foreign reserves is a convincing evidence of the financial strength. The growth prospect and accumulated wealth turn China into a key political and military power in international politics.

On the other hand, many domestic problems suggest that the RMB internationalization must be gradual and long-term. Yi Gang, the PBC deputy governor and head of the State Administration of Foreign Exchange, even rejected the idea that making RMB a reserve currency is a principle goal of policy and pointed out that conditions were "very far" from favouring the renminbi as a reserve currency (Kroeber, 2013). The current currency reform aims to solving these existing problems and thus creates more conditions for RMB internationalization, such as developing offshore RMB market, interest and exchange rate reform and RMB capital account opening. As summarized before, many measures have been taken to increase the RMB cross-border settlement and develop offshore RMB market. Although the Chinese authorities do not publicize formal reform agenda and roadmap, it signalled that it will propose plans on loosening control over the yuan and interest rates, increasing capital account convertibility, removing quotas on foreign investment in the nation's bond and stock markets and so on (Bloomberg, 2013).

International Environment

The international context of China's currency policy reform and proposal on reforming IMS mainly refers to the 2008 global financial crisis, structural shortcomings of the current IMS exposed during this crisis and the consequent changes of the international economic pattern. The flawed IMS provided excessive low-cost liquidity to the US market that inflated the US housing market and resulted in the macro-imbalance between the West and the East, and consequently, caused the 2008 global financial crisis to a large extent. This flawed system started with the signing of Jamaica Agreement (or Jamaica Accord) in 1976, which normally eliminated the peg system between gold and the US dollar under Bretton Woods system and accepted the concept of a managed float. After the implementation of the Jamaica Agreement, the capital inflow and public debts of the US started to rise and the US has gradually formed the unique economic model that the deficit of the current account has been made up by the surplus of capital account and the public debt. A new “dollar recycle”, which was depicted as a revived Bretton Woods system (Dooley, Folkerts-Landau & Garber, 2004), has been gradually formed. In this model, some countries, particularly emerging countries like China, exported huge amount of goods to the US and hence have amassed enormous foreign reserves mostly claimed in the US dollar. Then those dollars reflowed into the US market by purchasing the US treasury bonds and other investments in the US market. “Despite its relative stability, the current ‘non-system’ has the inherent weaknesses of a setup with a dominant country-issued reserve currency, wherein the reserve issuer runs fiscal and external deficits to meet growing world demand for reserve assets and where there is no ready mechanism forcing surplus or reserve-issuing countries to adjust” (Lago, Duttagupta & Goyal, 2009, p.4).

In addition to the macro-imbalance, other challenges to the current IMS, which are causally related to the macro-imbalance, have been analyzed in the global financial governance literature. In Caliari’s (2011, p.1) view, in addition to “ensuing an orderly exit from global imbalance”, the major challenges to international monetary system include “facilitating more complementary adjustments between surplus and deficit countries without recessionary impact, better supporting international trade by reducing currency volatility and better providing development and climate finance”. In different terms, the Palais-Royal Initiative (2011), a research group, summarized the persistent dangers of the current global monetary system as ineffective global adjustment process, financial excesses and destabilizing capital flows, excessive exchange rate fluctuations and deviations from fundamentals. With many similarities, Salvatore (2011, p.807) comprehensively observed the shortcomings of the present international monetary system in the following aspects: the large volatility of exchange rates, the wide and persistent misalignments of exchange rates and huge trade imbalances, the failure to promote greater coordination of economic policies among the leading economic areas, and the inability to prevent international financial crises or to adequately deal with them when they do arise. Despite disputes on the details of the problems of IMS, generally, there is a consensus that the current IMS centered on the US dollar is flawed and needs to be improved.

The change of the global economic order, particularly since the 2008 global financial crisis, is an important context in which China has proposed and been gradually implementing its revisionist currency policy with the intention of reforming the current IMS. The most crucial feature of the change is the falling of the previous hegemon-the US, the stagnation of the conventional power - the EU and the rapid growth of emerging countries, especially China and India. As Easton (2011) observed, the new international economic order is likely decided by five major economies - the US, China, the EU, India and Japan. None of them, however, will be able to dominate the others like Britain in the 19th and the US in the middle 20th century. As China rises in international economy, it will inevitably pursue higher position in the IMS.

State Ideology

The foundation of China's state ideology is Socialism. Socialism in China is clearly divided into two stages - Mao's era and Socialism with Chinese characteristics. Mao defined socialism as an opposite counterpart of capitalism. In this sense, anything that is developed in capitalist countries should not be accepted by socialist countries. After Mao's administration, Deng Xiaoping put forward the concept of socialism with Chinese characteristics, which paved the way for developing the market economy in China. It was argued that market economy was not synonymous with capitalism and the planned economy is not the definition of socialism. This new ideological innovation set the stage for the creation of a socialist market economy and China's economic miracle in the following decades. Meanwhile, it also raised the question of whether China is still a socialist or not. Hart-Landsberg and Burkett (2005) argued that market reforms in China are leading inexorably toward a capitalist and foreign-dominated development path. Scholars even described entrepreneurs with close personal and political ties to the CPC as "red capitalist" (Dickson, 2003) and the market as "red capitalism" (Walter & Howie, 2011). However, from the perspective of economic development model, China is unique and different from the mainstream capitalist countries.

The unique development ideology has brought leverage to China during and after the 2008 global financial crisis. After the 1997-1998 Asian financial crisis, the mainstream Asian development way, which had been extolled for creating the Asian economic miracle and is called Developmental State (DS) model, many scholars argued, came to the end. As a result, the Washington Consensus, as a dominant development method in capitalist world, spread to Asian economies and the world. As the explosion and exacerbation of the 2008 global financial crisis originated from the US, the major promulgator and prototype economy of the Washington Consensus, tremendous changes have happened. Countries that have actively propagated and been deeply affected by the

Washington Consensus seemed to be hurt by the crisis more severely. In contrast, China has suffered comparatively little from the crisis because of their unique development model. This allowed China to play an incrementally important role in the global governance. Whether China is still a developmental state is a whole another topic and a disputed question. One fact is that China has not accepted, or at least not completely adopted, the neoliberal development ideology. Towards the current international monetary system that was established under the guidance of neoliberalism, China is critical and reform-minded.

Another crucial aspect of the state ideology is Chinese Nationalism. Revitalizing the Chinese nation and "Chinese Dream" are major reflections of Chinese Nationalism. Deng Xiaoping put forward the concept of "revitalizing the Chinese nation" in 1990 against the context of rising international anti-Chinese wave after the Tiananmen Square incident. The explicit purpose was to inspire Chinese home and abroad to get through the ordeal. The concept of "rejuvenation of the Chinese nation" that is used today was formally proposed in the XV Congress of the CPC (Guo, 2013). The former leader Jiang Zemin (1997) said in the report at the 15th National Congress of the Communist Party of China that:

> "*It is a stage in which we will narrow the gap between our level and the advanced world standards and bring about a great rejuvenation of the Chinese nation on the basis of socialism. It will take at least a century to complete this historical process. It will take a much longer period of time to consolidate and develop the socialist system, and it will require persistent struggle by many generations, a dozen or even several dozens*."

Since then, rejuvenation of the Chinese nation has become a long-term and grand objective of the Chinese government. "Chinese Dream", proposed by the new leader Xi

Jinping, is the extension and incarnation of this objective. Domestically, Chinese Dream is tied to “national rejuvenation, improvement of people’s livelihoods, prosperity, construction of a better society and military strengthening as the common dream of the Chinese people that can be best achieved under one party, Socialist rule”(Bishop, 2013). Internationally, as the Chinese government claims, “Chinese Dream is not a call for revanchism and Chinese nationalism at the expense of its neighbors” (Tao, 2013). The state-sponsored nationalism is a legitimization strategy of the Chinese government and Party on the one hand, and also a guideline for specific foreign policymaking on the other hand.

Interpretation

The Chinese government and key policy elites’ interpretation of the current international and domestic environment determines the final strategy and attitude of China. In regard to the IMS, the first and foremost interpretation is that it is unequal, favouring developed countries, especially the US. Though the US dollar is no longer the standard currency as it was in the Bretton Woods system, not only has the post Bretton Woods system not weakened the power of the US dollar, but it also made the US “legally abandon the international obligations of the US dollar as an international standard currency ”(Cao, 2010). In other words, the US dollar is actually a global reserve currency, while its issuer has not taken the correspondent responsibility but rather takes advantage of the “exorbitant privilege” to serve its domestic economy (Eichengreen, 2011). The Quantitative Easing (QE) policy right after the 2008 global financial crisis and its negative influence on China is treated as a smoking gun of the abuse of the privilege by the Chinese government and academia. The series of QE policies of the US injected tremendous liquidity into the market, stimulated the economic recovery by encouraging investment and consumption and caused the sharp depreciation the US dollar, which brought more competitive advantage to the export sector and hence mitigated the severe trade deficit and solved partially the intractable unemployment issue (Le, 2010; Gao & Yu, 2010).

However, the US government has not taken the side effects to other countries into consideration. First, the devaluation of the US dollar caused by the QE policies devalued the huge foreign reserves of some other countries, particularly China (Gao & Yu, 2010; Zhang, 2009). At the same time, the huge public debts of the US shrank and China, as its biggest creditor, suffered the loss of assets as the devaluation of the dollar. As Dan Steinbock (2010) comments, "successive waves of QE would amount to debasing the value of the dollar, and thus inflating away massive US debts". Second, the outflow of the huge amount of dollars to other countries and the price increase of the dollar-denominated international commodities, such as crude oil, copper and precious metals, due to the weak dollar will together result in global inflation (Xin, 2010; Wang, 2010). With investors seeking higher returns, the QE drove short-term portfolio flow into high-yield emerging-market economies, which could inflate dangerous asset bubbles in Asia, Latin America, and elsewhere (Dan, 2010).

Finally, the devaluation of the dollar increases the risk of international trade protectionism. The unconventional method that the US adopted to reinvigorate the sluggish economy undermined the comparative advantages of some other countries and has generated negative impacts. Consequently, the other countries could take opposite measures, such as currency devaluation and higher trade barriers, to mitigate the impingement. Briefly, mainstream Chinese literature and media and the government tend to interpret that the so-called "currency war" is orchestrated by the US authority to transfer the cost of rescuing the US domestic economy abroad via its exorbitant currency privilege and the flawed international monetary system (Guangzhou Daily, 2010). In this sense, China falls into a "dollar trap", in which China can neither get itself out nor change the policies that put it in into that trap in the first place (Krugman, 2009). As deputy Division Chief of Research Institute of Finance of Development Research Center of the State Council Wu Qing (2008a) summarized, "in the US dollar-centered international monetary system the US can easily transfer its own financial crisis to other countries".

The second interpretation related to the IMS reform is that it must be in a gradual way. In 2009 Zhou Xiaochuan's proposal of creating a super sovereign currency is usually treated as the Chinese government's official thinking on the IMS reform. This rehashed idea is long held in the Chinese government although, as Vice Foreign Minister He Yafei stressed, it is claimed as an academic discussion rather than the position of the Chinese Government, because China did not want to be seen as a state that was aspiring to radically change the current system (Ren, 2012). The philosophy of the Chinese government in both domestic economic reform and international monetary system reform is gradualism. At the onset of "Opening-up" reform, the Chinese government under the leadership of Deng Xiaoping made a choice between "big-bang" and "gradualism" and, as a result, the latter became the guideline of China's economic and political reform. The process of the gradual reform is called by Deng "fording the river by feeling for the stones". Therefore, toward the IMS reform, gradual reform rather than "big-bang" restructure is the main trend in the Chinese government, academia and media.

For example, in the 2008 G20 Summit on Financial Markets and World Economy, China's former president Hu Jingtao (2008) put forward four principles of reforming international financial system, among which is incremental reform. An incremental reform is to seek gradual progress on the basis of maintaining the stability of the international financial markets, proceeding in a phased manner and achieving the final objectives of reform through sustained efforts. Cheng Daofu and Wu Qing from Development Research Center of the State Council, an advisory body to CPC Central Committee and the State Council of China, expressed the necessity of the gradualism. Cheng pointed out that the future change must be in a gradual way (Pan, 2009). Wu (2008a) focused on the conflict of interest of major countries in reforming the IMS and consequently argued that the policy coordination among major states and radical change of the IMS in the short-term is impossible. The Chinese economist Li Daokui also emphasized the importance of gradualism by saying that radical change of the IMS would impact negatively the stability of IMS and the foreign reserves of countries (Pan etc., 2011).

Third, the 2008 global financial crisis provided a gold opportunity to reform the IMS and elevate the international position of RMB. Although Deng Xiaoping called for "keeping a cool head, maintaining a low profile and never taking the lead", he also emphasized "aiming to do something big". The 2008 global financial crisis is interpreted as a chance to do something big for the Chinese government. The crisis motivated China to reform both domestic and international monetary systems. Domestically, the 2008 global financial crisis motivated a new round of China's domestic economic reform, deputy director of the Financial Research Institute of the State Council's Development Research Centre Zhang Chenghui said in an interview (Zhu, 2009). Some scholars even think the following several years are the best time for RMB to invest abroad (Pan, 2013). Internationally, China's international position has been enhanced since the eruption of the crisis, particularly in the global financial governance (Zhang, 2013). The crisis exposed again the shortcomings of the current IMS and, consequently, has provided a golden opportunity to revise these flaws. In addition, some scholars even think that the crisis and the post-crisis reform is a good way for the Chinese leadership to shift global focus from pressuring Beijing on appreciation of the renminbi to pressuring Washington on the dollar and assuage the public's dissatisfaction, particularly falling exports and rising unemployment, by transferring the public's outrage towards the US (Murphy & Yuan, 2009). To sum, the following Table 5.4 illustrates China's *Guojia Liyi* in the IMS reform and the three structuring factors mentioned above.

Table 5.4 *Guojia Liyi* and the Influencing Factors in Reforming IMS

Guojia Liyi of China and Objectives	Influencing Factors			
	Material Factors		Ideational Factors	
	Domestic	International	State Ideology	Interpretation
Reforming the US dollar-dominated IMS and enhancing RMB's international presence - elevating RMB to be a settlement currency, an investment currency and, finally and gradually, a global reserve currency.	Domestic development, such as the extraordinary performance of domestic economy; Domestic problems.	Structural shortcoming of the current global monetary system; 2008 global financial crisis; The changes of international economic pattern.	Socialism; Development Ideology; Nationalism; Emerging Countries.	Unequal IMS - "currency war" and "dollar trap"; Gradualism; Gold Opportunity; Others

The Formation of *Guojia Liyi* and its Three Constituents

Guojia Liyi, as explicated in the previous chapters, contains three constituents - personal epistemic interests, interests of the state and national interests. The existing literature usually equates *Guojia Liyi* with national interests and thinks national interest is the final and sole motivation of national policy and action. However, in the short and medium term, personal epistemic interests, such as the epistemic interests of policy elites and party leaders, and interests of the state, especially the interests of government led by the CPC, may influence China's domestic and international policy and stance. Therefore, while analyzing certain policies or strategies of China, personal epistemic interests and interests of the state should be taken into account and treated as part of the *Guojia Liyi*. The following section analyzes how the three structuring factors formed China's *Guojia Liyi* on reforming the IMS through influencing its three constituents.

In personal dimension, key policy elites are more confident to propose ambitious proposals to reform the current IMS and domestic currency system in favour of China and pursue reputation in international academia or/and politics. The confidence has both internal and external sources, which are respectively the extraordinary domestic economic development and the global recession caused by the 2008 global financial crisis. Zhou Xiaochuan's super-sovereign currency proposal is a good example. Actually, similar proposals were made before by Chinese officials or scholars. For instance, in 2004, Li Guanghui, an official from the Ministry of Finance, proposed a three-level IMS reform framework. The basic elements of Zhou's proposal are covered in Li's framework (Ren, 2012). However, Li did not attract the same attention as Zhou is. The major reason for the difference is that the outbreak of the global financial crisis provided Zhou's voice an opportunity to be heard and the extraordinary domestic economic performance during the crisis made the voice from China more influential in international community. Moreover, the state ideology also influences the thinking and interpretation of scholars, policy elites and political leaders, which are major information input of China's policy-making. Political leaders usually put the socialist ideology in an important position. The concept "socialist market economy" put forward by Deng Xiaoping is the premise for today's discussion on participating IMS reforms and completing domestic market economy by improving China's currency policy. Chinese development ideology and identity have long been hot topics in discussions of Chinese scholars and policy elites. The identity as an emerging country and the unique government-led development model lead a consensus and a dispute within Chinese intellectual circles. On the one hand, the existing IMS is commonly interpreted by developing countries, particularly China, as an unequal and biased system in developed countries' favour, especially the US. Therefore, there is a consensus among Chinese scholars, policy elites and political leaders that the current IMS ought to be reformed and China will benefit from this reform. On the other hand, given that reforming the entrenched IMS needs a very long time, China attempts to contribute to this reform from the inside by promoting RMB internationalization and diversifying international reserve currencies.

Related to these domestic measures, there is a dispute in Chinese intellectual circles. A number of Beijing-based intellectuals believe the government should actively pursue renminbi internationalization with the eventual goal of achieving reserve currency status, while a number of scholars outside Beijing policy circles question whether it is in China's best interests to internationalize the renminbi at this juncture (Murphy & Yuan, 2009). A major reason for this dispute is that the conditions for RMB internationalization are not enough and a rush to action violates the fundamental principle of gradualism as mentioned before.

In regard to the IMS reform, the Chinese government's specific interest is to sustain China's economic development and political stability and enhance China's international status by creating a more reasonable and favourable IMS and elevating RMB's position in this system. China, as an emerging and socialist country, has long been dissatisfied with the IMS. As an emerging economy, "China's financial rise is catapulting the country to the forefront of global finance and the international monetary order" (Chin and Helleiner, 2008; Wang and Chin, 2013, p.1266). Meanwhile, China falls into a “dollar trap” that implies persistent upward pressure on China’s currency, due to its dependency on the foreign investment and trade and the dollar-centered IMS (People’s Daily, 2013). As a socialist economy, China’s unique government-led development model is in sharp contrast or even in conflict with the neoliberal development model. The major international financial institutions, mainly IMF and WB, and the US, which have been maintaining the current IMS, have also been advocating and spreading neoliberalism. Therefore, the current IMS is interpreted to serve the neoliberal states, rather than other developing and emerging countries, which drives China’s effort to reform the IMS.

The 2008 global financial crisis and the structural flaws of the IMS exposed in the crisis provide the Chinese government a chance to reform the IMS in favour of China’s development. In the international arena, China’s say has been elevated, but is still limited. The US still maintains its dominant position in the world economy and the dollar-centered IMS is still entrenched. This international economic pattern makes the Chinese government realize the chronicity of the reform. Therefore, in the course of reforming the IMS, what China can do and has done is only to suggest and urge the major international financial institutions and economies to consider or even accept its suggestions. Given the limited leverage of China in reforming the IMS, China focuses on the domestic arena and attempts to propel the IMS reform through RMB internationalization, which is conducive to China to survive the “currency war”. However, the domestic problems make RMB internationalization disputed as discussed above. Consequently, considering domestic problems like RMB capital account inconvertibility and irrational industrial structure and under the guidance of the gradualism principle discussed above, the Chinese government has launched a phased-in currency policy reform, which aims to internationalize RMB by three stages in tandem - settlement, investment and reserve currency. The on-going policy is focusing on the first two stages.

A core interest of Chinese nation, as mentioned before, is rejuvenation. This interest is closely related to the Chinese nationalism discussed above. Compared to the personal epistemic interests and interests of the state, national interests are long-term and at macro level. The specific content of Chinese nation rejuvenation mainly includes but not limited to improvement of people's livelihoods, prosperity, construction of a better society and military strengthening. The most important precondition for realizing these objectives is economic development. The current IMS, however, is interpreted as a cause for the "currency war" and "dollar trap" and hence is not conducive to China's sustainable development. In this sense, reforming the IMS and enhancing RMB's international position become inevitable for maintaining China's development and rejuvenating Chinese nation. The 2008 global financial crisis and the depression of world economy provide China a chance to do so.

In summary, the following Table 5.5 summarizes the influence of material and ideational factors, particularly international and domestic political economic factors, state ideology and interpretation, on the three constituents of *Guojia Liyi*.

Table 5.5 Formation Matrix of China's *Guojia Liyi* in IMS Reform				
Influencing Factors		Personal Epistemic Interests	Interests of the state	National Interests
Material	Int'l	The 2008 global financial crisis gives China's policy elites more confidence to propose IMS reform and RMB internationalization, and more opportunities to pursue international reputations.	The 2008 global financial crisis and the structural flaws of the IMS exposed in the crisis provide the Chinese government a chance to reform the IMS in favor of China's development; The international economic pattern makes the Chinese government realize the chronicity of the reform.	The 2008 global financial crisis and the depression of world economy is a chance to elevate Chinese nation's international position.
	Domestic	The extraordinary domestic economic development has encouraged Chinese leaders to pursue more reputation for themselves and their country.	The extraordinary domestic economic development has encouraged the Chinese government to change it currency policy and reform the IMS; However, the domestic problems make the RMB internationalization a long-term objective.	Reforming the IMS and enhancing RMB's international position is important for maintaining China's development and, therefore, for rejuvenating Chinese nation
Ideational	State Ideology	Scholars, policy elites and political leaders' personal thinking on reforming the IMS is under the influence of the state ideological framework.	As a socialist country with Chinese characteristics and an emerging country, reforming the current IMS formed by major developed countries decades ago will be conducive to maintaining China's identity and economic development.	Chinese nationalism; The unique development ideology is at least appropriate to China's situation.
	Interpretation	There is a consensus on the IMS reform, but a dispute on RMB internationalization.	Chinese state must survive the "currency war" launched by the US; Gradual reforms on both the IMS and domestic currency policy are better choice for the Chinese government.	Weak correlation

Conclusion

China is reform-minded toward the current international monetary system and has taken critical actions domestically and internationally with the intention to urge reform of the IMS. The driving force behind this attitude and action is China's *Guojia Liyi* related to the IMS. The *Guojia Liyi* and the policy objectives based on it are that reforming the US dollar-dominated IMS and enhancing RMB's international presence in China's favor - elevating RMB to be a settlement currency, an investment currency and, finally and gradually, a global reserve currency. The formation of the *Guojia Liyi* is influenced mainly by both material (international and domestic political economic environment) and ideational factors (state ideology and interpretation). The channels in which these factors structure the *Guojia Liyi* are the three constituents - personal epistemic interests, interests of the state and national interests. Personal epistemic interests, mainly the views and interpretation of scholars, policy elites and political leaders, which is the major information input of China's policy-making, influences the *Guojia Liyi* in the short term. In the medium term, the interests of the state are usually the most important factor in making national policies, while in the long term, national interests guide the direction of governments' policy-making. China's *Guojia Liyi* related to reforming the IMS is a synthetic action of the three dimensions under the influence of the material and ideational factors mentioned above. In personal dimension, reform proposals are put forward with disputes on the way, speed, extent and timing of the domestic currency reform and the IMS reform. On the state level, considering the domestic problems like RMB capital account inconvertibility and irrational industrial structure and under the guidance of the gradualism principle discussed above, the Chinese government has launched a phased-in currency policy reform, which aims to internationalize RMB by three stages in tandem - settlement, investment and reserve currency. The attitude of China toward the IMS reform and the strategy of China in pursuing its objectives are influenced, to a limited extent, by the interests and interpretation of scholars, policy elites and political leaders, and, to a large extent, reflects the interests of the state and the long-term national interests. *Guojia Liyi*, which contains all the three aspects, is the driving force of China's attitude and strategy in the IMS reform.

Chapter Six: Determinants of China's Exchange Rate Policy

China's growing economic might in the world economy and its incrementally important currency, the Renminbi (RMB or yuan), have made Chinese domestic exchange rate policy generate prodigious international spillover effects. The related literature, therefore, has paid attention to the changes and determinants of China's exchange rate policy. Nonetheless, the mounting attention is not equal to the clearer comprehension or even an academic consensus on determinants of China' exchange rate policy in any sense. On the contrary, many voices have emerged. These different opinions focus on various aspects, including mainly external pressures, domestic decision-making process and national interests and preferences.

External pressures have been considered a key factor in forming China's exchange rate policy. Given the international spillover effects of China's exchange rate policy, such as on trade balance, employment and investment flow, major Western economies and IOs, especially the US and the IMF (or the Fund), have kept close eyes on China's exchange policies. There is ample evidence that the US has exerted pressure on China to reform its exchange regime. For example, the *2010 US House of Representatives Documents* denounced China's undervalued exchange rate for hurting the US economy and workers (Congressional Documents and Publications, 2010). Congressman Sander Levin, chairman of the House Ways and Means Committee, said "China's exchange-rate policy is one of China's many mercantilist policies that distort trade and investment flows and place a drag on US economic growth and job creation" (Asia Pulse, 2010). Along with the Western economies, relevant IOs have also exerted pressure on China to reform its exchange regime towards what has been dubbed the "Washington Consensus". Among many IOs is the IMF, which, by and large, has claimed that the RMB is undervalued and that China's exchange regime needs to be reformed although the specific views of the Fund have altered in different periods. Following the 1997 Asian financial crisis during which China adopted a "no devaluation" policy and until 2005 when Chinese authorities launched the exchange regime reform, the IMF spoke only vaguely about the desirability of greater flexibility in the RMB's value.[18] After China announced adoption of a managed floating exchange rate regime based on market supply and demand in 2005 and until the stagnation of this reform in 2008, the Fund lavished praise on China. From 2008 when the exchange regime stagnated mainly as a result of the 2008 global financial crisis to 2010 when China relaunched the exchange rate reform, critical words, such as "substantially undervalued" (IMF, 2009) or "fundamentally misaligned" (Beattie, 2009), appeared in IMF documents or discussions assessing China's exchange rate policy. Since 2010 when China decided to return to a managed floating exchange system and further reform RMB exchange rate regime, the Fund changed its assessment on China's exchange rate from "substantially undervalued" to "undervalued" and recently to "moderately undervalued" (IMF, 2012a).

The continuous pressure from the US and related IOs and the concurrent exchange rate reform of China in the last decade lead to a plausible conclusion that international pressure drives China's exchange rate reform and compels China to a status-quo power in

[18] For example, in the Public Information Notices (PINs) concluding 2003 Article IV Consultation with China, most IMF directors noted that 'there is no clear evidence that the renminbi is substantially undervalued' and 'increased flexibility of the exchange rate over time would be in the best interest of China' (IMF, 2003).

the global financial governance. For instance, Buckley (2012) argued that "the main factor pushing China toward RMB appreciation is US pressure, considering that China does not wish to jeopardize the stability resulting from lucrative trade with the US". This argument, however, oversimplifies the reality. China's exchange rate policy is not a simple consequent following an antecedent. In the same vein, China cannot be categorized as a complete status quo or revisionist power.

Another group of scholars explain China's exchange rate policies focusing on the policy-making mechanism. Specifically, the related studies mainly focus on formal and informal lobbying practices on China's exchange rate policy (Kennedy, 2009), cleavage between the Chinese Ministry of Commerce (MOFCOM) and the PBC (Freeman III & Yuan, 2011), influence of policy elites (Liew, 2004) and the exchange rate policy-making mechanism per se (Yi, 2007). These literatures indubitably contribute to understanding the determinants of China's exchange rate policy, but fail to put forward a comprehensive framework to explain the formation and changes of it. As Steinberg and Walter (2011, p.27) argued, these numerous political factors, "including the preferences of industries, policymakers, political parties as well as institutional arrangements, such as democracy, elections, the electoral system, the number of veto players and central bank independence", do not always matter, and many of them have different effects under different circumstances.

Against this backdrop, this chapter applies the two-stage model to explore the determinants of China's exchange rate policy and how these determinants influence the formation of China's exchange policy. Specifically, this chapter explains China's exchange rate policy by focusing on both the formation of China's interests and preferences (*Guojia Liyi* in Chinese) and the specific domestic decision-making process. The remainder of this chapter proceeds in three sections. The first section examines the formation of the *Guojia Liyi* in reforming China's exchange regime. The following section explores the decision-making environment of China's exchange rate policy in three stages---2005 reform, 2008 stagnation and 2010 relaunch. A final section concludes by offering implications.

Formation of China's *Guojia Liyi* in Exchange Regime Reform

Guojia Liyi, as explained in the previous chapter, is the driving force of China's domestic and foreign policies. Generally, China's *Guojia Liyi* contains three constituents - personal epistemic interests, interests of the state and national interests and is determined by both material and ideational factors - political economical environment, state ideology and interpretation. This section applies the *Guojia Liyi* formation matrix proposed in the theoretical chapter to explain China's *Guojia Liyi* in exchange regime reform.

The most important step of China's exchange regime reform in the new century is the establishment of a managed floating exchange rate regime based on market supply and demand with reference to a basket of currency initiated in 2005 (PBC, 2010). As discussed above, the US and global financial governance institutions, particularly the IMF, had long called on China to reform its exchange regime. However, this reform in 2005 was not a direct result of these international pressures, but a deliberate move of the Chinese government considering China's *Guojia Liyi*. The *Guojia Liyi* has prioritized economic development since the third Plenary Session of the 11th CPC Central Committee in 1978. It has sought to promote and maintain economic development by establishing and improving the socialist market economic system while enabling the market to fully play its role in resource allocation (Xinhua, 2003). In terms of the exchange regime, the *Decision of the Central Committee of the Communist Party of China on Some Issues concerning the Improvement of the Socialist Market Economy* issued by the third Plenary Session of 16th CPC Central Committee in 2003 unambiguously stipulated China's objectives as seeking to establish and improve a managed floating exchange rate regime based on market supply and demand as well as to keep the exchange rate of the currency basically stable at an appropriate and balanced level. This specific *Guojia Liyi* in reforming China's exchange regime is determined by both material and ideational factors, mainly domestic and international political economic environment, state ideology and interpretation.

Domestic and International Environment

The domestic and international political economic environment makes key policy elites realize the necessity and feasibility of exchange regime reform and exerts pressures on the Chinese government to reform the problematic exchange system. The international environment and its influences on China's *Guojia Liyi* in exchange regime reform can be observed from the following three respects. First, international experiences on exchange regime reform provide key policy elites and the Chinese government both positive and negative examples and have urged China to reform. Chinese scholars studied widely the successful and failed international exchange reforms, including Asian-pacific countries like Japan (Zhu, 2007) and Australia (Tang, 2005), some transition countries (Zhu, 2006), such as Poland, emerging countries like India (Lu & Cha, 2011), Thailand (Huang, 2006) and Chile (Zhang, 2005) and even developed capitalist countries, such as Germany (Liao, 2011). Poland, for example, actively launched a series of exchange rate reforms, evolving from pegging to one single currency to a basket of currencies and later to managed float or even free float. Consequently, it avoided possible societal and economic instability after the collapse of the USSR. In sharp contrast, in the decade before the 1997 Asian financial crisis, Thailand applied a pegged exchange rate regime, in which the Exchange Equalization Fund (EEF) defended the Baht value against the US Dollar, and was unwilling to reform the formation mechanism of its exchange rate. As a result, in the 1997 Asian financial crisis, Thai economy had suffered catastrophically. Second, as the recovery of Asian economies from the 1997 Asian crisis, the “no devaluation” policy that had been adopted since 1997 as an expedient policy against the 1997 crisis became inappropriate and needed to be changed.

Third and more importantly, the Chinese government faced huge pressures from major Western countries, global financial governance institutions and even international academia, as mentioned before. The May 2005 *US Treasury Department Report on International Exchange Rate Policies* asserted that Chinese exchange rate policies “are highly distortionary and pose a risk to China’s economy, its trading partners, and global economic growth”, and without substantial alteration, “China’s policies will likely meet the statute’s (Omnibus Trade and Competitiveness Act of 1988) technical requirements for designation”. In the 2003, 2004 and 2005 IMF China Article IV Consultation, the

Fund continuously expressed its desirability for a more flexible Chinese exchange rate. In addition, many scholars from central banks, research institutes and academia, including Eichengreen (2004, 2004b), Bernanke (2005) and Frankel (2005), enunciated their views on China's exchange rate policy, most of which concur with the US government's view (Laurenceson & Qin, 2006). Although these international factors influenced China's decision to reform its exchange regime to some extent, according China's exchange rate reform to these factors, is simplistic and misleading (Goujon & Guérineau, 2005). Domestic factors, as governor of the People's Bank of China Zhou Xiaochuan remarked, are key factors in making China's currency policy (Xinhua, 2010).

The domestic environment is the principal determining factor of the formation of the *Guojia Liyi* that guided China's exchange regime reform particularly from 2005 onward. On the one hand, as Broz and Frieden (2006, p.591) observed, national states' cooperation and coordination in international monetary system "rest on the foundation of national currency policies", which "involve trade-offs with domestic distributional implication" and "electoral implication". In China's case, the electoral implication of China's currency policy is minimal considered the authoritative nature of China's political system. On the other hand, the (potential) distributional implications changed China's domestic environment, which mainly refers to the domestic pressures on and pre-conditions for reform. The former includes pressures of changing the long-time "twin surpluses", mitigating inflationary expectation and increasing the independence of currency policy. According to economic theory, under a free floating exchange rate regime, the sum of current account and capital account should be zero, while under a fixed exchange rate regime, imbalances between capital account and current account can be adjusted through foreign exchange reserves. By 2005 China had been running twin surpluses in current account and capital account for 15 years, a world record (Yu, 2006). The influx of huge foreign currency pressed the RMB to appreciate. To maintain a fixed exchange rate the Bank of China had to purchase foreign currency and, as a result, increased tremendously the funds outstanding for foreign exchange. This huge amount of money would result in inflation in goods market and asset bubble in capital market, which would hurt the macro economy of China.

As the famous "Impossible Trinity" (Mundell, 1963) stipulates, an economy cannot simultaneously maintain a fixed exchange rate, free capital movement and an independent monetary policy. Independent monetary policy is treated as part of the state sovereignty by the Chinese government. Free capital movement is the long-term objective of China's financial system reform. Therefore, the fixed exchange rate has to be changed in order to maintain or achieve independent monetary policy and free capital movement, and exchange reform became urgent. As Hersh (2014, p.2) observed, "leaders and top economic policymakers have set clear intentions to open China's capital account and to halt direct policy interventions in setting interest rates, the exchange rate, and prices for other assets and financial services". The Chinese government's strategy to handle this "Impossible Trinity" trilemma, as pointed out in the *2014 China International Balance of Payments Report* issued by the State Administration of Foreign Exchange (SAFE), is to further improve market-based exchange rate formation mechanisms for the renminbi, enhance the government's capability of coping with increased capital mobility and ensure the independence of China's monetary policy (SAFE, 2015).

In addition to these domestic pressures, the 2005 exchange regime reform was based on some pre-conditions. Zhou Xiaochuan summarized these pre-conditions as bank sector reform, decreasing unnecessary controls on foreign exchange transaction and foreign market development (Xinhua, 2005). He noted that China's banking system had been reformed by 2005 and that 70-80% banks had stepped into a virtuous development circle; some unnecessary constraints on capital account transaction had been cancelled and capital market had been further opened up; financial system had been reformed and financial market was more mature. These reforms before 2005 created a relatively friendly policy environment for the 2005 exchange regime reform.

State Ideology

The Chinese modern state ideology centered on Socialism with Chinese characteristics and the scientific outlook on development has embedded the idea of market economy in the mind of key policy elites and prompted the state to redefine the boundary between government and market. The exchange regime reform particularly since 2005 reflects the market economy idea and is a crucial step to redefine the government-market boundary. In the late 1970s, Deng Xiaoping's economy-centered "reforms and opening" policy replaced Mao's revolution-oriented and politics-centered domestic and foreign policies. Deng's idea prioritized economic development and launched the creation of Socialism with Chinese characteristics, the combination of socialism with market economy. As Deng said in the famous South Tour speech (People's Daily, 2012):

> *"planning and market forces are not the essential difference between socialism and capitalism. A planned economy is not the definition of socialism, because there is planning under capitalism; the market economy happens under socialism, too. Planning and market forces are both ways of controlling economic activity".*

Following this view, China started to construct its socialist market economy. The exchange regime reform is vital part of the socialist market economy construction. The subsequent generations of political leaders have largely inherited the ideology and aimed at developing a socialist market economy in China. In the official documents of the Chinese government, "accelerating the improvement of the socialist market economy" is highly frequent wordings and has been treated as the pivot of China's economic development. For example, in Hu Jintao's (2012) report at the 18th Congress, a whole section is about "Accelerating the Improvement of the Socialist Market Economy and the Change of the Growth Model".

As the socialist market economy developed, many social issues have emerged, particularly environment degradation, unbalanced development and absence of human rights. Consequently, the government proposed the Scientific Outlook on development to improve the growth model. The new development ideology, on the one hand, changes the definition of development from GDP growth to social and human development, and, on the other hand, seeks to redefine the boundary between state and market. The exchange regime reform initiated in 2005 aims to delegate more power to the market which had been defined as a "basic" role in allocating resources since the initiation of the market economic construction in 1992. Recently, the "basic" role was even enhanced to be a "decisive" role in the third Plenary Session of the 18th CPC Central Committee. As one of the key pillars of market economy system, the market-oriented exchange regime reform is both important content and premises of completing market economy mechanism.

Interpretation

The structuring effects of the domestic and international environment and state ideology on *Guojia Liyi* are through the interpretation of great people, key policy elites and/or people and the judgment of the incumbent government. Interpretation here refers to political decision-makers' and government's understanding of the domestic and international environment based on the state ideology. In the medium term, the reform legacy of the great person Deng Xiaoping and the consequent Socialism with Chinese characteristics have provided the subsequent political leaders a thinking pattern in making domestic and international policies. Confined by the state ideology, in the short term, policy elites may have their own understanding of the domestic and international environment and make policies based on that understanding. As far as the exchange regime is concerned, key policy elites's interpreation on the domestic and international environment and state idology espouses a market-oriented reform as a medium-term objective.

The most important person in the exchange rate reform in the past decade is Zhou Xiaochuan. Zhou, a scholar official, has been in charge of the PBC as governor since late 2002. In March 2013, he was reappointed unconventionally to the same position, which makes him the longest-serving central bank governor since the founding of the new China in 1949. The basic academic view of this western-educated governor strongly advocates establishing more free-floating and flexible exchange regime. Therefore, since his inauguration in the PBC, Zhou has been prompting the exchange regime reform toward a market-oriented mechanism. Consequently, Zhou is called an “arch-reformer” (Xia, 2004) and “Mr. RMB”. Moreover, Yu Yongding, a financial expert for the Monetary Policy Committee, is another important policy elite, whose formulation of gradual style of modest appreciation was adopted in 2005 reform (He, 2011). In addition, many high-level officials and advisers of the PBC who received Ph.D. degrees in universities from the US, such as Yi Gang, Zhou Qiren, Li Daokui and so on, favor currency reform (Freeman III & Yuan, 2011).

The identity and ideology of the government and the internal cause and external pressures together form the judgment of the government that exchange regime reform in the medium or long term is necessary for sustainable development. As enunciated before, under the guidance of the Socialism with Chinese characteristics and considering the domestic and international situation, the Chinese government treats the exchange regime reform as a crucial step for redefining the boundary between state and market and finally completing the market economy. Despite some short-term side effects, a market-oriented foreign exchange reform has been a long-term objective of the Chinese government. A recent reform plan from the Chinese government released following the Third Plenum of the 18th CPC Central Committee clearly demonstrates this long-term objective, saying that the Chinese government vows to “improve the market-based yuan exchange rate formation mechanism and speed up the marketisation of interest rates”. Some scholars even predict China may achieve the long-term objective with foreign exchange reform, as well as interest rate and capital account reforms by 2020 (Li & Shi, 2013).

In summary, from a long-term perspective, reforming China's exchange regime is in favour of economic development, construction of socialist market economy and the flourishing of Socialism with Chinese characteristics. Therefore, the 2005 exchange rate reform, on the one hand, met the expectation of international community inadvertently, especially the major Western countries and international institutions like IMF, while, on the other hand and more importantly, it was motivated by the *Guojia Liyi* determined largely by domestic and international environment, state ideology and interpretation of key policy elites. The Table 6.1 summarizes the structuring effects of the material and ideational factors on China's *Guojia Liyi* in reforming exchange regime through influencing the three constituents of it. Though the *Guojia Liyi* related to exchange regime reform advocates a market-oriented reform in the long run, China's exchange rate system reform in the past decade has still experienced ups and downs, which can be explained by further looking at the different decision-making environment.

<table>
<tr><th colspan="5">Table 6.1 Formation Matrix of China's Guojia Liyi in Exchange Reform</th></tr>
<tr><th colspan="2">Factors</th><th>Personal Epistemic Interests</th><th>Interests of the state</th><th>National Interests</th></tr>
<tr><td>Material</td><td>Domestic and International political economic environment</td><td>Key policy elites have realized the necessity and feasibility of exchange regime reform, considering the domestic and international political and economic environment.</td><td>The Chinese government has been facing domestic and international pressures for reforming the exchange regime; Domestic reform environment became mature.</td><td>Weak association</td></tr>
<tr><td rowspan="2">Ideational</td><td>State Ideology</td><td>The idea of market economy has been embedded into the minds of key policy elites.</td><td>The Socialism with Chinese characteristics and the scientific outlook on development attempt to redefine the boundary between government and market. Exchange regime reform is a crucial part of the redefinition.</td><td>In the short and medium term, national interests are relatively stable. National rejuvenation and Chinese Dream are based on China’s modern ideology in the long run.</td></tr>
<tr><td>Interpretation</td><td>Key policy elite’s interpreation on the domestic and international environment and state ideology espouses exchange regime reform as a medium-term objective.</td><td>The identity and ideology of the government and the internal cause and external pressures together form the judgment of the government that exchange regime in the medium or long term is necessary for sustainable development.</td><td>In the short or medium term, national interests are largely stable and, the personal and collective understanding of national interests is also stable.</td></tr>
<tr><td colspan="5">Guojia Liyi
Promote and maintain economic development by establishing and improving the socialist market economic system while enabling the market to fully play its role in resource allocation;
Seeking to establish and improve a managed floating exchange rate regime based on market supply and demand as well as to keep the exchange rate of the currency yuan basically stable at an appropriate and balanced level.</td></tr>
</table>

How the Decision-Making Environment Matters

China's exchange rate policy-making process under different administrations has varied slightly. Under the Hu-Wen administration (2003-2012), several policy organs and elites played crucial role in making exchange rate policy. The Central Politburo Standing Committee of the CPC (PSC) has been standing at the center of China's exchange rate policy-making, supported by some functional units like the General Office that provides administrative and logistical support (Yuan, 2012). Another body that is directly accountable to PSC and is crucial in making exchange rate policy is the FEALSG. Wen Jiabao, former Chinese Premier and chair of the FEALSG, was the key policy elite in exchange rate policymaking. Hua Jianmin, deputy secretary-general of the FEALSG, and Ma Kai, deputy secretary-general of the State Council, were key assistants of Wen in evaluating policy alternatives and making final decisions. The PBC became the most influential exchange rate policy input after the CBRC was formed in 2003 to take over supervision responsibilities on China's banking sector. Zhou Xiaochuan, governor of the PBC, was and remains one of the most influential policy elite in exchange rate policy-making of the past decade. In addition, Yi Gang, director of the PBC monetary policy department, is also influential in exchange policy formulation due to his monetary economics expertise. The MOFCOM, which was formed in 2003 in response to China's accession to the WTO, was also important in providing input for the exchange rate policy. Consequently, Bo Xilai, former Minister of Commerce, had a certain influence on China exchange rate policy-making under Hu-Wen administration. The Chart 3.3 in Chapter

Three illustrates the major actors and structures in China's exchange rate policy making under Hu-Wen administration.

These policy organs and elites made the final decision to reform China's exchange regime to a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies in 2005. This policy output accords with the *Guojia Liyi* and corresponding policy objectives mentioned above. In 2008 and 2010 respectively, however, similar policy organs and elites made different decisions related to China's exchange rate policy. This difference was not due to changes of China's *Guojia Liyi*, which has favoured exchange regime reform in China in the long run, but due to the different influences of six key factors in the decision-making environment, which are lobbying of interest groups, institutional conflict, complexity of the issue, international pressures, emergent events and risk appetite of decision makers. The remainder of this chapter will explore how the six factors influenced the decisions on 2005 exchange regime reform, 2008 reform stagnation and 2010 reform relaunch.

2005 Reform

Lobbying of interests groups, especially the export sector, opposing the 2005 reform and the consequent appreciation of RMB was comparatively weak. To begin with, what must be pointed out is that interests groups can also influence exchange rate policy in authoritarian states. Many recent quantitative analyses verify the influence of political regime type on exchange rate policy, arguing that non-democratic governments are more insulated from domestic societal pressures (Steinberg & Shih, 2012). Many scholars have falsified this idea by exploring the multiple ways in which interests groups exert influence on and even change China's exchange rate policy (Yuan, 2012). Steinberg and Shih (2012, p.1407) argue that "interest groups have multiple points of access in nondemocratic regimes, and autocrats have strong incentives to keep the exchange rate at a level that is supported by powerful domestic interest groups to ensure their political survival". As far as China's exchange rate policy-making concerned, the lobbying consists of two layers---lobbying of interests groups on related government agencies and lobbying of government agencies on the central leadership. The latter specifically appears as the institutional conflicts between the PBC and the MOFCOM, which will be discussed subsequently. Here the lobbying particularly refers to the export sectors' influence on the central exchange policy, which was both direct and indirect. The direct manner was to lobby the MOFCOM through provincial and local level Chambers of Commerce, which serves as a middleman to pass along the concerns of the export sectors, especially big export companies, to the MOFCOM. The indirect way mainly refers to the manipulation of the media (Yuan, 2012).

The lobbying of the export sectors against the 2005 reform and the consequent RMB appreciation was not strong enough to impede the reform. The fundamental reason is that the interest of most export sectors had not been substantially damaged because of the limited RMB-appreciating effects of the 2005 reform as well as the compensation measures of the central Government. As the former Premier Wen remarked publicly, the exchange regime reform in China must insist on three principles---initiative, controllability and gradual way (Zhao, 2005). Initiative means to determine the form, content and timing of the reform according to the needs of China's domestic development and take into account its negative effects, especially on the stability of macro economy, economic growth and employment. Controllability means that the reform process must be in control in terms of the macro management and must avoid turbulence of financial market and substantial fluctuation of economy. Gradual way refers to that the reform should be taken step by step considering both the short-time and long-time development. The three principles convey a message to the export sector, the strongest lobbying group against the exchange reform, that RMB value would not be appreciated beyond most exporting companies' capability of adopting themselves to the change.

In the first two years after the 2005 reform (June 2005-June 2007) RMB appreciated by around 7.8% from 1:8. 28 to 1: 7.63 against the US dollar (see Chart 6.1). Despite the appreciation, the RMB was still considered undervalued and the export sectors still had some exporting advantage. Looking into the textile industry in China, for example, Yang (2009, p.188) observed "export conditions for the Chinese textile industry were ideal for three straight years after 2005, with annual growth of around 20 percent". In addition, compensation measures would smooth the 2005 reform by mitigating the negative effects of the reform on the exporting sector. As Steinberg and Shih (2012, p.1405) argued, "tradable industries do not always demand an undervalued exchange rate, but do so only when they are unable to receive other compensatory policies". During the 2005 reform, tradable industries were compensated by favourable economic policies and consequently, discouraged lobbying against the appreciation resulted caused by the 2005 reform (Steinberg & Shih, 2012). Nonetheless, in the one-year period between June 2007 and June 2008, RMB appreciated by about 9.6% from

1$:7.63￥ to 1$:6.9￥ (see Chart 6.1), which directly resulted in the stagnation of the 2005 reform.

Institutional conflicts regarding the 2005 reform, especially between the PBC and the MOFCOM, were evident but controllable and negotiable. The PBC and the MOFCOM are two major stakeholders in China's exchange rate policy. The PBC has been a strong backer and initiator of China's currency reform, while the MOFCOM opposed the 2005 reform and the consequent appreciation of the RMB, concerned that the competitiveness of China's export sector would be weakened. These competing stances stem from the different functions of the two government agencies. Among many others, the major functions of the PBC are to control inflation by formulating and implementing monetary policy, preventing and mitigating systemic financial risks to safeguard financial stability and maintaining the renminbi exchange rate at an adaptive and equilibrium level (PBC, 2013b). A more flexible exchange rate policy would be conducive to controlling inflation, handling the large amount of speculative capital inflows and maintaining China's financial and economic stability (Freeman III & Yuan, 2011). In contrast, the MOFCOM is mainly tasked with facilitating domestic and international trade. Obviously, the reform of China's exchange rate policy and the consequent RMB appreciation are harmful to China's export sector and foreign trade in the short term. As to the 2005 reform, the institutional conflicts were negotiable and a weak reform consensus had been finally gained with the effort of the PBC. On the one hand, the compensation measures discussed above mitigated the export sector's lobbying and, consequently, the external pressures of the MOFCOM to oppose the reform. On the other hand, the PBC carried out a mass of coordination and negotiations within the government, including extensive discussion and research ranging from policy departments to academic research institutes, and finally obtained the support of the central government and domestic public opinion and mainstream media (He, 2011).

The externalities of the 2005 reform are not overly complex. The disputes between the PBC and the MOFCOM demonstrated clearly the major negative and positive effects of the 2005 reform. Therefore, decision makers can balance these effects before making final decision. Although there are still some uncertain issues, such as the extent to which RMB should appreciate and the export sector would be affected negatively, the general picture is clear that with the countering measures against the negative extremities of the 2005 reform the positive effects would outweigh the potential negative ones.

Short-time international pressure is another important factor that influenced the 2005 exchange reform. As discussed above, before and during the 2005 reform, China faced huge pressures from major Western countries, especially the US, international organization like the IMF and international academia to reform its currency policy. Although, as emphasized many times before, external pressures are not the direct antecedent of the consequent 2005 reform, its influences on policy elites and finally on the policy-making process cannot be dismissed. These external pressures, are the interpretation and expectation of foreign actors, both countries and IOs, on China's currency policy. According to Constructivists' ideas, intersubjective understanding among social actors determines each actor's identities and interests, which will influence social actors' interpretation of the situation that they are facing and, consequently, their decisions (Wendt, 1992). This idea is still applicable to personal policy elites. Chinese policy-makers perspectives will be influenced, by the interpretation of foreign actors. Different from the influence of external pressures on *Guojia Liyi* formation in the medium or long term discussed above, the impact of external pressures on decision-making process is short-term and relative less evident, since the short-term pressures can be comparatively easily managed by the incumbent government through skilful diplomacy. Yet, in the long term, the Chinese government needs to take substantial actions rather than merely diplomatic tactics to alleviate external pressures. As such, in this highly globalized world, it is not sufficient for countries to make policies only based on domestic situation, even though domestic environment is still the major source of national policies.

During the 2005 exchange reform, there was no emergent event that influenced the decision-making process. Emergent events always require immediate response in short time and unconventional measures to deal with. Therefore, the more emergent the event is, the more cognitive the decision will likely be. In other words, when emergent events happen, the decision-makers may consider more how to deal with these emergent crises in the short term, rather comprehensively assess the long-term effects of these expedients.

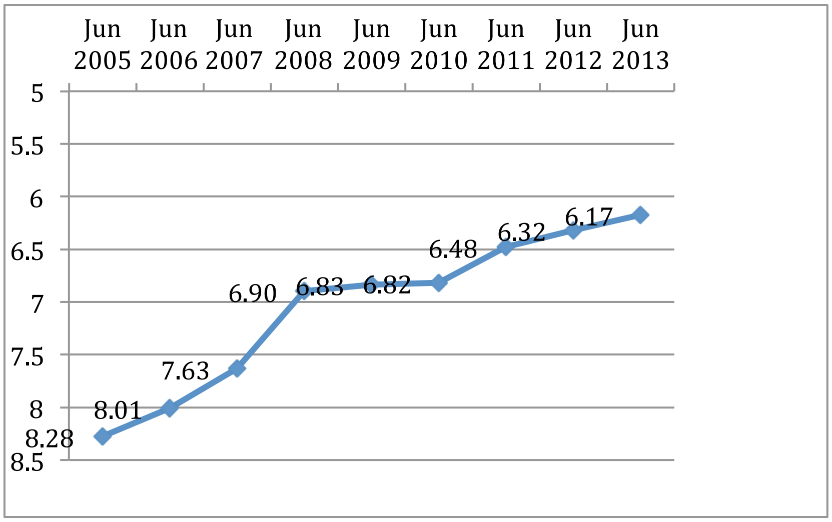
Lastly, key policy elites and political leaders were motivated to launch the 2005 reform despite some potential risks. As mentioned above, these risks include negative influence on China's export sector, exchange rate fluctuation and some other unpredictable potential risks. But key policy elites, particularly Zhou Xiaochuan and his colleagues in the PBC strongly advocated establishing more free-floating and flexible exchange regime. Their efforts in both making the reform plan and persuading the central government to carry out the plan were remarkable particularly in the years before 2005. Therefore, in this period, although there was institutional conflict as mentioned above, the voices of these policy elites advocating exchange regime reform were louder than the opposite and the key exchange rate policy elites were more willing to take the potential risks of reforming China's exchange regime. An important reason for the relative high risk appetite of key policy elites in the exchange reform is the stable international and domestic macro economic situation in this period, which brought a high risk resistance capability to the Chinese economy.

2008 Stagnation

In July 2008, China suspended the managed float exchange rate system and froze the RMB nominal value against the dollar at 6.83, which indicated the 2005 reform had officially stagnated. In the following approximately two years (July 2008 to the first half of 2010) the exchange rate remained at a stable level around 6.83. This period is called here "2008 stagnation". The reason for the exchange rate policy transformation is not that the related *Guojia Liyi*, on which the policy-making is based, has been changed, but the decision-making process had been influenced by some factors mentioned above. In the long or medium term, China's *Guojia Liyi* related to exchange rate policy is still to promote and maintain economic development by establishing and improving the socialist market economic system in China and enabling the market to fully play its role in resource allocation. However, the influences of these factors mentioned above had been substantially changed in the short term.

The lobbying of export sectors against the currency reform and the continuous appreciation of RMB became far stronger in the run-up to 2008 stagnation. The reasons for this increase lie in the following three aspects. First, the compensation policies to the export sector implemented before and around 2005 had faded away. Following the 2005 reform, the Chinese government gradually transferred its focus on curbing trade surplus and upgrading industrial structure by cutting export tax rebates several times and coercing export industries out of low-cost and market-saturated product lines (He, 2011). The withdrawing of these compensatory policies forced the export sector to lobby with more efforts for a favourable exchange rate policy. Second, the macro-economic environment, both international and domestic, was exacerbated, mainly by the eruption of 2008 global financial crisis. Internationally, the 2008 global financial crisis depressed the world economy and, as a result, lowered the demand of the major exporting markets of China, especially the US and EU. Domestically, the tight monetary policy, the greater labour cost along with the new labour contract law and the declines of stock and property markets together reduced the profits of many export companies in few months (Steinberg & Shih, 2012). Third, the RMB value had been substantially appreciated since the 2005 reform, which directly shrank the profit margin of China's export sector. As shown in the Chart 6.1 below, the exchange rate against the US dollar experienced the fastest increase between June 2007 and June 2008.

Chart 6.1 China's Exchange Rates against US Dollar between 2005 and 2013



Source: IMF Data and Statistics

The direct consequence of these three factors is the survival crisis of most exporting companies and, the subsequent lobbying blitz. Taking the textile industry as an example, in the first nine months of 2008 textile exports growth rate decreased by 11.9 percent relative to a similar period in 2007, due to decreasing numbers of purchase orders, declining export rebate rate (from 13% in 2006 to 5% in middle 2007), increasing manufacturing costs and continued shrinking industry profits (Yang, 2009). Confronted with the worsening situation, the China Textile Industry Association (CTIA) set out a series of survey on the real condition of China textile industry, mainly in provinces of Jiangsu, Zhejiang, Guangdong, Hebei, Shandong and Fujian, and concluded that China's textile industry was facing a survival crisis (Suo, 2008). Subsequently, the CTIA summarized the survey results and sent to the MOFCOM for help. According to Steinberg and Shih's (2012) interviews, the growing hostility to exchange rate appreciation of textile industry in 2008 transformed into lobbying efforts, especially on the governments of coastal provinces, which pushed their case with the central government and warned that more favourable exchange rate and rebate policies were required to prevent mass bankruptcies and social unrest.

As the major target of the lobbying of the export sectors, the MOFCOM's attitude against the exchange rate reform initiated in 2005 and the continuous appreciation of RMB became much tougher. Consequently, the institutional conflicts between the PBC and the MOFCOM became sharper in this period. The MOFCOM, which, as mentioned before, has always performed as an objector to fast exchange rate reform and appreciation, was more active in impeding fast RMB appreciation on behalf of the exporters under these circumstances. In July 2008, the MOFCOM made a formal proposal to the State Council, pleading to slow the pace of yuan appreciation in order to give exporters more time to adjust (Chan, 2010). The reason is that the exacerbated situation of export industries resulted in a lobbying blitz for the MOFCOM, which, thereupon, became more steadfast in opposing the fast exchange regime reform against the PBC, representing the interests group of export companies and also on behalf of its own agency interests.

The eruption of the 2008 global financial crisis was an emergent event that made the assessment on the extremities of China's exchange rate policy on domestic and international stakeholders much more opaque and complex. In the period before the initiation of the 2008 global financial crisis, as discussed before, the international and domestic effects of the exchange rate reform was comparatively easy to gauge. Yet during the economic depression, it became hard to discern what negative effects were caused by the crisis or by the exchange rate reform. Therefore, the exchange rate reform was often a scapegoat of the global financial crisis exploded in the Western market. Many negative impacts of the global financial crisis were attributed to the exchange rate reform. For example, appreciation of RMB and the sharp decline of the major Western market demand due to the weak economy in these major countries both resulted in the decrease of Chinese export during the 2008 global financial crisis. For export companies, they usually ascribe all the decline of export to the RMB appreciation or think that seeking to depreciate or slow the appreciation of RMB is the major way to regain the previous trade advantage. Under these conditions, on the one hand, the export sector lobbied the related government agencies for slowing RMB appreciation or/and gaining more other favourable policies sparing no efforts; on the other hand, the Chinese government, facing the complicated domestic and international environment, tended to stall the previous exchange rate reform waiting for a clearer international and domestic economic situation.

Short-time international pressure in this period was not as huge as around the 2005 reform, although China's exchange rate policy has always faced international pressures. The major reasons for the less international attention of China exchange rate policy in this period lie in mainly two respects. First, major Western countries, especially the US and the EU, had troubles maintaining their own economies due to the eruption of the crisis. Second, major international financial governance organizations were hard pressed to fix the problematic international financial governance system and rushed off their feet in rebuilding a new system.

Unlike during the 2005 reform, in 2008 the turbulence of international and domestic economy and the complexity of the effects of continuous exchange rate reform made the key policy elites who advocate exchange reform and RMB appreciation more cautious and risk-averse. In the midst of the financial crisis, the first task of the Chinese government was to maintain economic growth. Therefore, "*Bao Ba*" (ensuring 8 per cent GDP growth) became the mantra among Chinese officials of all ranks in 2009. Against this background, all other issues, including the exchange regime reform, had to give way to this target.

2010 Relaunch

On June 19 2010, the PBC announced that "in view of the recent economic situation and financial market developments at home and abroad, and the balance of payments (BOP) situation in China, the People´s Bank of China has decided to proceed further with reform of the RMB exchange rate regime and to enhance the RMB exchange rate flexibility" (PBC, 2010), which indicates that the nearly two-year (July 2008-Jun 2010) dollar-pegged exchange rate policy came to the end and the currency reform initiated in 2005 was relaunched. The international community praised this move, although it was far from their expectation. For example, right after the PBC's announcement, the former IMF chief Dominique Strauss-Kahn said this move was "a very welcomed development" that "will help increase Chinese household income and provide the incentives necessary to reorient investment toward industries that serve the Chinese consumer" (People's Daily, 2010). Moreover, as mentioned above, since 2010, the fund changed its assessment on China's exchange rate from "substantially undervalued” to “undervalued’ and recently to ‘moderately undervalued”. Although China’s exchange rate policy has still been criticized by major Western countries and international financial governance institutions, the 2010 relaunch of the exchange rate reform revealed China’s stance in reforming its currency policy.

Therefore, generally in this period, China can be treated as a status-quo power in terms of its willingness in reforming its exchange rate policy toward the expectation of international community. However, the 2010 policy change of China is not driven by the external expectation, but the *Guojia Liyi*. As enunciated before, reforming the problematic exchange rate policy, in the long run, conforms to China’s *Guojia Liyi*. The re-peg to the US dollar between 2008 and 2010 is only a temporary policy, while establishing a more flexible RMB exchange rate is China’s fundamental economic policy, as a well-known Chinese economist and former China’s central bank adviser Yu Yongding said (BBC, 2010). The temporary policy is a result of the perturbing influences of several key factors on the decision-making process. The relaunch of the exchange rate reform reveals that, first, from the long-term perspective the policies of China related to global financial governance must be in accordance to its *Guojia Liyi*, and, second, in terms of the 2010 relaunch these perturbing factors failed to bound the decision-making process as they did in 2008 stagnation.

The export sector continued to lobby against the RMB appreciation and called for maintaining exchange rate stability. The CTIA vice president Gao Yong, for instance, complained in April 2010 that “the current average profit rate of the whole textile industry is about 3%-4% and, thus if the RMB appreciates by more than 5%, more than half of the textile companies will die off" (Xu, 2010). However, the lobbying was not influential enough to change the final decision on the exchange rate policy for two reasons. First, since 2008 the Chinese government had made many favourable policies to the export industry. In the ten months from August 2008 to June 2009, the export rebate rate policy was adjusted 7 times and the export rebate rates of textile, some labour-intensive products and some mechanical and electrical products had been increased. These compensation measures mitigated the opposition to and transferred temporarily the focus of the export industry away from the exchange rate reform. Second, the PBC's attitude on continuing the exchange rate reform in this period was much more steadfast, which will be showed in discussing the institutional conflicts between the PBC and the MOFCOM subsequently.

Second, the major defender of export sector, the MOFCOM, lost its battle with the PBC in convincing the central leadership to stop or at least slow the exchange rate reform. In April 2010, under the guidance of the MOFCOM, local Chambers of Commerce launched an RMB exchange rate stress test and consequently concluded that Chinese export companies are highly vulnerable to RMB appreciation, saying for many industries, such as home appliances, autos and cell phones, a 3% appreciation in RMB would drive down their profits by 30% to 50% (Zhang et al., 2010). During the 2010 annual meetings of the National People's Congress and Chinese People's Political Consultative Conference, governor of the PBC Zhou Xiaochuan indicated that the re-pegged exchange rate to US dollar is an unconventional measure in response to the 2008 global financial crisis and will exit sooner or later. Subsequently, the former vice Minister of Commerce

Wei Jianguo pointed out that the current exchange rate policy is a corollary of China's opening-up policy and, therefore, is reasonable. He further explained that the foreign trade situation in 2010 would not be better than expectation and suggested the central government to maintain stable RMB value and increase support for the exporting sectors (Xu & Wu, 2010). The then Minister of Commerce Chen Deming also expressed his concern that China's export industry needs another 2 or 3 years to restore to the pre-crisis level and, therefore, any exchange rate policy change before that must be gradual and controllable (Xu & Wu, 2010).

However, these voices on maintaining stable RMB value and slowing exchange rate reform did not weaken PBC's determination to restore the 2005 reform, mainly because of the domestic and international pressures that the PBC was facing. The international pressures will be dwelled on latter. The domestic pressures of the PBC in this period mainly include economic structure adjustment and inflation. Adjusting economic structure and upgrading industrial structure has been a crucible for China's sustainable development. The eruption of 2008 global financial crisis highlights the importance of accelerating the transforming process from export-oriented to demand-oriented economy and from labour- and resource-intensive to capital- and tech-intensive industrial structure. Restoring the reform of RMB exchange rate formation mechanism is conducive to the transformation. As the former President of World Bank Group Robert Zoellick remarked, "as export-driven China remakes its society to depend more on consumer spending, it could become an opportunity to revalue the currency" (Agence France-Presse, 2010).

Fighting against inflation is another key battle of the PBC. Since November 2009 CPI figures have entered into positive territory and been rising, standing at 3.5% in August 2010 (Feng, 2010). In addition to quantitative instruments, such as bank reserve and restricting bank lending to dampen the increase of domestic liquidity, flexible exchange rate policy is another effective way. Briefly, the PBC held that a more flexible exchange rate policy and the gradual appreciation of RMB would not only protect against short-term inflation, but also be conducive to the long-term sustainable growth. In addition, the PBC held that the negative impact of exchange rate reform has been overestimated by mainly the MOFCOM. For example, Hu Xiaolian, the Deputy Governor of the PBC, said in an interview that 'between 2006 and 2008 [after the 2005 revaluation], China's exports increased by 23.4% annually, while imports increased by 19.7%, representing a golden age of foreign trade development. Looking back, we can say that some have overestimated the negative impact of foreign exchange reform whilst underestimated the adaptive capacities of Chinese enterprises' (Feng, 2010). Finally, the central leadership was more convinced by the PBC and reached a consensus to restore the 2005 reform.

China's exchange rate has been a hot issue in the global financial governance and faced exceptionally high pressures in the post-2008 crisis era, for it was blamed for resulting in the crisis. The basic logic of the criticism is that the manipulated exchange rate has brought significant advantages to China export industries and, therefore, led to the imbalanced trade surplus and the accumulation of huge amount of foreign reserve of China, which partly caused the 2008 global financial crisis (Obstfeld & Rogoff, 2009).

The cause of the financial crisis is completely another topic and will not be explored here. Holding this view, the major Western countries have exerted unparalleled pressure on China's exchange rate policy. For example, in early 2010 five US senators introduced a bill to compel the government to identify "fundamentally misaligned currencies" based on specific criteria, in response to "the longstanding frustration over the Treasury Department's refusal under successive administrations to cite China formally for manipulating its currency" (Chan, 2010). Moreover, in March 2010 130 House members sent a letter to require the Treasury to issue a finding of manipulation and the Commerce Department to impose countervailing duties to protect American manufacturers (Chan, 2010). Although the US government delayed decision on China currency manipulation many times and finally declined to name China as a currency manipulator, this is the first time of making such a provocative declaration since President Obama's administration, which was hesitant to provoke trade dispute during the global economic downturn and preferred to resolve issues through negotiation and engagement in international organizations, such as the Group of 20 (Schneider, 2010).

As the gradual recovery of world economy from and the fade-away of the fear of governments of the 2008 global financial crisis, exchange regime reform, replacing the target of ensuring 8 percent economic growth, has been put forward again by major policy elites whose personal academic or political views advocate reforming China's exchange regime in the long term. In addition, the domestic and international economic situations become easier to observe and assess as the world and China's economy come back to normal track. The effects of the exchange regime reform are consequently easier to gauge under a comparatively stable economic environment. Therefore, key policy elites were encouraged to resume the 2005 reform and take more risks from this reinvigorated reform. Lastly, no analogous emergent event as the 2008 global financial crisis has happened since 2010. The decision-making environment has been comparatively sable.

Conclusion

Examining China's exchange rate policy in the past decade leads to several conclusions. First, external pressure on reforming China's exchange regime, especially from the US and other major IOs, is only one factor among many influencing the formation of China's interests and preferences (*Guojia Liyi*) and the decision-making process on exchange rate policy to a limited extent. Second, *Guojia Liyi* is the fundamental driving force and substratum for making China's exchange rate policy. From a long-term perspective, China's *Guojia Liyi* is to promote and maintain economic development by establishing and improving the socialist market economic system in China and enabling the market to fully play its role in resource allocation. In this sense, China's exchange regime reform initiated in 2005 is a reflection of the *Guojia Liyi*. Third, in the short term, the specific exchange rate policies in different periods were not always in accordance to the *Guojia Liyi*, due to the influences of several factors on the decision-making environment. Table 6.2 summarizes the influence of six key factors on China's exchange rate policy-making in three stages. In the 2005 reform and 2010 relaunch, the weak lobbying and institutional conflicts, the low complexity of domestic and international economic situation, the high risk appetite and external pressures propelling exchange regime reform and no emergent events together formed a comparatively stable decision-making environment, in which the *Guojia Liyi* has been obeyed in making decisions. On the contrary, in 2008 stagnation, the indexes of these factors are in opposite direction, which made a complicated decision-making environment and, therefore, bounded the rationality of decision-makers. As a result, the exchange rate policy in this period (2008-2010) violated the long-term *Guojia Liyi*.

Table 6.2 Influences of Key Factors on the Exchange Policy-making Process

Factors	2005 Reform	2008 Stagnation	2010 Relaunch
Lobbying	Weak	Strong	Weak
Institutional conflicts	Weak	Strong	Weak
Complexity of issues in point	Low	High	Low
Short-time pressures from IOs and Western countries	High	Low	High
Emergent events	No	Yes	No
Risk appetite of decision makers	High	Low	High

The formation of interests and decision-making process both matter in explaining China's foreign and domestic policies, particularly in exchange rate policy. Analogously, the former is the navigator and engine of planes, which guide the direction and provide driving forces, while the latter is the specific air routes to destination, which may be changed by the external factors such as airflow, heavy weather, wars and even emergent situation of passengers. Despite detours, delays or even cancellation temporarily sometimes, planes aim to arrive at their destinations under the guidance of the navigator and the motivation of the powerful engines. China's exchange rate policy in the past decade is the same story. Under the guidance and motivation of China's *Guojia Liyi*, which can be briefly described as to promote and maintain economic development by establishing and improving the socialist market economic system in China and enabling the market to fully play its role in resource allocation, China strives to arrive at its destination along the route to reform its exchange regime, where a more free-float, flexible and complete exchange rate regime based on market supply and demand would be established.

Chapter Seven: Global Financial Regulation Reform and China's Strategies in the Post-crisis Era: The Chinese Version of Basel III

The 2008 global financial crisis, as mentioned in the previous chapter, was largely caused by a three-tier reason: the problematic international monetary system (IMS), the previous flawed international financial governance system and the US domestic policy mistakes and regulation deficiency. Therefore, the post-crisis reform in direct response to this crisis mainly focuses on these three aspects. However, the international monetary system is still flawed by the so-called "dollar recycle" mechanism. The huge macro-imbalance between the US and major emerging countries, especially China, still exists. The "exorbitant privilege" of the US dollar and the unparalleled position of the US economy pushed the implications of the US domestic monetary policies far beyond its national border. The post-crisis excessive expansionary monetary policy, though it has reinvigorated the US economy to some extent, risked triggering global "currency war" and trade protectionism. The US Dodd-Frank Act has brought substantial changes to the US financial regulation, but been questioned mainly for its complexity (Petrou, 2011) and potential negative impacts on the US real economy (HIS, 2012; IIF, 2011b). The international financial governance system has also seen dramatic changes and a new system is emerging, directed by the G20 and the FSB. The new system has constructed a reform framework of global financial regulation, ranging from minimizing systemic risks to strengthening regulation on shadow banking system and CRAs. However, the new system and the international financial reform conducted by it also have some shortcomings, such as the ineffectiveness caused by its informality and the unwillingness of inter-state cooperation, and the vague future of the G20.

Despite the slow and limited progress of the post-crisis global financial regulation reform, China seems to usher in a new period in global governance, particularly global financial governance. China has participated in reforming the IMS and international financial governance system acting as either a reformer or Networked International Financial Governance power. A previous chapter looked into China's stance in the post-crisis IMS reform. This chapter focuses on China's strategy in the post-crisis international financial supervision reform. Unlike the IMS reform, the global financial regulation reform has made certain progress. The first section of chapter overviews this progress by looking into the efforts to solve problems like procyclicality, the too-big-too-fail issue, lack of risk resolution mechanism, capital inadequacy and insufficient regulation on derivatives and credit rating agencies (CRA). To these reforms, China has adopted a more active and cooperative attitude. The second section concentrates on China's policy response to these international reforms. This active attitude and status-quo stance are determined by China's *Guojia Liyi*. The third section, drawing on the two-stage model, analyzes China's attitude toward the post-crisis global financial regulatory reform, taking the Chinese version of Basel III as a case.

Global Financial Regulation Reform in the Post-Crisis Era

The 2008 global financial crisis exposed flaws of the previous global financial governance system. As analyzed in Chapter 2, a new governance system has formed. This new financial governance system has made efforts to strengthen international financial supervision in order to close the loopholes of the global finance that caused the recent crisis. To be specific, these loopholes mainly include but are not limited to the procyclicality of financial sector, the too-big-too-fail issue, lack of risk resolution mechanism, insufficient regulation of derivatives and credit rating agencies, tolerance of off-balance sheet, flawed risk assessment method and capital inadequacy. The following part of this section reviews some of these major loopholes and international efforts to revise them.

Pro-cyclicality

With the advent of the 2008 global financial crisis, procyclicality, as a feature of global financial system, has aroused great attention. The procyclicality of financial sector has several possible sources. One is the information asymmetry between borrowers and lenders. In depression, even borrowers with extremely good credit history may find it hard to obtain funding, while, in good times, borrowers with bad credit history can get loans, such as the subprime mortgage loan. Another source of procyclicality in the financial sector is "the inappropriate response of financial market participants to changes in risk over time" (Gonzales, 2009, p.2).

Mounting attention has been paid to the procyclical problem by international regulators. In April 2008 *Report on Enhancing Market and Institutional Resilience*, the FSF (now the FSB) called for examining the forces that contribute to procyclicality in the financial system and developed options for mitigating it. Specifically, the FSF identified three areas as priorities for policy action, which are the capital regime, bank provisioning practices and the interaction between valuation and leverage. It also formed three working groups to support the formulation of policy recommendations in these areas. Around the three major areas, various international private and public organizations have taken different actions. For example, in 2010 the BCBS formulated a comprehensive set of proposals (Basel III) on the new CAD ratio to revise the procyclical problem. In addition, many countries or regional entities had planned various tools to mitigate procyclicality. In the US, the *Dodd-Frank Act* includes countercyclical capital requirements. In the EU, the De Larosière Report recognized the excessive procyclicality in the Basel framework and proposed to reduce it by several methods. In Spain, banks are required to set aside provisions during boom time according to a formula (Hardouvelis, 2010).

G-SIFIs (too big to fail)

G-SIFIs refer to "financial institutions whose disorderly failure, because of their size, complexity and systemic interconnectedness, would cause significant disruption to the financial system and economic activity" (FSB, 2010, p.1). Lehman Brothers is the last G-SIFI in the US allowed to fail during this financial crisis and other G-SIFIs at risk were rescued by public authorities. "Public bail-outs placed taxpayer funds at unacceptable risks and has increased moral hazard in a very significant way" (FSB, 2011b, p.7). As a consequence, at the Summits in Pittsburgh, Toronto and Seoul, the G20 leaders called on setting out effective arrangements for resolution of G-SIFIs. In response to the call, the Basal Committee proposed its *Consultative Document on Effective Resolution of Systematically Important Financial Institutions*, which "contains a comprehensive package of proposed policy measures to improve the capacity of authorities to resolve systematically important financial institutions (SIFIs) without systemic disruption and without exposing the taxpayer to the risk of loss, and a time line for their implementation" (FSB, 2011b, p.3). The way BCBS proposed to assess the G-SIFIs consists of an indicator-based measurement approach, bucketing approach and supervisory judgment. Specifically, according to this qualitative method, 28 banks will initially be specified as G-SIFIs (BIS, 2011b). For these G-SIFIs, additional absorbency requirement will be charged. In addition to the BCBS's method of assessing G-SIFIs, the FSB also proposed policy recommendations on solving too-big-to-fail problem, which comprise strengthening national resolution regimes, establishing cross-border cooperation arrangements in the form of bilateral or multilateral institution-specific cooperation agreements, improving resolution planning by firms and authorities based on ex ante resolvability assessments, and removing obstacles to resolution arising from fragmented information systems, intra-group transactions, reliance on service providers and the provision of global payment services (FSB, 2011b). Moreover, the FSB and the International Organization of Securities Commissions (IOSCO) proposed assessment methodologies for identifying non-bank non-insurer systematically important financial institutions in early 2014 (FSB, 2014).

In addition to the BCBS's method of assessing G-SIFIs and the FSB's recommendations on mitigating or even solving the too-big-to-fail problem, other ways to assess G-SIFIs have been put forward. The Geneva Association, for example, proposed a two-stage approach to assess G-SIFIs in the insurance industry. In this approach, the first phase identifies potentially systematically risky activities and the relevant markets and the second phase identifies institutions that engage in potentially systematically risky activities to such massive scale that their failure or disruption could fracture the system (The Geneva Association, 2011). Thomson (2009) defines criteria for classifying firms as systemically important: size (the classic doctrine of too big to let fail) and the four C's of systemic importance (contagion, concentration, correlation, and conditions).

Living Will (Recovery and Resolution Plan, RRP)

Another issue related closely to solve the too-big-too-fail problem is resolution mechanism, or recovery and resolution plans (RRPs), or so-called "living wills". In November 2008 the G20 Washington Summit called for strengthening cooperation on crisis prevention, management and resolution, and reviewing resolution regimes and bankruptcy laws. In 2009, the G20 called on the FSF and the BCBS to "explore the feasibility of common standards and principles as guidance for acceptable practices for cross-border resolution schemes thereby helping reduce the negative effects of uncoordinated national responses, including ring fencing" (G20, 2009c, p.5). Upon the call, in March 2010, the Basel Committee Cross-Border Bank Resolution Group (CBRG) published a set of ten recommendations. In November of the same year, the FSB proposed a range of actions, work processes and timelines to promote effective resolution regimes which address the too-big-to-fail issue. In October 2011, upon the G20's call at Seoul Summit, the FSB published the *Key Attributes of Effective Resolution Regimes for Financial Institutions*, which sets out the core elements that are necessary for an effective resolution regime (FSB, 2011c). In June 2012, the G20 Los Cabos Summit reiterated its commitment to "make national resolution regimes consistent with the FSB Key Attributes" (G20, 2012, p.7) and to strengthen the intensity and effectiveness of supervision of SIFIs, and its support on "the ongoing elaboration of recovery and resolution plans and institution-specific cross-border cooperation agreements for all G-SIFIs" (G20, 2012, p.7).

Along with the international efforts, national or regional regulators have also endeavoured to establish RRPs. In the UK, for example, the *Banking Act 2009* created a special resolution regime for banks. The *Financial Services Act 2010* required the Financial Stability Authority (FSA) to establish rules, under which UK-incorporated deposit-takers will develop RRPs or living wills. In the US, the *Orderly Liquidation Authority of Title II* and the swap provisions of Title VII in the Dodd-Frank Act pay focused attention to RRPs. According to these rules, the US covered companies, including bank holding companies and nonbank financial companies designated by the Financial Stability Oversight Council (FSOC), and covered Insured Depository Institutions or SIFIs are required to prepare and submit resolution plans to certain authorities.

Regulation on Credit Rating Agencies (CRAs)

The International Organization of Securities Commissions (IOSCO) is the most active international institution in making regulation for CRAs. Earlier in 2003, the IOSCO published the *Statement of Principles Regarding the Activities of Credit Rating Agencies*. One year later, the IOSCO attempted to establish a code of conduct for the CRA industry by publishing the *Code of Conduct Fundamentals for Credit Rating Agencies* (the Code Fundamental), which stresses the quality and integrity of the rating process, CRA independence and avoidance of conflicts of interest, CRA responsibilities to the investing public and issuers, and disclosure of the code of conduct and communication with market participants (IOSCO, 2004). In 2008 right after the explosion of the crisis, the IOSCO issued a consultation report to analyze CRA's role in structured finance markets and propose recommendations for modifying the *Code Fundamentals* (IOSCO, 2008a). Shortly after, the IOSCO amended the *Code Fundamental* to urge CRAs to adopt, publish and adhere to a code of conduct containing the quality and integrity of the rating process, disclosure of ratings methodologies and historic performance data, and to prevent conflicts of interests (IOSCO, 2008b). Additionally, since 2009, the IOSCO has published several reports on international cooperation in oversight of CRAs and implementation of the *Statement of Principles and the Code Fundamentals*.

The reform framework guided by the G20 and the FSB under the new networked system is not only confined to counter procyclicality, resolve too-big-to-fail, establish and complete "living wills" and regulate CRAs. Many other aspects that were causally related to the recent crisis have also been examined, such as derivatives and over-the-counter transaction, off-balance sheet, risk assessment method, shadow banking system, compensation practice and accounting standards. The June 2012 report of the FSB to the G20 comprehensively summarized the international and national implementation progress of the G20 reform recommendations (FSB, 2012). It reveals that the international financial regulation is undertaking positive changes towards preventing the next crisis.

China's Post-crisis Financial Regulation Reform

Upon this wave of international financial regulation reform in direct response to the 2008 global financial crisis, China has performed actively and cooperatively. China has been a status-quo power, which responds actively to the calls from international financial regulators for reforming domestic financial regulation. In September 2011, the *FSB-G20-Monitoring Progress-China* comprehensively assessed the extent to which China had implemented the G20/FSB recommendations on strengthening financial regulation. According to this report, China had made great progress or had a clear plan in many key aspects of the G20-FSB recommendations, such as improving bank capital and liquidity standards, addressing risks of systematically important financial institutions, extending the regulatory perimeter, improving OTC derivatives markets and so on. Under the guidance of the two cores of the new global financial governance system-the G20 and the FSB, other international financial regulators, like the Basel Committee, the IOSCO and the IAIS, have issued more specific guidelines or recommendations on improving supervision on banking, securities and insurance industry. The section above gives a snapshot of these guidelines and recommendations by looking at several key areas of the international financial regulation reform. More specifically, the following section looks into how China has followed these international guidelines and recommendations on strengthening its domestic financial regulation, taking the four policy areas reviewed above as examples.

Chinese authorities have made substantial progress in implementing global rules on regulating the G-SIFIs. In January 2014, China's bank regulator, the CBRC, issued the

Guidelines for the Disclosure of Global Systematic Importance Assessment Indicators by Commercial Banks. This guideline requires China's G-SIFIs to disclose their off-balance-sheet exposures and other indicators (12 indicators totally) with the purpose to strengthen regulation of the "too-big-to fail" banks (Reuters, 2014a). The systematically important Chinese banks include the two banks identified by the FSB, namely Bank of China and Industrial & Commercial Bank of China, and other banks with on- and off-balance sheet assets worth at least 1.6 trillion yuan ($264 billion). As a result, 13 banks will be defined as systematically important banks and be applicable to the *Guidelines*, including 5 state-owned banks and 8 national joint-equity banks (Qiao & Shi, 2014). Specifically, the 13 banks are required by the CBRC to disclose indicators like the scale of on- and off-balance-sheet assets, claims on and liabilities to other financial institutions, nominal value of outstanding over-the-counter derivatives, assets held for both trading and available for sale and cross-border assets and liabilities on their websites or in their annual financial statements within four months of the end of their accounting year or no later than July 31 each year.

Closely related to solving the "too-big-to-fail" problem is a feasible post-crisis recovery and resolution plan or "living will", in addition to strengthening pre-crisis supervision. In December 2013, the Bank of China (BOC) became the first Chinese bank to officially issue the resolution plan. Shortly after, the China Merchants Bank (CMB) drafted its "living will". Although the direct driving force of the BOC and CMB's resolution plan is the strict regulation of the US market guided by the "Dodd-Frank Act", the living will proposals come at an appropriate time with profound significance for

China's banking industry. The Chinese government has been attempting to decrease the dependence of state-owned banks on the government. A resolution plan gives banks a mechanism to operate during risk time and is conducive to completing market mechanism and decreasing the role of government in the market economy. In addition, it indicates that China is serious about the guidelines and recommendations made by international financial regulators and has been preparing for implementing them gradually. China's bank regulators are thinking about applying a requirement for a living will to more banks. As Yan Qingmin, vice chairman of the CBRC, revealed, a resolution plan will be a prerequisite for any privately owned banks starting up here (Zhou, 2014).

China's regulation on CRAs has closely followed the advice of relevant international regulators, especially the IOSCO, and is even more rigorous than the international regulations. In 2006 before the financial turbulence the PBC enacted the *Credit Rating Guidance* and the *Regulations on Credit Ratings in the Credit Market and the Inter-bank Bond Market*. The Guidance and Regulations are consistent with the IOSCO's basic principles on CRAs practices, internal control, rating procedures, information disclosure and so on. The *Provisional Rules on the Administration of the Credit Rating Business in the Securities Market*, which took effect in September 2007, provides consistent or even more rigorous regulations than the *Code of Conduct Fundamentals for Credit Rating Agencies* issued by the IOSCO (FSB-G20, 2011). After the eruption of the 2008 financial turbulence, CRAs became the target of public criticism and reforming CRAs regulation became urgent. China has actively participated into the reform and the rule-setting process. For example, the CSRC, which has been a member of

IOSCO since 1995, was elected as a member of the new IOSCO Board at the 37^{th} IOSCO Annual Conference held in China in 2012. Although many problems still exist in China CRAs industry, such as underdevelopment, lack of independence and fairness and lagged legal system construction, one fact is that China has been actively pursuing international cooperation and following international regulations.

China's regulation on banking industry is another convincing example of China's compliant and active attitude to the global financial governance. Generally, "regulation and supervision of China's banking system has made impressive progress in the past few years, led by an activist, forward-looking regulator China Banking Regulatory Commission (CBRC), with a clear safety and soundness mandate that has been supported by banks and by the State" (IMF, 2012b, p.4). To be specific, the progress can be observed by looking at China's implementation of the Basel Principles, including Basel I, II, 2.5 and III. According to the assessment of the IMF on the compliance of China with the Basel core principles, China is compliant or largely compliant with nearly all the 25 core principles only with two exceptions (IMF, 2012b, pp.17-22). One is the independence, accountability and transparency. The IMF (2012b, p.17) specified that "budgeting arrangements, external headcount approval requirements and authority (though not used to date) for State Council overrides of CBRC rules and decisions compromise CBRC effectiveness and could affect operational independence". The other is risk management process. Although the CBRC has put in place high-quality internationally-compliant guidance on risk management, banks have not yet fully complied. The report from the BCBS (2012) on the Basel III implementation categorized

China into the highest rank (final rule in force) among the four in implementing Basel II and 2.5, commenting that "new capital regulation that combines Basel II, 2.5 and III was released in June 2012 and will be effective on 1 January 2013. The new capital regulation will be applied to all banking institutions supervised by the CBRC" (BCBS, 2012, p.2). This new capital regulation is called the Chinese version of Basel III.

The Chinese version of Basel III is the localization and extension of the Basel III, which came into terms among the members of the Basel Committee on Banking Supervision in September 2010. In narrow terms, the Chinese version of Basel III refers to the *Capital Rules for Commercial Banks (Provisional)* (hereafter the *Capital Rules*) issued in June 2012. More broadly, it also includes several supporting documents, especially the *Supervisory Guidance on Capital Instruments Innovation for Commercial Banks* and the *Notice of the CBRC on Transition Arrangements for the Implementation of the Capital Rules for Commercial Banks*. Earlier in 2010, the CBRC issued the *Leverage Ratio Rules for Commercial Banks*, the *Consultation Paper on the Capital Rules* and the *Rules on Liquidity Risk Management of Commercial Banks (Provisional)*. The three documents contribute to the formation of Chinese version of Basel III. *The Guiding Opinions of CBRC on the Implementation of the New Regulatory Standards in China's Banking Sector* issued in 2011 was dubbed as the "Chinese version of Basel III" (Yu & Zeng, 2012) before the issue of the *Capital Rules*.

This Chinese version is more rigorous than the original Basel guidelines in several aspects. First, the minimum capital adequacy ratio (CRA) for common equity is increased to 5% from the 4.5% of Basel III. The SIFIs are subject to a 1% additional capital surcharge. As a result, the CARs of SIFI and non-SIFI reach to respectively 11.5% and 10.5%. Second, the minimum leverage ratio, defined as the ratio of core Tier I capital to adjusted total asset, is raised to 4% (3% in Basel III). Third, in light of the current situation of China's banking industry that is focusing on traditional loan transaction, the Chinese version of Basel III incorporates two new indexes - loan loss provision (no less than 2.5%) and provision coverage ratio (no less than 150%) (Ning, 2012, p.53). The following Table 7.1 summarizes the key principles of the Basel III and the Chinese version.

Table 7.1 Comparison of Basel III and Chinese Version of Basel III

Key Principles	Basel III	Chinese Version of Basel III
Capital Requirement	Common equity: 4.5%, Tier I capital: 6%, Tier 2 capital: 8% ; Additional Capital buffers: 2.5% for a mandatory capital conservation buffer, 0-2.5% for a discretionary counter-cyclical buffer; Capital adequacy ratios for all banks: 10.5%.	Common equity: 5%, Tier I capital: 6%, Tier 2 capital: 8%; Additional Capital buffers: 2.5% for a mandatory capital conservation buffer, 0-2.5% for a discretionary counter-cyclical buffer; 1% capital surcharge for SIFIs; The CARs of SIFI and non-SIFI would be at least 11.5% (8% minimum +2.5% extra +1% SIFI) and 10.5%.
Leverage Ratio	Minimum leverage ratio: 3%	Minimum leverage ratio: 4%
Liquidity Requirements	Liquidity coverage ratio and net stable funding ratio: no lower than 100%	Liquidity coverage ratio and net stable funding ratio: no lower than 100%
Loan Loss Supervision	Standardized banks: limited to 1.25% of risk weighed assets; IRB (internal ratings-based) banks: limited to 0.60% of risk weighted assets	Loan loss provision: no less than 2.5%; Provision coverage ratio: no less than 150%

In addition to the rigorous content, the implementation of Chinese version of Basel III is timelier and stricter than major counterpart countries, especially the EU and the US. The Basel III was required to be implemented on January 1st 2013. China complied with the requirement, while the EU and the US both postponed the implementation of Basel III to an undefined date (Wang, 2013a). Not until June and July 2013, the EU and the US respectively issued final Basel III based capital regulation. The strict content and implementation of Chinese version of Basel III imposed huge pressure and burden on China's banking industry, specifically small and medium banks, in capital supplementation. Therefore, on 7th December, the CBRC issued the *Notice of the CBRC on Issues concerning Transitional Arrangements for the Implementation of the Capital Measures*, which sets a 6-year transitional period for the reserve capital (2.5%). To be specific, by the end of 2013, the reserve capital charge is 0.5% with an average annual increase of 0.4% for the next 5 years leading up to the 2018 deadline; by the end of 2013, the capital adequacy ratio for SIFIs should reach to 6.5% (core Tier I), 7.5% (Tier I) and 9.5% (Tier II). Generally, the Chinese version of Basel III closely aligns with the Basel III global standards according to the report from the BCBS (2013). Specifically, 12 out of 14 assessed components were graded "Compliant", while two components were graded "Largely Compliant". The overall framework of China's capital regulation was assessed as "Compliant".

Differing from China's reformist attitudes towards the G8, the current global monetary system and the Bretton-woods financial institutions (IMF and WB), China has performed as a status-quo power in the post-crisis financial regulation reform. China has actively implemented or prepared for the implementation of the principles and/or recommendations from relevant international financial regulators. The above section gives a snapshot of China's post-crisis financial regulation reform. A subsequent question is what are the driving forces of China's disparate strategies or attitudes in the global financial governance? This is also the core research puzzle of this thesis. The theoretical chapter established a two-stage theoretical framework with the intention to explain the inconsistency. The following section applies this framework to China's attitudes toward the post-crisis financial regulation reform, taking the banking regulation, particularly the Basel III, as a case.

Case Study: Interpreting the Chinese Version of Basel III

This chapter focuses on the banking industry, taking the Chinese version of Basel III as an example, for two major reasons. First, banking industry is dominant in China's financial system. During the Lujiazui Forum in 2013, Li-Gang Liu, chief economist for greater China at the Australia and New Zealand Banking Group Limited (ANZ), claimed that the ratio of China's banking asset to GDP has exceeded 250%. This number may not be accurate, but reveals a key problem of China's financial system---unbalanced development centered on banking industry. The reasons and consequences of the unbalanced development have been explored deeply in related literatures, such as Anderson (2006), Geretto and Pauluzzo (2008) and Cai (2006), and, therefore, are not the focus here. One fact is that the unbalanced development or even abnormal growth of China's banking sector attaches extreme importance to the banking regulation. Second, as a crystallization of the international banking regulation in the past decades, Basel III represents the trends of the international banking regulation. China has actively responded to the new trends and even made stricter and timelier Chinese version, which conveys China's active attitude to the post-crisis financial regulation reform guided by relevant international regulators. In this sense, the formation of the Chinese version of Basel III is an ideal case to illustrate the post-crisis financial regulation reform of China.

The Basel accords (I, II, 2.5 and III) in China have been widely studied from various perspectives. The Basel III in direct response to the 2008 global financial crisis has gained particularly more attention in China. The mainstream studies focus on the influence of the Basel III on China's banking regulation (Wang, 2013b; Ba, 2011) and the influence of the Chinese version of Basel III on banking industry (He, 2011), specifically commercial banks (Yu & Zeng, 2012), state-owned banks, listed banks (Cai, 2011) and small and medium banks (Zhang, 2012b). Few studies delved into the policy formation of Chinese version of Basel III. Against this literature gap, the two-stage model proposes a framework to analyze the underlying driving forces and the policy formation process.

Formation of *Guojia Liyi*

The formation of *Guojia Liyi* is mainly determined by material (domestic and international political economic environment) and ideational factors (state ideology and interpretation), through influencing the three constituents of it - personal epistemic interest, interests of the state and national interests. As to the Chinese version of Basel III, the *Guojia Liyi* is to strengthen China's banking regulation by adopting the new international regulation (Basel III), considering China's unique situation and with the purpose of preventing financial crisis and sustaining China's economic growth. Table 7.2

summarizes the *Guojia Liyi* and the two types of factors, while Table 7.3 lists the influence of the three factors on the three constituents as mentioned above. The following section specifies the influence of these factors on the formation of *Guojia Liyi*.

Material Factors

First of all, domestic political and economic situation is the fundamental basis of China's policy on financial reform. The government-led economic pattern and the comparatively closed financial market made China suffer less from the 2008 global financial crisis, compared to other major countries, especially the US and the European countries. During the crisis, the Chinese economy still maintained 9.26% growth by average from 2008 to 2012 according to World Bank's statistics. Whilst the Western gigantic banks, especially the US banks like Lehman Brothers, collapsed in the crisis, Chinese banks have been growing in terms of total assets. At the end of 2012, Industrial and Commercial Bank of China (ICBC), for the first time, topped the list of the biggest banks in the world, displacing other global titans such as Deutsche bank, HSBC, Mitsubishi UFJ Financial and Credit Agricole (Cunningham, 2013). The ICBC's assets reached to $2.8 trillion with an increase of 14% over the previous year. Six other Chinese banks rank in the biggest 50, which makes China the largest national contingent in the list (Cunningham, 2013). Meanwhile, China's banking system faces many problems, such as non-performing loans, the risks of shadow banking and the slackly-supervised derivative market. The two aspects - growing size and importance in the global market and the potential risks - call on a stricter banking regulation.

This basic domestic situation of China's banking industry motivated the birth of the Chinese version of Basel III from three levels. On the personal level, key policy elites come to a consensus to strengthen banking regulation and consequently sustain China's economic growth, but call on establishing the banking regulation system with Chinese characteristics. Earlier in 2009 right after the eruption of the 2008 global financial crisis, the former director of the General Office of the CBRC Lai Xiaomin (2009) stated that strengthening banking supervision is closely related to economic development, social and economic stability and national security. Zhou Xiaochuan expressed in the 2011 Boao Forum for Asia that the financial reform suggestions from the G20 and the Basel III are crucial for the economic development of China and should be taken at an appropriate time (Shen, Zhang & Wu, 2011). The former chairman of the CBRC Liu Mingkang said in an interview that Chinese commercial banks, as the major force of securing the development of China's economy and society, must be stable and safe. Therefore, he said that Chinese banks are required to establish a long-term risk control mechanism with capital management as the core (Ling, 2011). In addition to these politicians, scholars also support strengthening banking regulation. For example, senior researcher of Bank of China Wenbin argued that risk of banking industry is the biggest potential risk in China. He also stressed that the health and stability of China's banking industry determine the development of China's economy (Fang, Liu & Zhang, 2009). Meanwhile, strengthening banking regulation does not mean to copy the international rules indiscriminately, but establishes a banking regulation system with Chinese characteristics, which consider both the commonalities and specialities of China's banking industry (Liu, 2011).

On the state level, the growing importance of China' banking industry in the global economy and the dominance of the banking industry in China's financial system require the Chinese government to pay more attention to its regulation. Meanwhile, the international financial regulation reform provides the Chinese government methods in the specific form of international rules to consolidate domestic supervision. The domestic banking reform in the past two decades provides a prerequisite for adopting these international rules or even stricter regulations. Since the "Southern Tour" of 1992, China's modern banking system has been gradually established through a series of reforms. These reforms established the legal framework under which commercial banks could operate, laid out the termination and transfer of control process for an insolvent bank, determined the registration requirements to become a bank and set out basic principles of operation and accounting standards (Werner & Chung, 2010). These factors together increase the feasibility of the Chinese version of Basel III. The 12th Five-Year Plan (2011-2015) of China explicitly stipulated the objectives of the Chinese government in enhancing financial regulation - "establish cross-border, cross-market financial regulation rules", "strengthen supervision on the systematically important financial institutions (SIFIs)" and " participate in the amendment to international financial standards".

On the national level, the premise of the rejuvenation of Chinese nation is the sustainable development of China. Strengthening banking regulation will secure the sustainability and stability of China's development as many policy elites argued above. Although in the short run China's banking system survived the current financial crisis and seemingly performs perfectly, in the long run these problems in China's banking system mentioned above must be fixed through further reform and stricter regulation. Otherwise, the sustainable development is likely negatively impacted and the process of the rejuvenation of Chinese nation may be interrupted.

Second, the international environment influences the issue of the Chinese version of Basel III. The flaws of the previous banking regulation and the 2008 global financial crisis partly caused by these flaws urged the birth of the Basel III. The international experience during the 2008 crisis makes China's policy elites realize the necessity and urgency of strengthening China's financial regulation, particularly on the banking industry. For example, in a seminar on retrospection of the 2008 financial crisis co-hosted by the China Society for Finance and Banking and the Chinese Academy of Social Sciences (CASS), many key policy elites and scholars expressed this necessity and urgency, including Zhou Xiaochuan, Li Yang (Deputy Director of CASS), Yan Qinming (Vice Chairman of CBRC), Yang Kaisheng (former President of ICBC) and other outstanding experts and scholars (Li & Nie, 2013). In an interview, a Chinese scholar Zhou Chunsheng summarized China's lesson from the 2008 crisis and the subsequent international supervision into four aspects - coordinated financial supervision, appropriate financial innovation, consolidating the warning mechanism of financial risk and completing financial governance structure (NetEase Finance, 2009).

The Chinese government, on the one hand, learned from the international experience and realized the importance of strengthening China' banking regulation, and, on the other hand, has faced the pressures from international regulators for implementing the Basel III. During the 1997 Asian financial crisis, the Chinese government realized the catastrophic influence of financial risks and launched a series of financial reforms after the crisis, including reinforcing prudential supervision system, reforming the property rights system of state-owned commercial banks, cultivating financial market and accelerating the financial law system construction (Wu, 2007). These reforms are partly the reason for the outstanding performance of China in the 2008 financial crisis. Since the 1997 Asian crisis, the Chinese government has become more sophisticated in regulating financial sector drawing lessons from regional and international crises. Meantime, international regulators, such as the BCBS, have exerted pressure on countries to obey with international rules. The Basel III is a good example. After it came into being, the BCBS has closely urged and monitored its implementation in member countries and assessed the consistency with the Basel framework. The Committee's Regulatory Consistency Assessment Programme (RCAP) is established specially for promoting adoption of its standards and monitoring its members' full and consistent compliance with the Basel framework. However, strengthening financial regulation is mainly domestically motivated as analyzed above.

From the perspective of national interest, the international environment has provided China an opportunity to participate into the global financial governance and consequently a chance to enhance Chinese nation's international position. The Chinese version of Basel III reveals the CBRC's desire to promote a healthy banking sector and to gain China a greater say at international financial forums for it is more stringent than the Basel III and its implementation is timelier (Sekine, 2011). The rejuvenation of Chinese nation is not only based on the economic development, but also on the recognition of the international community. The Chinese version of Basel III, which was found to be highly aligned with the Basel III global standard (BCBS, 2013), expresses the strong commitment of the Chinese authorities to implement the global regulatory reforms.

Ideational Factors

State ideology provides a thinking pattern for epistemic leaders and governments during a certain period of time. In the short or medium term, state ideology is relatively stable and invariable. Therefore, policies or decision during this period of time are all guided or at least largely influenced by this ideological system. As enunciated in the previous chapters, the contemporary Chinese state ideology has four major specific contents - Socialism with Chinese characteristics, nationalism, scientific outlook on development and state identity as a developing country. The formation of *Guojia Liyi* in implementing the Chinese version of Basel III is certainly influenced by the four aspects. The initiation of the modern Chinese state ideology is the theory of Socialism with Chinese characteristics, which was put forward in the 12th National Congress of the CPC by Deng Xiaoping in 1982. This theoretical breakthrough formed a new idea in the minds of Chinese political leaders and scholars that market economy is not equal to capitalism and can be also cultivated in the socialist China. This new idea has guided the policies of the Chinese government and brought China economic and social development in the past three decades. Adopting international rules like Basel III was impossible in the Socialist China under Mao's administration, because these rules were treated as an evil of capitalism. The Socialism with Chinese characteristics is a premise for China to participate into the world economic system and, more specifically, for the establishment of China's modern financial regulatory system.

The self-identity as a developing country prioritizes development rather than social ideological debate and requires China to integrate into the existing world economic system. In the 13th National Congress of the CPC in 1986, the Chinese government proposed that China is and will be for a long time in the primary stage of socialism. The judgment has given the Chinese government flexibility in making economic policies. China's self-identity as a developing country is closely based on this judgment. As a developing country, the priority of China is development, rather than disputes on social ideologies. This development ideology was further developed to be the Scientific Outlook on Development in the 16th National Congress of CPC. In the highly globalized world, development can only be achieved by integrating into the world and learning from international failures and success. Therefore, China acceded into the WTO in 2001 and has been actively adopting international rules. The Chinese version of Basal III was born against this background.

The rejuvenation of the Chinese nation has become a long-term and grand objective of the Chinese government and nation after being put forward officially in the 15th National Congress of the CPC. The specific content of the rejuvenation of the Chinese nation mainly includes economic prosperity and enhancement of international status of Chinese people and nation. The former is a necessary but not sufficient condition of the latter. For realizing the rejuvenation of Chinese nation, China must also convince the international community that it is a responsible country. Adopting international rules with an intention to consolidate the global governance reveals China's resolution to be a responsible country. However, the precondition is that these rules will not hurt or obviously hinder the economic development of China. The Chinese version of Basel III was made partly with the momentum to establish an image of a responsible China. Meanwhile, as mentioned above, the Chinese policy elites and scholars widely agreed that the benefits of the Basel III through strengthening banking regulation are much more than the potential disadvantages to economic development. In this sense, the Chinese version of Basel III is, to a certain extent, motivated by rejuvenating the Chinese nation.

In China's policy-making mechanism, interpretation of policy elites and the Chinese government decisively influences the formation of *Guojia Liyi* and consequently determines China's domestic and international policies. As the Table 7.5 indicates, the personal views of these policy elites in policy output agencies (or decision-making agencies) and policy input agencies usually determine or significantly influence the perspectives of their agencies. The major reason is the deficiency of a democratic decision-making mechanism in either each agency or the government overall. Through these agencies, the policy elites' interpretation will be largely transformed into the interpretation of the government and finally the attitude or strategy of the country in the international politics. The government, as an entity, of course, has its ideology, which is formed in the medium or long term. The ideology restricts the interpretation of policy elites and national policies. In the long run, the interpretation and the state ideology are confined by a long-term national objective or national interest.

In the specific case of the Chinese version of Basel III, China's policy elites come to consensus that strengthening banking regulation is conducive to China's sustainable development as analyzed above. This interpretation is influenced by the domestic and international environment and the state ideology. The 2008 global financial crisis makes China's policy elites realize the necessity and urgency of strengthening China's financial regulation, particularly on banking industry. Strengthening banking regulation and consequently sustaining China economic growth become a consensus among key policy elites. However, the banking industry with Chinese characteristics makes China's policy elites hesitate to totally and uncritically accept international rules but actively localize them. This explains why the Chinese government has not completely accepted the Basel III, but made a Chinese version. In addition, Socialism with Chinese Characteristics formed a new idea in the minds of Chinese political leaders and scholars that the market economy is not equal to capitalism and can be also cultivated in socialist China. This new idea is a premise for the establishment of China's modern financial system and, more specifically, the precondition for the discussion of the Chinese version of Basel III.

The Chinese government interprets the Chinese version of Basel III as a chance to enhance its international status and an opportunity to sustain domestic development by completing and consolidating the financial regulatory system. This interpretation is also impacted by the domestic and international environment and the state ideology. Internationally, the 2008 global financial crisis and the shortcomings of the international financial regulation are a caution for the Chinese government and its fast-growing economy to strengthening its domestic financial regulatory system. The integration of the international financial regulation has imposed pressures on the Chinese government to obey international rules. Domestically, the dominance of banking industry in China's financial market requires the Chinese government to pay more attention to its regulation. Meanwhile, the banking industry reform in the past decade provides a prerequisite for stricter banking regulation. In addition, the self-identity as a developing country and the judgment that China is and will be for a long time in the primary stage of socialism has prompted the Chinese government to integrate with the global economy and, more specifically, accept international rules like Basel III.

Table 7.2 summarizes China's *Guojia Liyi* in implementing the Chinese version of Basel III and the three major influencing factors. Table 7.3 demonstrates how the three factors determine the formation of *Guojia Liyi* by influencing the three dimensions of it.

Table 7.2 *Guojia Liyi* and the Influencing Factors in Chinese Version of Basel III

Guojia Liyi of China and Objectives	Influencing Factors			
	Material		Ideational	
	Domestic	International	State Ideology	Interpretation
Strengthening China's banking regulation by adopting the new international regulation (Basel III), considering China's unique situation and with the purpose of preventing financial crisis and sustaining China's economic growth.	The current situation of the domestic banking industry; Domestic economic situation.	Flaws of the international banking regulation, particularly the problems of the Basel II; 2008 global financial crisis; International integration or Globalization.	Socialism with Chinese characteristics; Scientific Outlook on Development; Nationalism; Development identity.	China's policy elites come into consensus that strengthening banking regulation is conducive to China's sustainable development and consequently the rejuvenation of the Chinese nation. An active stance of the Chinese government is necessary for pursuing higher international status.

Table 7.3 Formation Matrix of China' s *Guojia Liyi in Financial Regulation Reform*				
		Personal Epistemic Interests	Interests of the state	National Interests
Material	International	The 2008 global financial crisis makes China's policy elites realize the necessity and urgency of strengthening China's financial regulation, particularly on banking industry.	The 2008 global financial crisis and the shortcomings of the international financial regulation are a caution for the Chinese government and the fast-growing economy; The integration of the international financial regulation has imposed pressures on the Chinese government to obey international rules.	The 2008 global financial crisis and the international financial regulation reform provide China opportunity to participate into the global financial governance and, therefore, enhance Chinese nation's international influence.
	Domestic	Strengthening banking regulation and consequently sustaining China economic growth are a consensus among key policy elites; The banking industry with Chinese characteristics makes China's policy elites hesitate to totally and uncritically accept international rules and actively localize them.	The dominance of banking industry in China's financial market requires the Chinese government to pay more attention on its regulation; The banking industry reform in the past decade is a prerequisite for stricter regulation.	Strengthening banking regulation is important for maintaining China's development and, therefore, for rejuvenating Chinese nation
Ideational	State Ideology	The put-forward of the Socialism with Chinese Characteristics formed a new idea in the minds of Chinese political leaders and scholars that market economy is not equal to capitalism and can be also cultivated in the socialist China.	The self-identity as a developing country and the judgment that China is and will be for a long time in the primary stage of socialism has urged the Chinese government to integrate with the global economy and, more specifically, accept international rules like Basel III.	The Chinese version of Basel III is, to a certain extent, motivated by rejuvenating the Chinese nation
	Interpretation	China's policy elites come into consensus that strengthening banking regulation is conducive to China's sustainable development, but China's unique situation needs also to be taken into consideration.	Adopting the Basel III is conducive to China's economy and the enhancement of the international status of the Chinese government.	The Chinese version of Basel III doesn't violate, but contributes to the long-term objective of rejuvenating the China nation.

Policy-Making Process

The policy-making process of China has long been opaque due to the unique and less transparent political system. As a result, academia usually intentionally or unintentionally steers clear of the specific policy-making process and focuses on the background, content and influence of certain policies. In terms of the Chinese version of Basel III, as reviewed above, most studies are about the content and influence, while few looked into the specific policy-making. Part of the reason is that the information is inaccessible, while another part of the reason is that *Guojia Liyi* and the specific policy-making process are usually equalized because of the weak society and the strong state. In other words, the policy-making process is often treated as a consequent and inevitable step of *Guojia Liyi*, because the strong state is argued to be powerful enough to make and implement policies based on the *Guojia Liyi*. The two-stage model attempts to separate *Guojia Liyi* and policy-making process with an intention to emphasize the equivalent significance of the two.

Many agencies and policy elites are directly or indirectly involved in the policy-making of the Chinese version of Basel III. These participators can be categorized into two groups---policy input and policy output groups. The former aims to provide the latter policy options, while the latter has the supreme power to make final decision among these policy options. To be specific, the policy input related to China's banking regulation mainly refers to the PBC, the CBRC, and the MOF. In addition, China Banking Association (CBA) and the banking industry consisting of various banks also influence the policy input via exerting influences on the major policy input agencies and policy elites. In different policy areas, policy input agencies and the relevant policy elites may differ. The policy out or the final decision-making authority, however, is always the same. The PSC is the most powerful decision-making body in China. The 17th PSC, which made the Chinese version of Basel III, comprises 9 members. Each member has a portfolio covering a major policy area and holds key posts in various state organs, as summarized in the Table 7.4 below. In terms of economic-policy making in general and banking regulation in particular, Wen Jiabao and Li Keqiang have high leverage. On the one hand, they hold portfolio in finance and economy among the PSC members. On the other hand, they also administrate the State Council and the CFELG, which are another two key policy outs of China economic policy. Table 7.5 illustrates the policy input and output agencies and the related policy elites in making the Chinese version of Basel III.

Table 7.4 The 17th Politburo Standing Committee's Division of Policy Work (2007)

Members	Other Posts Held	Policy Sector	Leading Small Group
Hu Jintao	CPC general secretary, PRC president, CMC chairman	Foreign relations, military affairs	Foreign Affairs; Taiwan Affairs
Wu Bangguo	Chairman, National People's Congress	Legislative affairs	
Wen Jiabao	Premier, State Council	Government administration	Director, Finance & Economy
Jia Qinglin	Chairman, Chinese People's Political Consultative Conference	United front affairs	
Li Changchun		Ideology & propaganda affairs	
Xi Jinping	Executive secretary, CC Secretariat; president, Central Party School; PRC vice president	Party apparatus; Hong Kong & Macao affairs	Party-building; Hong Kong & Macao Affairs
Li Keqiang	Executive vice premier, State Council	Finance & economy	Deputy director, Finance & Economy
He Guoqiang	Chairman, Central Discipline Inspection Commission	Party discipline	
Zhou Yongkang		Internal security	Politics & Law Committee

Source: Miller (2011)

Table 7.5 Banking Regulation Policy-making Mechanism and Policy Elites between 2007 and 2013

	Institutions	Authorities	Key Elite(s) in Financial Regulation Policy
Policy Output	PSC	The most powerful decision-making body in China	**Hu Jintao** (President) **Wen Jiabao** (Premier, State Council; Director of CFELG) **Li Keqiang** (Executive vice premier, State Council; Deputy director of CFELG)
	State Council	The highest executive organ of State power, highest organ of state administration.	**Wen Jiabao** **Li Keqiang**
	CFELG	Sets agenda for PSC votes and hosts debates on economic issues; Makes final decisions on minor economic issues; Makes decisions on the distribution of fiscal and monetary subsidies.	**Wen Jiabao; Li Keqiang; Wang Qishan** （Vice Premier, in charge of economic, energy and financial affairs); **Xie Xiuren** (Minister, Ministry of Finance)**; Zhou Xiaochuan (**Governor, PBC)**; Guo Shuqing** (Chairman, CSRC between Oct. 2011 and March 2013)**; Shan Fulin** (Chairman, CBRC)**; Xiang Junbo** (Chairman, CIRC)
Major Policy Input	PBC	Formulate monetary policy and regulate financial institutions	**Zhou Xiaochuan** (Governor) **Yi Gang** (Deputy Governor, Administrator of the State Administration of Foreign Exchange (SAFE)
	CBRC	Conduct consolidated supervision to assess, monitor and mitigate the overall risks of each banking institution as a legal entity; Stay focused on risk-based supervision and improvement of supervisory process and methods; Urge banks to put in place and maintain a system of internal controls; Enhance supervisory transparency in line with international standards and practices.	**Liu Minkang** (Former Chairman, 2003- 2011) **Shang Fulin** (Incumbent Chairman)
	MOF	Administer macroeconomic policies and the national annual budget and handles fiscal policy, economic regulations and government expenditure.	**Xie Xuren** (Former Financial Minister) (August 2007---March 2013) **Lou Jiwei** (Incumbent Financial Minister)

	SAFE	Draft rules and regulations governing foreign exchange market activities, and manage the state foreign exchange reserves.	**Yi Gang** (Administrator)
Minor Policy Input	CBA	A non-profit self-regulatory organization of China's banking industry.	**Hu Huaibang** (President)
	Banking Industry	Big five state-owned commercial banks; Three policy banks; Joint-equity commercial banks; City commercial banks; Trust and investment corporations; Foreign banks.	**Jiang Jianqing** (President, Industrial and Commercial Bank of China); **Xiao Gang** (President, Bank of China, 2003-2013); **Zhang Yun** (President, Agricultural Bank of China); **Zhang Jianguo** (President, China Construction Bank); **Peng Chun** (President, Bank of Communication)

According to the two-stage model, *Guojia Liyi* usually guides state policy and strategy in the long run and in most cases. In some cases, however, the decision-making process may violate the *Guojia Liyi* due to the impacts of six factors - lobbying of interests group, institutional conflict, complexity of issues, short-time pressure, emergent events and risk appetite of decision makers. During the decision-making process of Chinese version of Basel III, these factors mentioned above did not exerted resistance force or enough resistance force, which ensured that the policy related to implementing the Basel III reflects China's *Guojia Liyi*. The following section analyzes the six factors specifically.

The lobbying of Chinese banking industry against the stricter Chinese version of Basel III is comparative weak. Since the issue of the Basel III by the Basel Committee in December 2010 and the subsequent announcement of the *Guiding Opinions on the Implementation of New Regulatory Standards in China's Banking Industry* by the CBRC in April 2011, the Chinese banking industry has lobbied for alleviating the burden brought by the new capital regulation. For example, Tang Shuangning, Chairman of the China Everbright Group, proposed postponing the implementation of the new capital regulation during the two sessions of 2012 (Dong, 2012). Chief economist at the Agricultural Bank of China Xiang Songzuo publicly criticized the radical implementation of Basel III in China (NetEase Finance, 2012). Facing this criticism and discontent, the Chinese government postponed the implementation of Basel III by one year to January 1st 2013. As Rabinovitch (2012) commented, "Chinese regulators had initially said they would push for an extremely rapid implementation of the new capital standards, but they have instead opted for a more gradual approach amid concerns about how weak banks would be able to raise the necessary equity". Despite the one-year postponement, the stringent Chinese version of Basel III finally came into force on January 1st 2013.

Although Chinese banks have still felt pressure from the new capital regulation, the lobbying against it from them is relatively weak because of the following reasons. First and more generally, the "paternalistic regulation" in China's banking sector restricts the freedom and responsibilities of the banking industry (He, 2013), leaving little space and momentum for banks to lobby. On the one hand, the strong government and its strong intervention into China's banking industry make the possibility of policy change due to the lobbying of industry less. On the other hand, the paternalistic way in which the CBRC has taken a stake in the commercial well-being of individual banks discourages banks to lobby for their own benefits, because they know the "parents" will take good care of everything. Second, in the short run, the pressures of Chinese banks brought by the Chinese version of Basel III are not unacceptable. As to capital adequacy, under the market-oriented reforms and the prudent capital regulation adopted by China's banking regulators, China's banks mostly have high capital adequacy ratios, which is almost close to the requirement of the Basel III. In respect to quality of capital, the capital structure of China's banks is relatively simple, with retained earnings and common stock constituting the majority of the tier one capital. With respect to business model, China's banks mainly focus on the traditional deposit and lending, rarely involving derivative financial instruments (Liu, He & Ge, 2011). For these two reasons, the lobbying of the banking industry for releasing the stringent Chinese version of Basel III is feeble.

These are not obvious conflicts among major policy agencies on strengthening China's banking regulation, especially between the PBC and the CBRC. Instead, the key agencies came to terms in implementing Basel III. In the recent years, it has been argued that the conflict of interest between the PBC and the CBRC has been escalating due to their different institutional functions and policy objectives. Between January 2010 and June 2011, for example, the PBC tightened liquidity by continuously raising reserve requirement ratio 12 times. Meanwhile, the CBRC issued the *Notice on Supporting Commercial Banks in further Improving Financial Services for Small-sized Enterprises* to increase the accessibility of small-sized enterprises to capital. The two measures are contradictory. The soaring reserve requirement ratio largely weakened the policy effects of the Notice issued by the CBRC (Europe Finance Net, 2011).

Another issue in point between the PBC and the CBRC is about the regulation on China's shadow banking system. The former calls for strengthening regulation while the latter concerns profits of China's major banks will be impacted. The "turf war" between the PBC and the CBRC is criticized for hampering China's financial system reform and imperiling market confidence (Anderlini, 2014). Although, very rarely, the two institutions jointly indicated on their official websites that they have been cooperating to promote the stability and reform of China's financial system and condemned the criticism as unfounded, the strained relation between the two institutions seems self-evident. As far as the Chinese version of Basel III concerned, however, the two institutions came into consensus. The PBC functionally focuses on the overall financial stability in China and has long asked for reforming and strengthening China's financial system. In contrast, the CBRC is tasked to supervise the banking industry and, sometimes, acted as a representative of banks to defend their interests against the relatively aggressive financial innovation and reform of the PBC. The 2008 financial crisis, as mentioned before, has exposed the major problems in global and China's financial system and highlighted the importance of strengthening banking regulation. Therefore, the CBRC has actively propelled the issue and implementation of the Chinese version of Basel III.

The complexity of banking regulation is decreasing. Since the birth of Basel I in 1988, international regulators have improved the international rules on banking regulation in the past more than two decades. The recurrent international and/or regional financial crises, particularly the 1997 Asian financial crisis and the 2008 global financial crisis, aroused rethinking and adjustment on these rules. The flaws and shortcomings of the previous regulation became obvious during these crises. For example, after the 2008 global financial crisis, as reviewed at the outset of this chapter, the major problems such as pro-cyclicality, too-big-to-fail and relaxed regulation on CRAs were exposed and have been correspondently solved or are being solved by improving the existing international and domestic regulations. The objective of post-crisis banking regulation reform is certain and determined, rather than vague and contentious like the international monetary system reform and the exchange rate policy reform. With a certain and determined objective of strengthening banking regulation, policy elites in both policy input and output agencies are more able to come into consensus during the specific policy-making process and stick to the *Guojia Liyi* related to banking regulation.

Short-time pressures from IOs and/or major countries may deflect the decision-making process away from the *Guojia Liyi*, particularly when the *Guojia Liyi* conflicts with the vested interests of the IOs and/or major countries. As to the Chinese version of Basel III, related international regulators have urged China to adopt the Basel III. The Chinese version of Basel III is assessed by these regulators as a qualified substitute of the original Basel III. In this sense, the Chinese version of Basel III reflects rather than violates the interests of these international regulators and thus has been encouraged by them. Major countries even lag behind China in Basel III implementation and face pressure from China. As mentioned before, the Basel III is required by the BCBS to be implemented in the member country on January 1st 2013. However, the EU and the US did not implement Basel III until June and July 2013 (Wang, 2013a). Therefore, unlike other issues like exchange rate policy or environmental protection, China has faced less external pressures and is more flexible to make and implement policy based on domestic situation.

Emergent events always require immediate response in short time and unconventional measures to deal with. These expedient responses and unconventional measures are usually in discord with the long-term *Guojia Liyi*, as analyzed in the previous chapters. After the 2008 global financial crisis, there has not been any emergent event that may change the process of Basel III implementation.

The risk appetite of key decision makers is closely related to the 2008 global financial crisis. As analyzed before, the catastrophic consequence of the financial crisis and the increasing interconnection of the global finance have made key policy elites, both politicians and experts, agree upon the necessity of strengthening domestic banking regulation. Chinese epistemic leaders, mainly including political leaders, government decision-makers and other epistemic community elites, still have a lingering fear of this disastrous crisis and, consequently, are more willing to take the potential risks to implement the Chinese version of Basel III. Table 7.6 clearly shows the influence of the six factors on the decision-making process. Overall, these factors created a *Guojia Liyi*-friendly decision-making environment. Consequently, the short-term policy is in compliance with the medium- or long-term *Guojia Liyi*.

Table 7.6 Factors Influencing the Decision-making Process of Chinese Version of Basel III

Factors	Influence
Lobby of Interests Group	The lobby of Chinese banking industry against the stricter Chinese version of Basel III is comparative week.
Institutional agreement or conflicts	These are not obvious conflicts among major policy agencies on strengthening China's banking regulation, especially between the PBC and the CBRC. Instead, the key agencies come into terms on implementing Basel III based on China's situation.
Complexity of issues in point	Since the birth of Basel I in 1988, BCBS has improved the international rules on banking regulation in the past more than two decades. The 2008 financial crisis aroused rethinking on these rules. The flaws and shortcomings of the previous regulation became obvious during the crisis. The objective of post-crisis reform is certain and determined. In this sense, the complexity of banking regulation is decreasing.
Short-time pressures from IOs and countries	International financial regulators exerted limited pressures on China to implement Basel III. Major countries even lag behind China in Basel III implementation and face pressure from China.
Emergent events	After the 2008 global financial crisis, there has not been any emergent event that may change the process of Basel III implementation.
Risk appetite of decision makers	Facing the catastrophic consequence of the financial crisis and the increasing interconnection of the global finance, key policy elites, both politicians and experts, agreed upon the necessity of strengthening domestic banking regulation and were more willing to take the potential risks brought by banking regulation reform.

Conclusion

The global financial regulation has undertaken substantial reforms in the post-2008 crisis era. China has actively participated in this wave of reforms by adopting the relevant international rules. The two-stage model proposes a framework to comprehend China's strategy in global financial governance in general and the post-crisis financial regulation reform in particular. This chapter, taking the banking regulation as an example, applies this model to the Chinese version of Basel III and aims to explain the formation of China's banking regulation policy. In the medium or long term, China's policy on banking regulation is driven by *Guojia Liyi*, which is to strengthen China's banking regulation with the purpose of preventing financial crisis and sustaining China's economic growth. In the specific case of the Basel III, China's *Guojia Liyi* is to strengthen China's banking regulation by adopting the new international regulation (Basel III), considering China's unique situation and with the purpose of preventing financial crisis and sustaining China's economic growth. The formation of this *Guojia Liyi* is mainly determined by material and ideational factors, specifically domestic and international political economic environment, state ideology and interpretation, through influencing the three constituents of *Guojia Liyi* ---personal epistemic interests, interests of the state and national interests, as illustrated in the Table 2.1 and 3.1. However, in the short-term decision-making process, the *Guojia Liyi* may be obeyed or violated, depending on the decision-making environment that can be specified as six factors as showed in the Table 3.4. As to the Chinese version of Basel III, these six factors did not exert enough resistance force on the stringent banking regulation. Consequently, the Chinese version of Basel III reflects China's *Guojia Liyi*.

Chapter Eight: Conclusion

This thesis examines China's strategy in global financial governance and explains China's disparate attitudes toward various global financial governance institutions and/or events by proposing a two-stage theoretical framework. China's position in global financial governance system has been substantially enhanced, particularly after the 2008 global financial crisis. Yet, the enhanced status does not ensure China is a complete supporter of the current order of global financial governance. Instead, China's policy varies. This thesis explains the variation by generalizing a theoretical framework. It puts forward a two-stage model, which is comprised of *Guojia Liyi* (Stage I) and decision-making process (Stage II). Chapter 3 elaborated the two stages and how they together determine China's policies in global financial governance.

Hypotheses

Main Hypothesis One: *Guojia Liyi* of China in various institutions or events of global financial governance may be different, because of the different structuring material and ideational factors and the consequent different leverages of the three constituents of *Guojia Liyi*.

Sub-Hypothesis one: *Guojia Liyi*, which is comprised of personal epistemic interests, interests of the state and national interests, is the driving force of China's policy in the global financial governance system.

Sub-Hypothesis two: Both material and ideational factors have significant influences on the formation of *Guojia Liyi*. To be specific, domestic and international political economic environment, state ideology and interpretation are three major structuring factors that determine the formation of *Guojia Liyi* through influencing some or all of its three constituents.

Sub-Hypothesis three: The three constituents have different weights in *Guojia Liyi* under different situations.

Main Hypothesis Two: given the ascertained *Guojia Liyi*, under some specific situations, the decisions are not always rational and in accordance to these interests and preferences due to the influence of many factors, such as lobbying, institutional conflicts and others.

Verification of the Hypotheses

The four case studies verify these hypotheses and consequently lead to two major conclusions with several supporting ones. One major conclusion is that *Guojia Liyi* is the driving force of China's policy in the global financial governance system and China's specific *Guojia Liyi* in various institutions or events of global financial governance is different. The four cases studies all examined China's *Guojia Liyi* in different fields or institutions of global financial governance. Chapter Four and Five exclusively focus on formation of *Guojia Liyi*, while only Chapter Six and Seven looked into the decision-making process. This arrangement of case studies reveals the crucial and indispensible role of *Guojia Liyi* in explaining China's foreign policy in global financial governance. In other words, *Guojia Liyi* is always the inner driving force of state policy and behaviour in the long term, while the short-term decision-making environment is only an intervening factor influencing specific decision-making process. To be specific, China's indifferent attitude toward the G8, active cooperation with the G20 and in the post-crisis global financial regulation reform, and critical views on the IMS and changing exchange reform policies are driven by China's *Guojia Liyi*.

The following Table 8.1 summarizes the *Guojia Liyi* of China in the four cases. Although the specific *Guojia Liyi* are different in various cases, some common points exist. The major grand *Guojia Liyi* of China is economic development, political stability and world recognition. All the specific *Guojia Liyi* is a derivative of the grand one. In other words, China's attitudes and policy objectives in the four cases take some or all the three grand *Guojia Liyi* into consideration.

Table 8.1 China's *Guojia Liyi* in Four Cases

Cases		China's *Guojia Liyi*	China's Attitudes
G8 & G20	G8	Maintaining China's economic development and enhancing China's international status without violating China's ideology	Indifferent
	G20	Securing the vested economic benefits and to gain more ones; Maintaining political stability and development through participating global governance and accelerating domestic reform; To be recognized by international community and rejuvenating Chinese nation.	Cooperative
IMS Reform		Reforming the US dollar-dominated IMS and enhancing RMB's international presence--- elevating RMB to be a settlement currency, an investment currency and, finally and gradually, a global reserve currency.	Critical
Exchange Reform		Promote and maintain economic development by establishing and improving the socialist market economic system while enabling the market to fully play its role in resource allocation; Seeking to establish and improve a managed floating exchange rate regime based on market supply and demand as well as to keep the exchange rate of the currency yuan basically stable at an appropriate and balanced level.	Changing
Global Financial Regulation Reform		Strengthening China's banking regulation by adopting the new international regulation (Basel III), considering China's unique situation and with the purpose of preventing financial crisis and sustaining China's economic growth.	Cooperative

This major conclusion is associated with several sub-conclusions. First, *Guojia Liyi* is comprised of personal epistemic interests, interests of the state and national interests. The concept of *Guojia Liyi* is different from the "interests" of mainstream Western IR theories and the "national interests" of Chinese studies. *Guojia Liyi* is a combination and permutation of personal epistemic interests, interests of the state and national interests. Throughout the four cases, personal epistemic interests are mainly academic recognition and political opinions, rather than individual self-interests[19]; interests of the states are mainly economic and political interests of the government solely ruled by the CPC; national interests are the interests of Chinese nation.

Second, the three constituents have different weights in *Guojia Liyi*. In all four cases, national interests in the specific form of rejuvenating of Chinese nation are an important component of *Guojia Liyi* in the long run. However, in the short or medium term personal epistemic interests and interests of the state also have high or even higher leverage. This is a major difference between the two-stage theoretical model and the Western and Chinese IR theories. "Interest" in Western IR theories is an abstract and system-level concept, which could be power, relative gains, capital accumulation or social construction. "National interest" in Chinese studies is simplified as "common material and spiritual needs of all the people of a nation state". The two system-level concepts tend to lose details and leverage in analyzing specific cases for ignoring interests on personal and state level. Personal epistemic interests and interests of the state also play a crucial

[19] This may be partly because of the unique property of foreign policy compared to domestic policy. Foreign policy focuses on inter-state relations, while domestic policy intra-state ones. Inter-state relations are less concerned with individual material interests than the intra-state ones. Another reason may be that policy elites or political leaders can usually pursue individual academic and political interests publically, but can only seek individual material interests cautiously and even stealthily.

role in making national policy and driving national behaviours. As to personal epistemic interests, the gradual completion of People's Congress system and the establishment of the collective decision-making principle have improved China's decision-making mechanism to be more democratic. Consequently, the power of individual politician or policy elites in decision-making has been weakened to some extent. However, key policy elites still maintain decreasing but significant influence on policy-making[20]. The interests of Chinese state have been a crucial part of *Guojia Liyi* due to the unified and consistent identity and ideology of the Chinese government and its strong leverage in society and economy, as explained in Chapter 3. In some sense, the interests of the state are equivalent with the interests of the CPC. National interests are long-term policy objectives and guide the formation *Guojia Liyi* in the long run, while personal epistemic interests and interests of the state have more practical influence on *Guojia Liyi* in the short or medium term. Comparatively, interests of the state are more influential than personal epistemic interests in making national foreign policy, given the clear state identity and ideology and strong state power[21].

Third, both material and ideational factors have significant influences on the formation of *Guojia Liyi* through influencing some or all the three constituents. Material factor refers to domestic and international political economic environment. Throughout these cases, some political economic factors are common, such as domestic economic

[20] As mentioned before, this is mainly because in a one-party-ruled government, complete democratic decision-making is less likely. In order to maintain the authoritarian regime of this single party, political power is concentrated on party elites.

[21] As explicated before, a unified and consistent identity and ideology more likely form consensus government goals in the medium or long term, while strong government's leverage in society and economy ensure realization of these goals.

development and international economic crises, particularly the 1997 Asian crisis and the 2008 global financial crisis. Some factors are idiosyncratic, such as the structural shortcoming of the current global monetary system in IMS reform case and flaws of the international banking regulation in global financial regulation reform. Ideational factors contain state ideology and interpretation. State ideology is formed in the long term and, therefore, is relatively stable. As analyzed in the previous chapter, Chinese state ideology has four key constituents---Socialism with Chinese characteristics, nationalism in the specific form of rejuvenating Chinese nation, state identity and development ideology. In all cases, some or all of the four aspects generated significant influence. Differently, interpretation is short-term and changeable. Interpretation is an inevitable path in which the influence of political economic environment and state ideology on *Guojia Liyi* is transmitted. The political economic environment and state ideology are interpreted first by policy elites and/or political leaders. Then, the individual or group interpretation forms the understanding of the Chinese government and finally become national policy. Table 8.2 summarizes the material and ideational factors in the four cases. These material and ideational factors structure the formation of *Guojia Liyi* through influencing personal epistemic interests, interests of the state and/or national interests. The formation matrix in Chapter Three clearly shows the influence of the material and ideational factors on the three constituents of *Guojia Liyi.*

Table 8.2 Summary of Material and Ideational Factors

Cases		Material Factors	Ideational Factors	
		Political Economic Environment	State Ideology	Interpretation
G8 & G20	G8	The domestic economic development and consequent growing systemic importance in world economy; Domestic barriers like inconvertibility of RMB; The 1997Asian financial crisis and the week performance of G8 in it and in world anti-terrorism.	Socialism with Chinese characteristics; development ideology and identity.	The G8 is dominated by the major Western countries; China's social and development ideology may be influenced negatively by the G8.
	G20	Domestic economic development; Domestic economic structure adjustment; The 1997 Asian and 2008 global financial crises have highlighted the importance for strengthening global financial governance.	A responsible country; A developing country; Nationalism	The G20 is chance to participate in global coordination, to adapt to and learn global governance, to represent the Chinese position and build China's external image, and a way to facilitate the adjustment of the domestic economic structure.
IMS Reform		Domestic development, such as the extraordinary performance of domestic economy; Domestic problems. Structural shortcoming of the current global monetary system; 2008 global financial crisis; The changes of international economic pattern.	Socialism; Development Ideology; Nationalism; Emerging Countries.	Unequal IMS —"currency war" and "dollar trap"; Gradualism; Gold Opportunity; Others
Exchange Reform		International experiences on exchange regime reform; The recovery of Asian economies from the 1997 Asian crisis; Huge pressures from major Western countries, global financial governance institutions and even international academia; Domestic pressures on and pre-conditions for reforming exchange policy.	Socialism with Chinese characteristics and the scientific outlook on development	In the long run, market-oriented exchange reform is beneficial for China's development.
Global Financial Regulation Reform		The current situation of the domestic banking industry; Domestic economic situation; Flaws of the international banking regulation, particularly the problems of the Basel II; 2008 global financial crisis; International integration or Globalization.	Socialism with Chinese characteristics; Scientific Outlook on Development; Nationalism; Development identity.	China's policy elites come into consensus that strengthening banking regulation is conducive to China's sustainable development and consequently the rejuvenation of the Chinese nation. An active stance of the Chinese government is necessary for pursuing higher international status

The second major conclusion is that given the ascertained *Guojia Liyi*, under some specific situations, the decisions are not always rational and in accordance to these interests and preferences due to the influence of many factors, such as lobbying, institutional conflicts and others. Table 3.2 in Chapter Three demonstrates the influence of the six factors on the decision-making process. The exchange reform (Chapter Six) and global financial regulation reform (Chapter Seven) cases examine how these factors influence policy-making environment and consequently China's specific policies in certain time periods (Table 8.3). Table 8.3 clearly shows that under certain situations of the six factors, national short-term decisions tend to be in accord with the *Guojia Liyi* formed before, and vice versa. One exception is the "short-term pressures from IOs and Western countries". In the exchange reform case, the major IOs and countries urged China to launch market-oriented reform, which accords with China's *Guojia Liyi*. However, in the global financial regulation reform case, international financial regulators exerted limited pressures on China to implement Basel III and major countries even lag behind China in Basel III implementation and face pressure from China. Therefore, external pressure is a significant rather than necessary factor in making the short-term decision accord with or deviate from the *Guojia Liyi*.

Table 8.3 Factors Influencing the Decision-making Processes of Exchange Reform and Financial Regulation Reform

Factors	Exchange Reform			Global Financial Regulation Reform
	2005 Reform	2008 Stagnation	2010 Relaunch	
Lobbying	Weak	Strong	Weak	Weak
Institutional conflicts	Weak	Strong	Weak	Weak
Complexity of issues in point	Low	High	Low	Moderately Low
Short-time pressures from IOs and Western countries	High	Low	High	Low
Emergent events	No	Yes	No	No
Risk appetite of decision makers	High	Low	High	High
Accord with *Guojia Liyi*	Yes	No	Yes	Yes

Consequently, the explanation for the inconsistent stance of China in global financial governance comes down to the following two points. First, China's specific *Guojia Liyi* in various institutions or events of global financial governance are different, due to the different structuring effects of political economic environment, state ideology and interpretation of the three constituents of *Guojia Liyi* - personal epistemic interests, interests of the state and national interests. Second, even if the specific *Guojia Liyi* are the same in different institutions or events, the short-term decision-making process may be influenced by some factors and, as a result, the short-term decisions may deviate from the *Guojia Liyi* formed before.

Innovation, Significance and Barriers

Building on and comparing to the existing literatures, the theoretical framework in this thesis has following significance and innovations, which are the reasons for establishing this two-stage model rather than using existing ones. First, this framework incorporates both external and internal factors in analyzing China's strategy in global financial governance. Foreign policy studies have experienced significant changes in the past several decades from the third image (international level) to the second image (at the state level). As mentioned before, in the period right after the World War II, foreign policy was "exclusively a reaction to external stimuli" (Rosenau, 1966) and foreign policy analysis focused on the third image. Since the 1950s and 1960s, the focus has moved to the domestic sources of foreign policy and the interplay of external and internal variables has appeared in foreign policy analysis. Even so, some scholars still criticized that "much of the discussion on foreign policy and state behaviour has remained limited to the analysis at the level of the third image" (Gupta, 2012, p.2) and "little foreign policy analysis actually ever focuses on the manner in which domestic political and socio-economic changes shape foreign policy and security agendas" (Bhalla, 2005, p.1).

As far as foreign economic policy in global financial governance is concerned, mainstream research also "has mainly focused on the international system as the level of analysis and has investigated predominantly questions on the performance of international organizations, on intergovernmental negotiations, and on the legitimacy of actors" (Schirm, 2008, p.3). Recent research has gradually realized the importance of the domestic sources of preferences of national governments. For example, Drezner (2003) stressed the need to focus on the origins of great power preferences in the global economy. Against this background, my framework takes into account both the external constraints and domestic sources of China's strategy in global financial governance. Evidently, by no means is this the first to combine domestic and international variables in foreign policy analysis. Many scholars have established various models that consider both external and internal factors, including Putnam's (1988) two-level games, neoclassical realism (Schweller, 1998), the domestic-structure approach (Katzenstein, 1976) and poliheuristic theory (Mintz, 1993). However, comparing these models, this theoretical framework is different in the following aspects.

Second, this framework treats both state and decision makers as units of analysis. Mainstream IR theories mostly consider state as a unitary unit of analysis, while FPA looks into the specific decision-making process with bureaucracy and political leader as units. Hudson (2005) describes the two kinds of theories as "actor-general theory" and "actor-specific theory". The former holds that "whatever decision-making unit is involved, be it a state or a human being or a group, that this unit can be approximated as a unitary rational actor and therefore be made equivalent to the state" (Hudson, 2005, p.2). The latter explores the "black box" of state by focusing on the participators of policy making. This theoretical framework admits the explanatory power of both sides and attempts to incorporate both by separating the formation of interests and preferences and foreign policy decision-making. At the *Guojia Liyi* formation stage (Stage I), state as a collectivity appears as a unitary actor in international politics, while in the decision-making stage (Stage II) various actors have been involved, including mainly political leaders, bureaucracies and other actors. In this sense, treating the two as separate stages helps better understand the coherence and inconsistency of China's foreign policies in global financial governance, although the two stages, in reality, are not clearly separated as two steps.

Third, this model takes both material and ideational factors into consideration. Mainstream IR theory studies formation of interest by separately investigating material and ideational factors. Some scholars, as mentioned before, attempted cross-fertilization of material and ideational factors in specific empirical analysis. These literatures focus on the interaction between material and ideational factors. For example, Meyer and Strickmann (2011) looked into how material and ideational factors are interrelated in analyzing the European Union's security and defence policy. In contrast, the two-stage model focuses on the structuring effects of material and ideational factors on China's Guojia Liyi, treating them as two relatively independent explanatory variables.

Fourth, unlike mainstream Western-focused theories, this framework pays more attention to personal epistemic interests and interests of the state, which have high leverage in less-democratic non-Western countries, such as China. Taking the classic two-level game as an example, Putnam (1988) analyzed foreign policy by exploring the negotiation at international level and ratification at domestic level. As to the domestic ratification, although he argued that it needs not to be democratic in any normal sense, the major cases in Putnam's paper are mainly democratic countries. In addition, some other literature that considers both internal and external determinants of foreign policy tend to treat re-election or remaining in office as a major internal motivation for policy making, such as Alons (2007). These analyses are evidently based on the Western parliamentary system. In contrast, this framework is established to explain foreign strategy of China, an authoritarian state, in global financial governance by casting more light on personal epistemic interests and interests of the state.

Lastly, the framework explains the intra-state rather than inter-state policy differences in the global financial governance. The mainstream IR and CP literatures on foreign policy analysis mainly focus on the inter-state comparison. For example, Schirm (2008) argues "convergence and divergence of governmental positions towards new governance cannot be explained solely by the logic of the international system nor by globalization, but instead strongly reflect domestic ideas and interests". Unlike Schirm, whose work focuses on the inter-state convergence and divergence in terms of their behaviours in global financial governance, this thesis explains the inconsistency and coherence of China's strategies in various fields or institutions of global financial governance. In one word, it is not about the different policies, strategies or attitudes among various states, but about these of one state in various events or institutions in global financial governance.

In summary, the two-stage model explains China's policy inconsistency in global financial governance through both ontological and epistemological integration. Ontologically, this model considers structure and agents and treats state and decision-makers as units of analysis. The new concept *Guojia Liyi* bridges the IR systemic-level interest of China with the interests of decision-makers emphasized in FPA by incorporating personal epistemic interests, interests of the state and national interests. Domestic and international political economic structure constrains the formation of *Guojia Liyi* by influencing its three constituents. Therefore, the structures influence interests of policy makers (agents) and policymaking motivated by *Guojia Liyi*. In return, the specific policy outcomes driven by *Guojia Liyi* and made through a policy-making process will change the structural factors through the domestic and international policy effects. In addition to the material structural factors, some ideational factors, particularly state ideology and interpretation, also influence *Guojia Liyi*'s three constituents.

Epistemologically, this model incorporates both rational and cognitive schools of thought by separating *Guojia Liyi* formation with specific decision-making processes and considering time as a crucial variable. In the medium or long term, policy makers rationally comply with *Guojia Liyi*, while in the short term, specific policy-making environment may intervene and deviate policy outcomes away from the policy objectives based on *Guojia Liyi*.

This middle-level framework is engaged in both abstract and concrete theorizing. The abstract theorizing emphasizes the motivation of state behaviour, *Guojia Liyi*, and the rationality of decision-makers in the long time. The concrete theorizing explains the formation of *Guojia Liyi* by exploring its three constituents and the material and ideational influencing factors and examines the changeable policy-making environment. As such, it is another attempt for "a theoretical middle ground between parsimony and complexity" (Hudson and Vore 1995, p.224).

Lastly, the two-stage model provides a useful analytical tool to study China's foreign policy in the global financial governance domain. Briefly, this analytical tool is comprised of two tables. One is the *Guojia Liyi* formation matrix (Table 3.2 in Chapter 3), the other is the influencing factors of decision-making process (Table 3.3 in Chapter 3).

Despite the innovation and significance discussed above, some barriers, questions or potential problems exist and require further research in near future. One question is about the applicability of this model. This thesis is confined to global financial governance, more specifically four cases. Hypothetically, this model should be applicable to other issue areas in global financial governance and, more broadly, other domains of global political economy, such as global environment governance and global trade. However, future research is required to verify the applicability. Another potential problem relates to the validity of the explanatory claims proposed through the two-stage model and verified through the four cases. On the one hand, is this model falsifiable? The four cases in this thesis are "most-likely" cases (Gerring, 2007) and verify the theoretical models. But can some "less-likely" cases (Gerring, 2007) be used to test the falsifiability of this model? On the other hand, the theoretical model aims to explain the policy output and inconsistency (explanandum or dependent variables) by two sets of factors (explanans or independent variables) --- material and ideational factors (international and domestic economic and political environment, state ideology and interpretation) at the Stage I and six other factors at the Stage II. These factors are drawn from related literatures. A consequent important question, however, is how to ensure or verify a causal relationship between the explanandum and explanans, which can lead to more predicative claims. In other words, why are the factors rather than others that caused the policy output and inconsistency? How is it possible to ensure that the explanans include all significant independent variables and, meanwhile, consider appropriately relevant moderating and intervening variables, which also have influence on the causal relationship? This thesis provided a valuable descriptive typology that is useful in disentangling the factors that may be relevant and tentatively explores the causality, which constructed a solid base for a more ambitious and method-driven research project aiming to answer these complex questions and incorporating more both “most-likely” and “less-likely” cases in the future.

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