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Assessing China's International Financial Power since the Global Economic Crisis in 2008

How did the crisis affect China's position in the international financial system?

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1. Introduction

For the past three decades, the international world order has been dominated by one hegemonic power, the United States. (Yilmaz, 2010, p. 193) In 1989, with the end of the cold war and the disguise of its sworn communist enemy, the Soviet Union, the US took advantage of the global power vacuum and assumed unipolar leadership by becoming the largest player in global economy backed by the strongest military force and most influential global political power by expanding its geopolitical and ideological reach. (Layne, 2009, pp. 148 - 149) It has done so arguably until the global financial crisis of 2008. As a result of the bursting housing bubble in 2004, housing prices fell, interest rates rose and owners were obliged to remortgage their houses for cash. Investors too lost confidence in their financial assets and wished to resell to the bank. The American government decided to bail out these failing banks by purchasing the distressed assets. When this failed and the US-based financial services bank Lehman brothers filed for bankruptcy, an already bad economic downturn turned into the worst recession since the Great Depression 80 ago. (Kelleher, Hall, & Bradley, 2012, pp. 1 - 3) Critics proclaimed the Anglo – American neoliberal era had come to an end proven by statements such as "For three decades we have moved towards market-driven financial systems. By its decision to rescue Bear Stearns, the Federal Reserve… declared this era over.", which had become commonplace. (Helleiner, 2010, p. 628) Different from previous financial crises, this one originated in the world's greatest economic, military and financial leader, the US. For the first time, the legitimacy of this much–applauded leader of the free world is questioned and alternative leadership is sought outside American borders. (Jacques, 2012, p. 585) Amidst this turbulent time, several emerging market economies have particularly attracted attention due to their rapid economic rise, growing capital and increasing international involvement. In this new context where the credibility of the US as a world leader is doubted, China has been a topic of much debate.

When scholars have analyzed America's strength as a global leader in the past, several sources of power are repeatedly explored: military power, soft power including diplomacy, economic and financial power. Though the latter two are fundamentally linked to one another, one could categorize finance as a specific aspect of economics. This paper examines financial power "when one state's behavior changes because of its monetary relationship with another." (Andrews, 2006, p. 2) Or as Sandra Heep puts it:

"The realm of international finance comprises the processes and institutions of the international allocation of credit as well as the distribution and the value of the currencies in which international transactions are denominated. […] Moreover, financial power is defined as power deriving from the realm of finance as opposed to power applied to the realm of finance." (Heep, 2014, pp. 15 - 16)

The US economy has been the world's largest since, at least, the 1890s. It has contributed on average 30% of the world's GDP and is the largest producer of gas and oil. (The Economist, 2012) America's military power too ranks as the number one in the world. In 2015, the US spent 596 billion USD on its military, followed by China who spent only 215 billion USD. (Statista, 2016) However, arguably America's main strength is its financial might, more specifically its mature financial markets and use of the domestic currency, the USD, as an international currency of trade and reserves. An immediate advantage is international seigniorage. This refers to profit created by a government when money is worth more than the costs to produce it. While the costs of printing USD bills is low, foreign holders must provide goods and services worth the face value of the notes to obtain it. (Papaioannouand & Portes, 2008, p. 37) Moreover, cost of capital is reduced for actors within the US when foreign demand for the dollar is high and invoicing international trade in home currencies is beneficial for exchange rate stability. (Pocklington, 2010, p. 9) Recently, the capacity to finance government debts by relying on foreign financial investments in US' financial 'safe haven', specifically in treasuries, was added to the lists of benefits. Unlike any other economy where banks play the central role, financial markets are the ultimate provider of most credit for all types of private and public investment. (Baily & Elliot, 2013, p. 1)

A last source of legitimation is US soft power. The concept was developed by Joseph Nye in 1990 who explained it in terms of the ability of a state to shape preferences of others through appeal and attraction without coercion, including diplomatic power – the art of conducting negotiations between players to gain strategic advantage or mutually acceptable solutions to common challenge. (Meriam Webster Dictionary) Analysts have used soft power to explain American exceptionalism as "the nation's devotion to freedom, the rule of law, and the practice of republican government,…" (Carnes, 2008, p. 61) Soft power can be played out in the international realm of finance and economy too. For example, when a state uses its financial resources to grant interest-free loans to developing countries in need. Although the donor country may not gain direct monetary advantage, its soft power in the region will increase.

The US Marshall Plan in 1948 issued to rebuild Europe after the devastating second World War is a good example of how soft power was boosted through financial might.

Recently, China's power has been a subject of analysis. Already with Deng Xiaoping's economic reform agenda of 1979 but especially since early 2000s, its spectacular rise can no longer be ignored. Similarly to analyses of America's might, China's can be divided up into several types of power. China's turbulent communist past has not permitted the country to build up much soft power. Leaders like Mao Zedong and events such as the Tiananmen massacre of 1989 have tainted its image in popular narrative. Although China has recently been trying to send signals to the global community of its intentions to act as a responsible international power or used its economic strength to increase its soft power by, inter alia, expanding its official development assistance program to a total of 14 billion USD to African developing countries (Wong, 2016), a long road lies ahead to come even close to a soft power status of America. China's military power is ranked second in the world, yet far behind that of the US. In size however, the People's Liberation Army ranks first, leading with 2.25 million active members, compared to 1.63 million in the US. (Statista) China's foremost source of power today is its economy. Numerous analyses have predicted that it will soon take over US' role as the world's leading economy. (Elwell & Labonte, 2007, p. 15) It is the largest manufacturing economy, largest exporter nation and fastest growing economy, with averagely double digit growth rates for the past thirty years. While it is definitely true that the Chinese economy has recently experienced a slowdown, with annual growth rates of 7.3% in 2014, this is still a major achievement compared to the German 1.6% or US' 2.4% in that year. With the crisis of 2008, its growing economic influence has been highlighted in times of a weakened US.

Far less attention however, has been given to the financial source of China's power. (Haiwen, 2009) In the years since the crisis, the international financial architecture has undergone several changes. With the developed world especially affected, emerging economies like China have taken the opportunity to increase their influence. Although its financial might is still nowhere near that of the US whose domestic currency serves as a major international currency and whose financial markets are deeper and more mature than anywhere else, the point made by this paper is that it *is* in fact growing and that it should not be neglected in a power analysis of China. Therefore, when examining China's overall growing position in today's international system, this research paper aims to include China's growing financial clout into the analysis despite both the fact that its size may not compare to that of the US and problems faced by its real economy. By dividing up this financial clout up into three different sources, explained in detail below, the paper argues for a more balanced account, that both includes the position of its real economy *and* that of its financial might, when drawing conclusions on its stance in the international system.

Besides the above, this research paper aims to contribute to filling 3 other gaps in academic literature. Firstly, when China's financial power *is* taken into account, very rarely has it succeeded in bringing together the different aspects of this financial power but all focus closely on one specific source, i.e. structural, relational *or* institutional. By using the three theoretical concepts of international financial power of Heep as a guideline, this thesis aims to bring together the main sources to provide an overall account on China's financial potential. While Heep uses China's model of governance, the developmental state, to explain China's acquisition of financial power, it is exactly the three different sources of China's financial might that form the basis of this paper. This portrays best the complexity of financial power by avoiding overemphasis on one source and thereby obscuring the others.

Secondly and as a result of the theoretical basis, this overall analysis will thereby avoid the trap of 'extremes': overstate or completely deny China's financial power. Analyses tend to *either* exaggerate China's power by advocating the idea that China will soon take over US' position as world leader *or* refer to inherent contradictions in its growth model that make it impossible for China to continue its current growth path and predict its collapse inevitable. The former refer to the US' waning and China's rising economic, financial, military and soft power while the latter use, inter alia, China's system of financial repression, capital controls and large foreign reserves to prove its inescapable downfall. Lastly and thereby remarkably different from Heep's analysis, this paper doesn't bring in the concept of the developmental state to understand China's potential. This avoids the trap of always resorting to China's extraordinary developmental state model as an overarching, causal explanation to clarify certain trends. This paper argues that China has its own micro-level of decision-making that doesn't always fit into this overall developmental state model and that it is certain events, such as the global crisis in 2008, that trigger this decision-making body to specific policy responses. Moreover, this approach also avoid always placing the Chinese developmental state in contrast to the US liberal, capitalist state. While comparative analysis is important and one should not ignore the US in Chinese international power analyses, an alternative perspective can shed an interesting, new light on the situation.

The paragraphs above have outlined the need for and the intentions of this paper. It will divided up into four chapters. The first will offer a literature review of previous works on China's financial power to which this analysis is, to a certain degree, indebted to and an explanation of the three theoretical concepts of financial power that serve as a guideline for the further analysis. The second will explain the crisis of 2008 but focus on what exactly this crisis made clear and how these realizations have come to influence China's role in the international financial sphere. Thirdly, China's financial power since then will be closely examined according to the three theoretical sources of power to paint the larger picture. Lastly, a nuanced conclusion will be drawn to situate China's position in the international financial system since 2008.

2. International Financial Power: A Literature Review & Three-Way Typology

2.1. A Literature Review

This paper uses the typology of power laid out by Heep as a theoretical framework. The typology will be explained in the following sections but before, it is important to review Susan Strange and Eric Helleiner's primary contribution to the conceptualization of financial power, two scholars Heep has consecutively based her analysis on. Strange was one of the first scholars, as early as 1976, to understand that money is inherently political. "It is a source and target of power in international relations", as scholar, Bejamin Cohen, puts it, leading to an "inseparability of money from politics". (Strange, 1976, p. 20) Furthermore, she concluded that if money is inseparable from politics, it is so from power as well since politics is driven by power. (Cohen B. , 2000) This realization, inter alia, led to her book 'States and Markets' in which she posits the term *structural* as the power derived from structures, different from relational power derived from relations. In contrast to others of the same time period who focus on tangible resources of power such as territory or the military, she claims that it is structural power in international political economy that is increasingly important. Structural power is defined as "the power to shape and determine the structures of the global political economy, […] to shape frameworks within which [actors] relate to each other, […] to change the range of choices open to others, without apparently putting pressure directly on them to take one decision or make one choice rather than others." (Strange, 1988, pp. 24 - 30) Strange argued that structural power was dependent on four elements: security, knowledge, production and finance. Here, the latter is of significance. She defines financial structure as "the sum of all the arrangements governing the availability of credit plus all factors determining the terms on which currencies are exchanged for each other." Over time, many have criticised Strange's work for being ambiguous and still limited yet no one denies the ground-breaking effect it had on the study of International Political Economy. As Heep notes, her book, as in this paper, the definition given for structural power by Strange will be narrowed down to the power that *derives from* structures, not including power that is *applied to* those structures. This paper then primarily looks at the structural financial power that derives from a domestic currency serving also the role of an international reserve currency, i.e. the dollar. However, the ability to shape other financial systems and their regulations due to the pressure that derives from the regulations of another state's superior, more mature, financial markets is not considered as structural financial power here. (Heep, 2014, p. 17)

While Strange was first in drawing a line between power associated with relations versus with structures, it was primarily Helleiner who, in 1989, refers to a state's creditor status as the main source of relational financial power. (Helleiner, 1989) To determine the size of this power, he posits that the amount of capital flowing out of a country and the duration of which it does so, is the primary determinant for a state's relational power. Secondly, one needs to look at the amount of control exerted by that state's government on these outflows. The larger a state's say in the allocation of this credit, the more pressure it can place on the state from which it wants something. Third concerns how vulnerable this creditor state is towards its debtors: the larger the pressure a debtor can place on the creditor state by not paying back their debt, the weaker the latter. (Heep, 2014, p. 20)

I mention Strange and Helleiner early on in the paper because their work serves as a foundation on which this paper is built and thus deserve particular attention. However, in the next sub-section, the three types of financial power will be discussed in further detail.

In their article, scholars Vermeiren and Dierckx advocate that the Chinese repressed domestic financial system and its inherent need for capital controls will inhibit China to acquire the financial might needed to pose a realistic threat to America and its neoliberal model. (Vermeiren & Dierckx, 2012) Without claiming the opposite, their article eradicates any possibility of change in this model and thereby the possibility of a more influential role for China in the international financial system. This paper argues that, although members within have expressed conflicting views on liberalization, the chief party leaders of Chinese government today are well aware of the limitations of its model and have shown determination and ambition to eliminate these obstacles by careful liberalization to increase its options and its future role in the international financial system. The conclusions drawn by the authors are proof of the polarized academic research when it comes to analyzing China's financial power. Moreover, they zoom in on one particular source of financial power, its structural might that is centered around internationalizing domestic currencies. While recognizing that China too has been taking steps in this direction, the authors refer to inherent contradictions in its developmental state model that makes it impossible to make the domestic currency fully convertible while maintaining this model of governance and thereby eradicate the applicability of this source of power to China's case. In the same line of argument, in different articles, Drezner and Helleiner and Chin too give a detailed analysis of China's increasing financial power based on its recent position as a 'net donor'. (Drezner, 2009) & (Chin & Helleiner, 2008) While such focused analysis of one specific source of financial power, relational power in this case, can be very insightful, academic literature still lacks an overall account of China's different sources of financial power.

Senior researcher, professor and writer Yang Jiang too supports a rather pessimistic view of the possibility of China to take on the role of a global monetary power. She argues that the priority of the ruling party is primarily to maintain control and stability. It is for this reason that China's financial policy is dominated by conservatives who fight against the reform and liberalization needed in order to play a bigger role. I question the natural link made between the priority to maintain domestic stability and consequently the commitment to fight reform. The financial crisis of 2008 highlighted China's flaws and pressing need to liberalize in order to maintain that much-aspired domestic control and stability that the conservatives stand for. Members of the ruling party may then well be increasingly willing to shift its stand and support liberalization, requiring great effort but foremost time and caution. Moreover, when it comes to China's institutional financial role, Yang Jiang refers to China's preference for bilateral agreements with shallow content that don't require significant domestic reforms, aimed at more practical and political gains rather than preparing itself for the role of a global monetary power that possesses a global currency to prove china's reservations about liberalization. This paper argues that although China may still prefer bilateral agreements, recent institutional developments, such as its initiating role in the Asian Investment Infrastructure Bank (AIIB) and its large capital contribution to the BRICS New Development Bank (NDB), show a clear willingness to compliment such bilateral agreements with more multilateral engagements in order to increase its institutional financial power.

On the other end of the spectrum and optimistic about the possibility of the internationalization of the Chinese domestic currency and rising role in international monetary relations is Jonathan Krishner. While agreeing with the majority of the cases argued in the first chapter of "A great Wall of Money", he naturally brings the US' into the picture when analyzing China's model to make his case of an increasingly powerful China as a global financial player. While it is the sole intent of the book to analyze China's power, he "feels China is the first on monetary scene in 70 years that can be seen as a potential adversary to the system's most prominent participant, the US. It will present a challenge, even in the best case scenario." By comparing China's current rising role to America's decreasing position, he indirectly implies China intends to challenge its leading position. In the same context, Drezner's article also provides a suitable example. The article opens with the statement: "China has challenged the US on multiple policy fronts since the beginning of 2009". While this may actually be true, when China's power analysis is constantly placed in comparison to a weakened US since the crisis, it is difficult not to implicitly strengthen the popular 'China threat' narrative which pictures China as a true threat to the US. Such a perspective eliminates the option for cooperation between today's two strongest nations, characterizing their future relationship as one of destructive competition. While one will always need another to measure itself relatively, this allows assumption that China's intentions are to take over the role of the US as the financial leader. This paper does not at all deny that the US has a position of primary importance nor that it is necessary to take it into account when analyzing other players, it should not be the focus of all discussion. With this paper, I aim to shed light on China's financial position from a different angle, one not always explicitly linked to the US.

The article by, inter alia, John Walley and Li Wang examines the institutional aspect of the crisis. Crisis management of the International Monetary Fund (IMF) came under severe attack in the Asian financial crisis of 1997. As a result, Asian countries responded by accumulating vast amount of reserves as self-insurance. The recent crisis has revealed the bigger issue at stake, the fact that the current regulatory arrangements are nationally based and not internationally. This results in regulatory competition to attract capital and thus unreliable flows of money threatening the stability of the system. The authors call for the need to have large globally integrated banks which could help with diversifying risk and increasing the available pool of resources. In retrospect, the authors seem to have been right. In 2014, the

Contingent Reserve Arrangement (CRA) was signed by the BRICS countries exactly as a supplement to the IMF services by pooling reserves at the availability of its members in times of liquidity crisis. The Chiang Mai Multilateralization (CMIM), BRICS NDB and the installation of the AIIB too, can serve as an example of the changing institutional environment and especially of an increased institutional financial power of Asian and developing countries, including China. China's assertiveness is often perceived as a threat to the US' dominant position in the region. The US government itself contributed to this narrative when discouraging countries to join the AIIB. One of the goals of this paper is exactly to discredit such narrative and stand by David Dollar's claim that "the US should be pleased that China is shouldering some global responsibility. […] Rather than a challenge to the American-led system, the AIIB is likely to be a useful complement to the existing system." Such a position allows for dialogue, cooperation and reform instead of hostility and destructive competition.

While owing much of my following analysis to Heep, her book too serves as an example of the need for a more careful analysis of China's financial power. As is the case here, Heep divides the concept of financial power up into three different categories: relational, financial and structural. She argues that the political economy of the developmental state, China's model of governance, inhibits the acquisition of the former, structural financial power, since its system of financial repression is not compatible with the development of financial markets that are capable of attracting international investors. For the same reason, establishing its currency as an international store of value is impossible since this aspect of currency internationalization requires the very development of financial markets that is not compatible with a system of financial repression. However, since the developmental state's system of financial repression allows it to withstand currency appreciation pressures, it gives China the power to maintain current account surpluses, an aspect of structural financial power that has so far been neglected in the literature due to its focus on the financial power of neoliberal political economies. Closely related to the latter point is the fact that developmental states typically embark on export-led growth strategies since financial repression isn't compatible with a focus on consumption. Although agreeing entirely with the technical content of the book, I feel what is missing is the recognition of the possibility for change. The crisis has highlighted many flaws in the international political economy and while China's model of developmental state may not be fit for acquiring structural financial power, it can be argued that China is determined to move away from this model, with urgency, exactly because it recognizes the weakness of its model.

2.2. A Three-Way Typology

The concept of ‘power’ has been a topic of scholarly discussion for many years. In 1988 and 1989 respectively, Strange and Helleiner have drawn up a typology of *financial* power and in 2014, their analyses were used by Heep in her book that will furthermore serve as theoretical guideline in this research paper examining China’s financial power since the global crisis. Heep defines financial power as a state’s ability to influence the behavior of other states through its financial relations with them. Financial power is then divided into three different categories: structural, relational and institutional.

2.2.1. Structural Financial Power

Strange defines structural power as the power “to decide how things shall be done, the power to shape frameworks within which states relate to each other, relate to people, or relate to corporate enterprises.” She adds that structural power is the power to “shape and determine the structures of the global political economy within which others operate [. . .]. It is a form of indirect power that limits the range of options available to others.” (Strange, States and Markets - An Introduction to International Political Economy, 1988, pp. 24 - 25) Structural financial power is understood to be mainly based on the international pulling power of a state’s financial markets and the function of its currency as an international store of value. Heep identifies five different ways in which structural financial power is at play. While beyond the scope of this research paper to go into all detail of these different aspects of financial power, it is important to understand that the common denominator of these abilities all rely on the role of a state’s currency as an international currency of reserves as well as the pulling power of mature domestic financial markets that are able to attract foreign capital. (Heep, 2014, p. 17) Up until today, only the US have fully experienced this privilege as the dollar still remains the main currency for international trade and reserves. Moreover, the US’ domestic financial markets are still the most mature and trusted for international investment, proving their legitimacy all around the world. Although it is certainly the case that the US have and up until today still do experience a position of structural financial superiority, this doesn’t mean that, because of the dollar’s international currency role, the US is the *only* player who can make the claim to some of this power. The ability of a state to delay adjustments to surpluses, one of the five listed by Heep, comes from the maintenance of a fixed exchange regime, capital controls and the ability to contain resulting sterilization costs. In this respect, China serves as a good example of how to derive structural financial power exactly because its domestic currency does not fulfill an international purpose but based on a repressed domestic financial system, discussed later in this paper.

2.2.2 Relational Financial Power

The second form of financial power is called relational financial power and concerns the ability of a state to influence other states directly by applying financial pressure. Unlike structural power, relational financial power is a form of direct might mainly exercised through the provision, refusal or withdrawal of credit. (Heep, 2014, p. 20) According to the IMF statistics of 2015, the most indebted nation today is the US. Crisis - struck European countries such as Greece and Italy too are found at the bottom of the list. With such large indebtedness and lack of credit available, it is difficult for these countries to leverage capital in order to gain influence and increase power in decision – making or policy implementation. Countries such as Japan, Germany and China with a positive Net International Investment Position (NIIP) however are considered creditor nations and have far more relational financial power as they have the possibility to use this capital for achieving their goals. (IMF, 2016)

2.2.3. Institutional Financial Power

Lastly, Heep defines institutional financial power as a state's ability to influence other states indirectly through the policy decisions of International Financial Institutions (IFIs). Since the end of the second world war and the establishment of the Bretton Woods institutions, the international financial architecture has, until today, been shaped by the IMF and the World Bank (WB). First and foremost membership but more importantly voting share, capital contribution and representation amongst staff and management within these institutions are primary sources to acquire institutional financial power. (Woods, 2003) Membership in other IFIs such as the Asian Development Bank too can help boost a nation's institutional financial power.

3. The Global Financial Crisis of 2008

On September 15th in 2008, the financial services bank Lehman brothers filed for bankruptcy and thereby signaled the shift from an already bad economic downturn to the worst recession since the Great Depression 80 years ago. (Kelleher, Hall, & Bradley, 2012, pp. 1 - 3) Different to the Latina American *peso* crisis of 1994 or the Asian financial crisis of 1997, this one originated in the world's greatest economic, military and financial leader, the US. Because of America's central position in the international economic sphere, primarily linked to the international role of its domestic currency, the crisis soon spread to the rest of the world, Europe first, followed by Asia and went from a national financial to a global economic crisis. (Lee & Sundaram, 2011, p. 18)

3.1. What did the Crisis Show?

Although difficult to determine the long-term impact of the crisis, it is possible to analyze short-term consequences 8 years later. It is not in the scope of this research paper nor its intent to analyze the technical aspects of crisis but to examine the larger political influence the crisis has brought about to the international environment, particularly to China.

For the first time since 1989, US leadership is widely doubted. Before, Western and Asian scholars alike referred to the enormous size of its economy and its mature financial markets as evidence for its economic and financial superiority, the amount of money pumped into the military for its military capacities and the democratic wave and spread of liberal values after the cold war for its cultural superiority and soft power. For many, especially in the developing world, the Asian crisis of 1997 marked the decline in the strong held belief of US superiority and voices advocating the flaws of this neoliberal leader were heard. Throughout the 1980s, Asian economies, led by Japan, were characterized by extremely fast economic growth, so fast the WB constituted this period as the "East Asian Miracle". (Wade, 2000, p. 86) When crisis struck, official, often Western, academic consensus concluded that its causes were primarily 'homegrown' and thus only had the Asian countries to blame for failure of governance. Crisis-countries however located the events as part of a series of financial crises among emerging market economies, associated with large foreign capital inflows that were suddenly retracted by foreign investors when speculations arose fear. They called the crisis a failure of international financial markets and blamed the dynamics of core economies and international capital markets based on America's neoliberal model, also called the Washington Consensus.[1] Only by 2008, due to the crisis, do commentators of *all* nationalities agree to the above and thereby explicitly undermine the validity of US' economic and financial system. (Wade, 2000, pp. 86 - 87)

To understand what China in particular learnt from the crisis and comprehend the measures taken to sooth its effect, it is necessary to analyze how exactly this Washington Consensus has contributed to both crises. When the Bretton Woods system broke down in with the end of the dollar's peg to gold in 1971, the era of neoliberal globalization began. By the 1980s, two unique trends could be identified typical of this post-Bretton Woods age: globalization and deregulation of financial markets, central characteristics of neoliberalism. (Helleiner, A Bretton Woods moment? The 2007 - 2008 crisis and the future of global finance, 2010, pp. 625 - 626) Without engaging in the debate whether or not there is really a true Washington consensus, one can say that it is exactly this neoliberalism that forms the foundation of the larger concept.

As explained above, the Asian financial crisis didn't delegitimize the neoliberal standards. That the crisis could be blamed on the behavior of global financial markets was not recognized outside the affected Asian countries and thus had little effect on the legitimacy of this Anglo – American neoliberal model.

The crisis of 2008 made sure the credibility of US' leadership and the superiority of the neoliberal model centered around globalization and deregulation of financial markets was widely questioned by both Western and Asian commentators alike. The belief in the self–healing powers of markets and in the financial leadership of the Anglo–American frontrunners suffered a large setback. China's official news agency, Xinhua, headlined "Washington's political chaos proves it's time for a de-Americanised world." (Khor, 2013) The crisis exposed the internal flaws of the US financial system, highlighting the problems that come with assigning an international role to a domestic currency. Largely due to the USD's international use, the regional financial crisis was able to spread so quickly to become a global economic one. Although the dollar appreciated at the start of the crisis until early 2010 proving its flexibility in times of turbulence, this paper argues that the credibility of a domestic currency

[1] Some scholars argue there is no such thing as a consensus, not a Washington nor Beijing Consensus. While acknowledging the discussion going on in scholarly circles, this paper will, for the sake of simplicity, refer to the Washington Consensus as a set of neoliberal rules and beliefs used to govern international institutions such as the IMF and WB. These support economic liberalization, deregulation, free trade, weak government control, self-healing powers of the markets, …

serving an international role was nevertheless severely undermined. In September 2009, the central bank governor Zhou Xiaochuan announced the need to diversify away from an international system centered around the dollar towards a future system with several reserve currencies. He recognizes that this isn't a job done overnight and that it would be impossible and inadvisable for the stability of the system to transition in a time of crisis. Moreover, there is not yet a suitable alternative to take the USD's place. However, that large political circles within and without China are convinced of the benefits of diversifying away from the American dollar, a gradual process requiring time, is clear.

The collapse of the Washington Consensus leaves the international governance system without a 'guidebook' that offers the solutions to crises and the emerging market economies with strong faith in alternative governance models and particularly the ability of their own model to gain international financial influence. In this context, the crisis can, in part, serve as an explanation for China's increasingly assertive role in the international financial system. How exactly will be discussed in the next section.

Another explanatory factor for China's financial assertiveness since the crisis, is the exposure of not only the flaws in the US' system but also in China's: its dependency on European and American consumer demand for continued economic growth. At the end of 2007, China's economy begun to slow down. When crisis hit the world, its economic growth rate dropped from 13% in 2007 to 9% in 2008 and continued to shrink to 6.1% in early 2009. Due to its capital controls, China's financial institutions were relatively protected. However, as professor Liqing Zhang stated in 2009, with China's accession to the WTO in 2001, its real economy has been deeply involved in global production networks explaining the poor economic growth statistics at the time leading up to and after the crisis. (Zhang, 2009)

The external shocks can be deduced back to several sources yet one is of particular relevance: China's export–led economic model. Due to the free fall of international demand, China's export sector was badly hurt. (Zhang, 2009) Since 1989, this export-led model has been extremely successful to boost economic growth and increase living standards. Although still minimal compared to the industrialized world at the time, consumption and individual incomes rose significantly, with real per capita consumption of peasants rising at an annual rate of 6.7% from 1975 to 1986. However, the crisis signalled the need for change. In the last two months of 2008, China's export dropped 2.2% and 2.8% year–on-year respectively, after continuously increasing for seven years since 2001. In the first half of 2009, the export decreased by 21.8%. The crisis exposed the dependency of China's export-led model on the well-being of the economy of its customers, primarily Europe and America. Its economic growth goes hand in hand with that of the developed world: when the Western consumer decides to stop buying cheap Chinese manufactured goods, China stops selling. Although this structural flaw was already recognized before, the crisis made clear that change is not simply necessary but needs to happen fast.

This chapter has identified two relevant flaws exposed by the global financial crisis: the strengthened belief in alternative models sparked by the collapse of the Washington Consensus as well as the urgency of rebalancing China's export–led economic model to decrease dependency on Western economies. The following section analyzes how these flaws exposed by the crisis sparked responses by the Chinese government specifically to boost their *financial* power.

4. How did China's Responses to the Crisis Contribute to its International Financial Power?

Above explains why the global financial crisis of 2008 can serve as a suitable moment in time to examine China's current position in the international financial system based on particularly two realizations brought about by the crisis. This section provides an overall analysis on China's financial power by dividing this power up into three different sources, explained in section 1.

4.1. China's Structural Financial Power

Structural financial power is primarily derived from the international pulling power of a state's financial markets and the function of its currency as an international store of value. Until today, the US' serves as the textbook example of such structural power based on mature financial markets and the dollar's international role. The crisis undermined the belief in the suitability of domestic currencies adopting the role of an international reserve currency, leaving the world looking for alternatives to avoid spill-over effect when the domestic dollar influences its value internationally. But what has the crisis meant for China's structural financial power? This chapter argues that China's structural financial power has indeed been rising due to policy responses by the government in reaction to the crisis of 2008 while acknowledging that it is still nowhere near capable of directly challenging US' superiority in this field.

With the credibility of the US' neoliberal model at stake, the belief in an alternative international system was remarkably voiced by central bank governor Zhou Xiaochuan in 2009 who, for the first time, explicitly identified the need to reform the international monetary system and diversify away from the dollar. Zhou writes:

> "The outbreak of the current crisis and its spill-over in the world have confronted us with a long-existing but still unanswered question, i.e., what kind of international reserve currency do we need to secure global financial stability and facilitate world economic growth. (…) Issuing countries of reserve currencies are constantly confronted with the dilemma between achieving their domestic monetary policy goals and meeting other countries' demand for reserve currencies. (…)The desirable goal of reforming the international monetary system, therefore, is to create an international reserve currency that is disconnected from individual nations, such as SDR." (Xiaochuan, 2009)

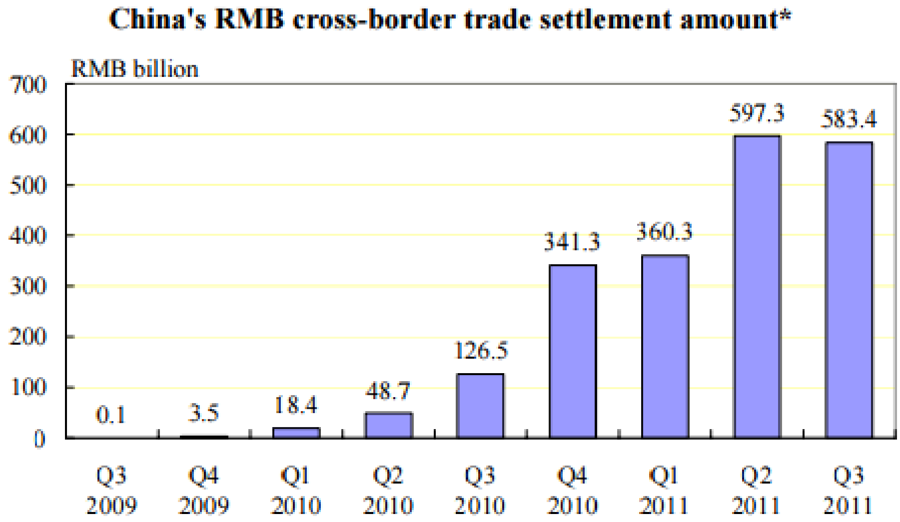
Zhou's essay proved the crisis' impact on the perception of the international monetary system within many, though not all, political circles in China. For the first time, a Chinese government official explicitly voiced the need for reform the system due to the inability of monetary authorities to focus on domestic goals while carrying out their international responsibilities. The USD's multiple facades had long been made aware of, but the crisis did prove that the costs of this system have now by far outweighed its benefits. Urgent need for reform was finally appreciated by the chief party leaders and a plan of action is obtaining concrete form.

Before zooming in on this plan, a second observation is to be made. The legitimacy crisis of the US' leadership model can definitely in part explain the strong stand against the dollar's double role but the realization of the dependence of China's economic model on Western economies too is reason to support this cause. China's export–led model is based on its continuous accumulation of foreign reserves in order to keep the value of the Renminbi (RMB) artificially low to increase export sales. 60% to 70% of these reserves are held in USD and re-invested back into the US by buying its treasuries. (Vermeiren & Dierckx, 2012, p. 1658) That China today still holds the largest amount of foreign reserves can be both positive and negative. On the one hand, it increases China's relational financial power by its strong creditor position, discussed in the next sub–section, but on the other hand, the value of these reserves is entirely dependent on the value of the USD and thus the American economy. If the dollar dropped in value, so does the actual value of China's reserves. (Yu H. G., 2009, p. 1) Zhou's essay indicates that the Chinese government is aware of this structural dependency yet struggles to tackle the problem as dumping these treasuries and selling USD may help at first but will cause the dollar's value to depreciate and thereby the worth of the remaining reserves too.

Moreover, the stimulus package pumped into the Chinese economy by the government as a response to the crisis arguably had a reverse effect, increasing the export-dependency. On 9th November 2008, the Chinese government announced a stimulus package of 4 trillion RMB to minimize the effect of an extreme drop in export demand and boost domestic consumption. (Yu Y. , 2010, p. 1) Instead, this enlarged the imbalance between investment and private consumption in China and increased the reliance on external demand. Because the majority of the stimulus package was invested into infrastructure projects, leaving less than 20% that went to social spending, the average Chinese household didn't not consume significantly more. When investment grows faster than consumption, rapid expansion is required in foreign markets to maintain strong growth. (Akyuz, 2011) The share of domestic investment increased from 42% in 2007 to 50% of GDP by the end of 2009 while the share of private consumption fell to a record low of 33.8%. (Vermeiren & Dierckx, 2012, p. 1685)

These experiences combined, the Chinese government has admitted the pressing need for concrete steps to decrease this dependence. This is proven by its numerous efforts to internationalize the RMB. Not to replace the dollar's international role as that would only relocate the problem, but to diversify away from a system centered around one currency. Before the crisis, the RMB had very little exposure to international markets due to government controls that prohibited almost all exports or use of the currency in international transactions. The Asian crisis already made clear that RMB internationalization would help China's financial stability yet discussions were often set aside as this inevitably brings in the debate about RMB convertibility and the need for full liberalization. (Yu H. G., 2009, p. 1) The recent crisis however, reemphasized the urgency of economic rebalancing bringing back the topic of currency internationalization. Although it will take time and great changes in China's current financial model, it remains possible. China has taken considerable steps to foster the RMB's rise in international finance in a number of ways. (Steinbeck, 2015) Concretely, an international currency needs to fulfill three roles: medium of exchange (for settlement), store of value (for saving), and unit of account (for denomination). (Ito, 2011, p. 3)

To enhance its role in the private sector as a medium of exchange, RMB has to be used in currency exchanges between two other currencies. Today, it is increasingly used in various types of payment due to deregulation that allowed firms to settle and invoice trade in RMB since increased trade between Chinese cities and Hong Kong in 2009. In June 2009, China signed a memorandum of cooperation with the Hong Kong Monetary Authority to allow cross border trade in RMB. (See table below) A month later, five other authorities in the region had joined the memorandum. (Deutsche Bank, 2014, p. 2) By August 2011, more than 30 Chinese provinces settled cross–border trade in RMB, including with other international trading partners. RMB is for example increasingly used in border trade with Myanmar and Laos, accepted as a payment method in neighboring countries like Mongolia. (Ito, 2011, p. 5)



Source: People's Bank of China (PBoC), China Customs, World Trade Organization

To increase the RMB's role as a medium of exchange in the official sector, it will need to serve as a vehicle for currency market intervention, i.e. when the transaction is not denominated in the domestic currency of the importer nor the exporter. In December 2008, China signed its first bilateral Currency Swap Agreement (CSA) with Korea as a response to the crisis. (Yu H. G., 2009, p. 4) Before, China only singed treaties of the like under the Chiang Mai Initiative (CMI) in which the bonds remained denominated in USD. (Eichengreen, Walsh, & Weir, 2014, p. 14) From 2009 until today, China signed bilateral CSAs with 32 counterparties to facilitate trade in RMB. However, although the use of RMB in the region is increasing, most settlements still happen in USD. (Yu H. G., 2009, p. 4) To further increase the RMB role in international markets, China will need to deregulate its capital controls to allow a two-way flow. Because the RMB is still not fully convertible, its inflow is limited. Liberalizing controls on capital accounts would "broaden oversees investment channels and encourage overseas holders to hold RMB assets." (International Monetary Institute, 2014, p. 139)

To boost the RMB's role as international store of value, the Chinese government has taken steps by increasing its offshore market, especially in Hong Kong. (Yu Y. , 2014, pp. 8 - 9) Raising deposits held by Hong Kong residents in RMB was key to enhance its role as reserve currency. Already in 2007, rising issuance of RMB–denominated ‘dim sum’ bonds took off. Recently, Singapore, Taiwan and the UK have followed. Dim sum bonds are issued outside of China but in RMB. They became especially attractive to foreign investors seeking yuan-denominated assets but were restricted by capital controls. This deregulation allowed the offshore market to develop and further internationalized the use of the RMB. (Norton Rose Fulbright, 2012) Especially the issuance of bonds amounting to 800 million dollars to the UK in 2012 was a milestone in RMB internationalization. (Prasad, 2016, p. 56)

The third major development since the crisis proving China’s priority assigned to internationalization are its efforts to increase its role as unit of account. (Ito, 2011, p. 4) In the private sector, shortly after the crisis, in July 2009, trade between China and its partners was increasingly invoiced and financial transactions denominated in RMB.

Moreover, when a currency is used in denominating securities, it also serves as a unit of account. Officially, to be used as a unit of account means to define exchange rate parities in RMB and act as a measurement of value for another currency. In this respect, China announced its wishes to add RMB to the SDR basket, a world reserve currency proposed by the IMF as an alternative to one domestic currency. If the RMB becomes fully convertible, than its inclusion could indeed become reality. On August 11 in 2015, the People’s Bank of China adjusted the RMB exchange rate against the USD to better reflect market conditions. The net effect was a devaluation of 1.9% relative to the dollar, its weakest point against the dollar in three years. The adjustment was an effort to comply with IMF requirements to include the RMB in the SDR reserve currency basket by making trade more open and market-based. (Ryan & Farrer, 2015) While this devaluation was effective in getting the IMF to officially include the RMB, it’s effects were severe on the Chinese economy. The devaluations caused great market fluctuations and turbulence in Chinese stock markets. The government even suspended trade several times in an attempt to offset the effects of the devaluation. One could argue this in fact proves China is not yet ready for liberalization of this size. However, it equally proves the government’s commitment to the cause since the crisis as drastic policy responses of this kind are not taken overnight.

Overall, the developments described show the current chief party leader’s support for increased liberalizations. However, the difficulties that have come along with this also make clear that a long and difficult road still lies ahead. In this respect, it is necessary to nuance the argument above that China’s structural financial power has indeed been rising due to policy responses by the government in reaction to the global financial crisis of 2008. Although the point remains, this paper too recognizes the trap of overestimation and ignoring the fact that China operates in an international system in which the US is still, by far, the actor with greatest structural financial power. Firstly, China's capital markets are still far behind in terms of breadth and depth, especially compared to the US. Moreover, due to regulatory barriers on access to China's capital markets, interaction and openness to foreign markets is very restricted. Furthermore, China's remaining capital controls and controversial exchange rate management, despite ongoing deregulation, continue to slow the internationalization process. Last, integration of China's capital markets in the international financial system has long been obstructed by low efficiency, high transaction costs, and weak supervisory and regulatory frameworks. Reforming this bureaucratic supervisory system will be necessary to increase competitiveness. (Wu, 2009, pp. 33 - 35)

When translating these qualifications into numbers, one finds that, in 2012, more than 80% of the international trade finance and 90% in foreign exchange finance was still done in dollar. Moreover, table 1 shows the most traded currencies in foreign exchange markets and confirms the high use of the USD as well as the Euro, relative to their high market share in global trade. The RMB, still constrained by exchange control, is therefore not even mentioned in the overview as its share of world payments is significantly lower than in world trade. (Auboin, 2012, p. 9)

Currency Distribution in Foreign Exchange Transactions

Currency	2001	2004	2007	2011
US dollar	89.9	88.0	85.6	84.9
euro	37.9	37.4	37.0	39.1
Japanese yen	23.5	20.8	17.2	19.0
Pound Sterling	13.0	16.5	14.9	12.9
Australian dollar	4.3	6.0	6.6	7.6
Swiss Franc	6.0	6.0	6.8	6.4
Other currencies	25.4	25.3	31.9	30.1

Source: Bank of International Settlement (BIS), Triennial Bank Survey, 2010
Notes: Since two currencies are involved in every transaction, the sum of percentage share of individual currencies equal 200%.

Even within Asia, the USD remained in the region the dominant invoicing and settlement currency for international trade. The USD's share in export invoicing of Korea and Japan was as high as 84.9% and 52.4%, respectively, in the early 2000's. In import, USD's share in Japan and Korea amounted to 70.7% and 82.2%, respectively. More recent statistics haven't been published yet but that the USD's use in Asian trade has not diminished and remains a major currency in the region still holds today. (Auboin, 2012, p. 11) However, that the RMB's share as an international payment currency by value has increased from 1% in 2013 to 2.5% today and will continue to increase as more trade between China and its trade partners is done in yuan, is already a great accomplishment. The RMB has more difficulties when it comes to international transactions between third parties, not involving China. In this respect too, one could argue that the RMB is today not yet a true international currency as the SUD remains the choice for third-party transactions. The table below shows an overview of the currencies used by Thailand when trading with the EU, US and other ASEAN countries revealing that the USD remains the number one choice. (ASEAN, 2010, p. 14)

Invoicing Currencies of Thailand's Trade (World) (Percent)

	Export						Import					
Year	US$	Yen	Euro	UK£	Baht	Other	US$	Yen	Euro	UK£	Baht	Other
2001	86	6	2	0	4	2	78	10	4	1	4	4
2002	85	6	3	0	4	2	77	10	5	0	4	3
2003	84	6	3	0	5	2	76	11	4	0	6	3
2004	82	7	3	0	6	2	76	12	5	0	5	3
2005	82	6	3	0	7	2	78	11	4	0	5	3
2006	82	6	3	0	7	2	79	10	4	0	5	3
2007	81	6	3	1	7	3	80	9	4	0	4	3
2008	81	6	3	1	7	3	81	9	4	0	4	2

Source: Bank of Thailand, Bangkok.

Although the Chinese government is slowly advancing in overcoming these obstacles proven by the many above-mentioned policy choices taken, it is true that, so far, China's structural financial power is relatively weak. It will take political will and foremost time to change that. The government will need to sequence this liberalization process to avoid sudden exposure to international capital markets its regulatory framework hasn't been adjusted to. However, the crisis *has* proved to be a benchmark for the current chief party leaders supporting liberalization in general, RMB internationalization in particular to actively move in this direction. Policy choices made since show China's considerable progress in internationalizing its currency and its determination to no longer be the rule-taker to a rule–maker in the international financial realm, yet in no way imply that China intends nor is anywhere near capable of directly challenging the USD's international role. (Ito, 2011, p. 2)

4.2. China's Relational Financial Power

The second source of global financial might is termed relational power. This refers to a state's ability to provide, refuse or withdraw credit and thus concretely to its creditor status. (Chin & Helleiner, 2008, p. 87) In 2004, China obtained the status of a large net creditor nation until it ranked second in the world by 2007, after Japan. (Haiwen, 2009, p. 4) With such a large amount of credit available, China's autonomy and influence in the international arena increased significantly. (Chin & Helleiner, 2008, p. 87) China has tried and succeeded several times to use this relational financial power to push through policies in other countries with limited sources of credit. Before going into detail of how exactly it has done so, it is important to first examine how the government was able to allocate so much credit.

China's emergence as a creditor nation was, in part, made possible by the massive current account deficit ran by the US since the end of World War 2. To be able to fund this deficit, the US relied on official creditors to buy USD-denominated assets, i.e. buy dollar debt. In response to the Asian crisis, this accumulation accelerated as a form of self-insurance when the IMF had failed to provide sufficient financial aid. In 2007 alone, emerging markets accumulated roughly thirty times the amount of currency reserves that the IMF lent out during the Asian crisis. (Dunaway, 2009, pp. 15 - 16) By that time, US current account surplus approached 0.7% of global GDP and by March 2009, China's financial institutions owned 1.5 trillion USD debt. The flipside of the story however, is that, while this greatly increases China's say in its own decision making, it too makes them more reliant on the American economy and the success of the USD as an international currency. The crisis made clear that too many foreign reserves denominated in the same currency makes an economy very vulnerable to fluctuations of that currency and the stability of others. The Chinese government has undertaken steps to diversify away from a pool of USD foreign reserves, in part by internationalizing its own domestic currency.

This credit accumulation stems from state control over Chinese financial assets that give it decision-making power over domestic and international credit allocation. The relational financial power derived from this accumulation of credit has been voiced out in the past. In December 2008, American financial expert, James Rickards, said that China possessed "*de facto* veto power over certain US's interest rate and exchange rate decisions." (Javer, 2008) Similarly, Gao Xiqing stated that "[The U.S. economy is] built on the support, the gratuitous support, of a lot of countries. So why don't you come over and […] at least, *be nice* to the countries that lend you money." (Gao, 2008) While discussion is ongoing on the ability of capital-rich countries like China to compel other great powers like the US into policy shifts, capital acquisition definitely allows a state to resist pressure from others and increases the ability to pressure others. It is true that with great powers like the US, capital-rich China may not be able to directly challenge them into certain policy shifts, due to prevailing structural power as well as the fat that China itself is dependent on the US, it definitely leaves room for cooperation and diplomatic dialogue that would otherwise be easily replaced by unilateral action by the US. For example, on 3 April, 2010, a long-awaited report was issued by US Treasury Secretary Greithner that would officially state the administration's stance on China's exchange rate policy and whether or not to label it a 'currency manipulator'. Against all expectations, Greithner carefully stated that "China's inflexible exchange rate has made it difficult for other emerging market economies to let their currencies appreciate. A move by China to a more market-oriented exchange rate will make an essential contribution to global rebalancing." He added that diplomatic dialogue in meetings and in multilateral forums "are the best avenue for advancing U.S. interests." (Greithner, 2010) Greithner's statement is very careful, arguably because of China's financial leverage that derives from its creditor status.

China has tried and succeeded to use this relational financial power to push through policies in other countries with limited sources of credit. For example, it has successfully persuaded countries in need of credit in return to officially recognize Taiwan as a part of China in return for this credit. In 2008, China bought 300 million dollar-denominated government bonds off Costa Rica in return to shift its diplomatic recognition of Taiwan towards China. (Bowley, 2008) Another example are China's numerous 'loan–for–oil' deals signed with oil-rich countries. In 2009, China lent Kazakstan's national energy company 5 billion USD in return for cheaper oil. (US Energy Information Administration, 2015) While this kind of power is not solely in the benefit of China as China still requires to 'buy' the advantages, it does give the government the ability to ask for almost everything as long as they can afford it. What may seem of no importance to the partner, i.e. diplomatic recognition of China, helps China push its international political agenda.

Another example of China's relational power at play can be found in its financial assistance to foreign governments, especially in Asia and Africa. In order to try to increase the returns on these foreign exchange reserves, they need to be reinvested. Especially since 2004, thhe year China went from debtor to net creditor status, China's financial resource for foreign aid has increased rapidly, averaging 29.4% from 2004 to 2009. By the end of 2009, China had aided 161 countries and over 30 international and regional organizations. (Information Office of the State Council, 2011, pp. 3 - 11) Even after the crisis, between 2010 and 2012, the scale of China's foreign assistance kept expanding. China provided 89.34 billion RMB (14.4 billion USD) of foreign aid of which over 50% went to Africa, 30% to Asia.

China's rapid development has made it the largest consumer of primary resources, with domestic consumption rates four times those of the US. As a result, China has needed to look outside its own borders to find these much needed resources. China's foreign aid activities in Africa and Latin America serve these immediate economic interests. In Southeast Asia, longer term diplomatic and strategic objectives are often the primary goal by boosting their soft power in the region. (Lum, Fisher, Leland, & Gomez - Granger, 2009, p. 2) In 2008, a US report for congress states that "China's diplomatic engagement has earned the country greater respect in the region. Its rise as a major foreign aid provider enhanced its relations with Southeast Asian states. […] China's growing ability to affect the actions of state actors largely stems from its role as a major source of foreign aid, trade and investment." (Lum, Morrison, & Vaughn, 2008) One way in which these aid and lending programs spread Chinese soft power is their unconditionality. (Chin, 2012, pp. 215 - 217) When lending money from IMF, nations are required to adhere to certain conditions such as human rights, democracy, transparency, etc. China has always advocated that foreign nations shouldn't interfere in domestic affairs, making its loans much more attractive to developing nations. With the recent crisis, Western countries have even greater conditions to their loans. Instead, China's engagement with the continent has only increased. According of Fitch Ratings, the Export–Import Bank of China has extended 12.5 billion USD more in loans to sub–Saharan Africa between 2001 and 2010 than the WB has. (Cohen M. , 2011) Moreover, Chinese money from these programs often go to large publically visible projects such as roads, railways etc. increasing local support due to the tangibility of the results of China's presence and thus its soft power in the region. (Brandt, et al., 2012, p. 12)

When it comes to translating this relational financial power into tangible results with other players its size, such as the US, China has encountered more difficulties. Drezner states that "more often than not, the attempt to use financial power to exercise political leverage against great powers has failed." Even implicit threats can have a coercive effect. Creditors may use financial relations to build up sympathetic domestic lobbies in debtor countries. With powerful nations like the US, there are often always other sources of credit available, limiting China's potential leverage over this target government. Moreover, directly leveraging its creditor status over the US may result in sanctions on their side and cause China to retaliate, since America's indebtedness to China makes the latter vulnerable to USD exchange rate fluctuations as previously explained. However, China does have to option to slow down the purchase of new debt or shifting the composition of foreign holdings. Even implicit threats can have a coercive effect. During the 2008 presidential campaign, Barack Obama stated, "It's pretty hard to have a tough negotiation when the Chinese are our bankers."

The above paragraphs make clear that there are two sides to China's relational source of financial power, just like its structural source. Already before but especially after the crisis in 2008, China recognized the need to invest its large foreign reserve holdings to decrease its dependence on the US through financial aid, infrastructural loans, trade–for-oil deals, etc. The amount of credit available to China has thus given it the opportunity to be a more confident, initiating player in the international financial system. However, that doesn't mean this creditor position has given China unconstrained power to coerce others, especially great players, into policy changes or favored treatment. Moreover, China's creditor position is primarily based on the current account surplus it was able to run the past decade due to its export- and investment-led model. The crisis and recent economic slowdown have proved this model to be outdated and highlighted the need to move towards a more liberalized system including the domestic consumer to keep up the current account surplus and thereby protect its relational financial power. Concretely, the model refers to an economic liberalized system introducing market discipline where capital controls are of the past to allow wider cross-border money flows, where residents can buy foreign assets freely, where banks are undone from government control and interest rates can float freely and the domestic currency is fully convertible. In the long-term, this will allow China to maintain the current account surplus and thus its creditor status. (Heep, 2014, p. 100)

This liberalization, however will be very difficult and receive lots of protest from within the party. It will decrease the state's control over the allocation of these foreign reserve assets, risk short-term financial instability but particularly diminish the party's control over the economy and thereby risk social unrest and threaten the unity of a one-party state. The government fears that China's large pool of foreign reserves will flood out of the country when liberalizing the controls and allowing increased money flows. Vested business interests will be hurt already causing great political resistance. (Ling, 2015) However, China's relational financial power and the maintaining of its creditor position in the past has largely relied on its ability to run a current account surplus over the years. The crisis proved the unsustainability of the export-led model and the current economic slowdowns its urgency. This shift is likely to be postponed for as long as possible due to the vested interest within the party that strongly oppose liberalizing China's financial model. China's future relational financial power will thus rely on the ability of the government to harmonize these opposing factions and push through liberalization measures to keep status of creditor nation.

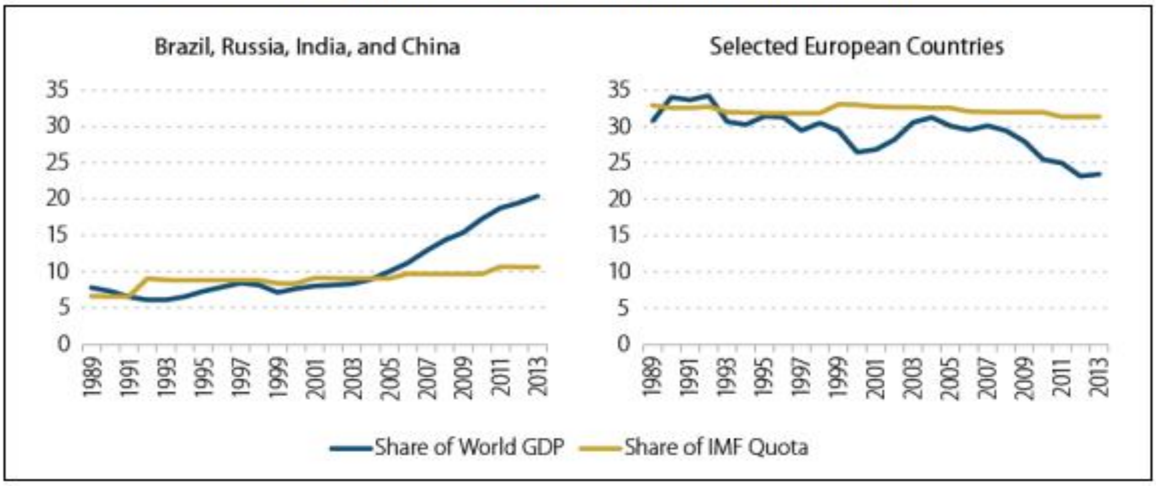
4.3. <u>China's Institutional Financial Power</u>

The final source of China's financial power is its institutional might, defined previously as "a state's ability to influence the behavior of other states through the policy decisions of international financial institutions in general and the IMF and the WB in particular."

Until China's accession to the WTO in 2001, its interaction with these IFIs was termed "socialization": China internalized the norms of these institutions through participation. Since the early 2000s however, Chin notes a remarkable shift in attitude where China, in this case in the WB, "actively working to move the Bank beyond some of its established endogenous norms and practices." (Chin, 2012, p. 211) China has advocated the need for fundamental reform of the international financial architecture based on misrepresentation and Western values entrenching the IFIs over the past decade. For the first time, it has taken a step back from the Bretton Woods organisations. Before, China, amongst other developing countries were alone in doing so but when crisis struck in 2008, president George W. Bush called the G20 together instead of the G7/8. (Chin, 2012, p. 214) This decision is proof of the significance of the crisis for institutional power of the developing world. To determine the scope of this increased power within IFIs, three factors need to be examined: a state's voting share within, the amount of funding it provides to these institutions and its representation of staff members and management. (Heep, 2014, p. 107)

Both the IMF and the WB have a 'weighed voting system' based on scientific formula created to reflect each member country's size in the global economy. The larger one's voting power, the larger one's say in the institutions. With their installation at the Bretton Woods conference in 1944, the US gained the most voting shares and financed one third of the institutions. (Gianaris, 1990, p. 916) Since then, the world economy has experienced tumultuous rebalancing yet the US voting shares remained extremely high when underdeveloped countries were often underrepresented. (See tables below) With the Asian crisis but especially the global crisis of 2008, economic weight has been shifting from the West towards the East, delegitimizing US's veto power in these institutions. In this new international realm, former governor of the People's Bank of China, Dai Xianglong, has argued that the existing "international monetary and financial system can no longer accommodate the needs of international economic and financial development, and, therefore, the system needs to be reformed". (Dai, 1999) In 2009, China, among others was able to leverage its increasing economic weight in the G20 to adjust the shares in both IFIs to better reflect the changed international relations. Concretely, in 2010, the WB signed off on voice reforms increasing voting shares of developing and transitioning countries by 3.2%, totalling up to an increase of 4.6% since 2008. Until then, China accounted for 15.4% of the global GDP but only had 3.8% of the IMF voting shares.

IMF Quota and Share of GDP:
Selected Emerging Markets and European Countries Since 1989



Source: IMF, *International Financial Statistics*; World Bank, *World Development Indicators*.

BRICS Voting Rights in the IMF compared to GDP.
(GDP share measured in nominal US Dollar terms; IMF Voting Rights as of August 2014)

	% Share of IMF Voting Rights	% Share of World GDP
China	3.81	12.4
India	2.34	2.6
Russia	2.39	2.8
Brazil	1.72	3.0
South Africa	0.78	0.5
TOTAL	11.04	21.2

Sources: IMF; IHS

Moreover, in December 2010, the Board of Governors of the IMF agreed to a deep package of governance reforms to avoid losing all legitimacy. The Board proposed to shift 6.2% of the voting shares to "dynamic" emerging market economies. Together with earlier reforms of 2008, this totalled to 9%. (Nelson & Weiss, 2015, p. 1) The IMF's managing director at the time, Dominique Strauss-Kahn, referred to this package as "a historic agreement […] in the fund's 65-year history and biggest ever shift of influence in favour of emerging market and developing countries." Four emerging market economies, China, Brazil, India and Russia, are now under the top 10 members of IMF, with China in third place behind the US and Japan. (Sharma, 2015) Although agreed upon in 2010, the reform package was only formally approved as late as December 2015 due to the US veto power, with 16.75% of all shares, against the reforms. This caused enormous frustration among Chinese politicians and further loss of belief in the Western–dominated institutions. Yi Gang states, on behalf of China, that "we are deeply disappointed that the 2010 reforms were not ratified by the deadline of September 15, 2015, which further undermines the credibility, legitimacy and effectiveness of the Fund." (Yi, 2015) Furthermore, knowing that these reforms are likely to be a one–time thing, scholars requested a change in formula calculating voting shares to prevent future misrepresentation but no steps have been taken. While this executive board may not vote often, it remains important to keep up IMF's legitimacy by representing all members equally to be able to cooperate successfully.

The more money donated by a member to the institution, the more this institution relies on this member for resources and therefore, indirectly, the greater its institutional financial power. While the amount of a member's contributions is primarily based on its voting shares within, the New Arrangements to Borrow (NAB) allow IMF members to contribute more in times of need. Since the crisis, its main contributors in the west experienced great economic setback. The IMF called upon China to provide financial resources to help them out. Initially, the Chinese government felt that it was not its duty to rescue the developed world and put great pressure on the IMF by refusing to participate. At the time of the governance reforms in 2009 however, China pledged to contribute 50 billion USD through note purchase. Both China's provision of money and its initial refusal to give in to IMF pressure are manifestations of China's power increase within the fund since the crisis.

In the WB too, China recently increased its financial contribution. When it joined in 1980, China was classified as a recipient member, receiving loans till 1999. Until 2011, China was listed as a middle–income country, borrowing to 39.8 billion USD. Today, it is categorized as an upper-middle-income country and uses Bank funding for relatively small projects. Its rise in classification has come with a change from recipient to donor status as well, proving its growing influence within. In 2008, China contributed 30 million USD to the 15th Bank's replenishment and 50 million USD to the 16th in 2010. (The Bretton Woods Project, 2011) In the future, China may not need much more money from the WB anymore as it itself is climbing up the ladder of development yet it still continues to borrow a relatively large amount indicating the government's commitment to support the institution and keep up its influence within. Over time, China will be able to use its credit as leverage by threatening to withhold contributions to make its voice heard.

The crisis marks positive development for China's representation among IMF's staff members and management too. As part of the reforms, the system of appointed Executive Directors will be replaced by one based on election. Previously, the 5 member countries with greatest voting power appointed a director of their own while the remaining were elected. As a result, in 2012, the board counted 8 directors from advanced European countries. The reforms ended this system of appointment, increasing the institutional power of developing countries, including China. (Nelson & Weiss, 2015, pp. 4 - 8) Furthermore, the IMF's managing director has historically always been a European when the WB president American. This standard was questioned in return for merit-based selection. In fact, IMF's current deputy managing director, Zhu Min, is of Chinese nationality. While China, as a state and member of these IFIs, may not have played a particular role in these achievements, the outcome proves a changing institutional environment to reflect a new geopolitical reality in which emerging market economies have a greater say. China too, will benefit from these changes and boost its institutional financial power.

While advancing in established institutions, China has taken institutional financial power into its own hands to avoid future frustration. The BRICS launched several new initiatives to better reflect the new international system in which the US is no longer the unipolar actor but emerging markets have a louder voice. (Biswas, 2015, p. 2) The crisis of 2008 served as a catalyst for this stream of initiatives in structurally disadvantaged regions within the existing Western framework. This theoretical approach has been labelled ‘systemic context’ by Henning who argues that “particular conditions are especially propitious for East Asian financial cooperation. The discrepancy between East Asia’s influence within IFIs is likely to continue to fuel ambitions for cooperative arrangements outside the ambit of multilateral organizations.” (Henning C. , 2005) Concrete examples are the CMIM, the CRA, the AIIB and BRICS NDB.

4.3.1 Chang Mai Initiative Multilateralization

As a response to the Asian crisis and IMF’s malfunction in helping out Asian countries in need, ASEAN + 3 started the CMI in May 2000 aimed at expanding swap networks between member countries. Such swaps allow local currencies to be exchanged for USD to alleviate international liquidity problems on short–term basis and offer an alternative to the IMF. (Henning R. , 2002, p. 14) In the aftermath of the crisis, especially China and Japan felt strong incentive to create regional currency management to deal with the USD crisis. It decreased the dollar’s attractiveness as a currency for foreign investment. (Hassdorf, 2011, pp. 125 - 126) Agreed upon in 2007 and implemented in 2010, the CMI was boosted to a new stage of regional financial cooperation: Chiang Mai Initiative Multilateralization. This entails a ‘self–managed reserve pooling agreement’, that started off with 120 billion USD and was doubled in size two years later. With CMIM, ASEAN + 3 countries have signed off to an agreement to make available their foreign reserves in case of financial crisis to other member countries. With this commitment, at a relatively large price since China is likely to remain a creditor helping out others in crisis, China primarily befriended its closest neighbours with whom trade and political dialogue is, until today, most successful. By taking part in initiatives, both Western and non-Western, China increases the number of political platforms available, diversifying its options when looking for partners or legitimation.

4.3.2 Asian Infrastructure Investment Bank

In October 2013, China announced its plans to establish a 'new multilateral development bank of the 21st century', called AIIB. With the limited annual amount of 10 billion USD, the Asian Development Bank (ADB) doesn't fulfil the region's yearly infrastructural need of around 800 billion USD. A new IFI was necessary to finance infrastructure for growth in Asia. Moreover, the AIIB will benefit China's Silk Road Project by infrastructure plans along this route and counter the global institutional realm now dominated by the developed economies in which China and others continue to underrepresented.

By October 2014, 22 countries signed membership into the bank and by March 2015, 58 filed to become a founding member, including major European economies like Germany and France, excluding the US and Japan. (Renard, 2015, p. 1) Although based on multilateralism, China's influence in the AIIB is expected to be significantly larger than others. China will be funding 50% of the initial capital, giving it a larger say into the institution than other members. This will decrease China's dependency on the US and European economies as this money stems from its large pool of foreign exchange reserves. The leadership role China has taken on proves its increasingly assertive role in the international financial system, as a rule maker in general and a donor of credit in particular. The AIIB's headquarters will be located in Beijing, after much dispute with South Korea, proving China's influence at work. As the largest shareholder, China has moreover led decision-making. For example, Jin Liqun, chair of supervisory board of China's sovereign wealth fund, is leading a working group, set up by the Chinese Ministry of Finance, to outline the bank's structure and procedures. (Robert, 2015, p. 10)

Different from ADB and WB loans that go from environmental issues to gender equality, the AIIB solely focuses on infrastructure within Asia. (Fleming, 2016) While similar in geographic coverage of Asia, the ADB's leading country, settlement currency, business focus, financing structure, membership structure, ect. is different. Moreover, China's role is larger within the AIIB than Japan is for ADB. Despite differences, both institutions are required to fulfil the region's infrastructural needs.

	AIIB	ADB
Headquarter	Beijing	Manila
Membership	57	67
Business focus	Infrastructure	All developmental sectors
Leading country	China	Japan
Settlement currency	Not yet decided upon but likely RMB, USD or a basket of currencies	USD
Initial capital	50 billion USD	100 billion USD

The AIIB and WB too are in many respects similar to one another. China has been learning from the Bretton Woods institutions since the 1980s. It is therefore more alike than it is different yet novel in that the US didn't initiate nor dominate the AIIB. (Wan, 2016, p. 86) However, the AIIB aims to be more efficient and less politically driven with fair representation of its members. Moreover, the AIIB solely focuses on infrastructural projects in Asia while the WB covers all developing regions of the world concerning far more divers matters.

As the official website points out, the AIIB "will complement and cooperate with the existing MDBs to jointly address the daunting infrastructure needs in Asia". China is not aiming to compete with the Western-dominated institutions like the WB and ADB directly. In fact, in April 2016, the AIIB signed an agreement with the WB to undertake joint projects and undermine the perception that the former is an enemy to the latter. However, "the AIIB also intends to make adjustments to some of the regulations in the established MDBs to raise operating efficiency and improve upon current operating practices." (Sekine, 2015) Economist Magnier writes that "the AIIB aims to differentiate itself from other lenders with a leaner, more efficient structure that ultimately gives Beijing veto power over major decisions". To do so, the AIIB will, unlike the ADB and WB, install an unpaid, non-residential board of directors, which will decide on budgets and projects. (Magnier, 2015) This allows for a more unbiased management. Although China has between 25 and 30% of all the bank's votes, which ultimately gives it veto power to block motions, the unpaid, non-residential board will likely push back if China tries to procure its own national advantage. Moreover, China has, as a founding member, made clear that it's willing to waive its veto power in day-to-day operations. Operating without a residential board of directors and leaner staff will save money and prevent friction between the management and resident staff is expected to help boost efficiency of the bank too. However, the bank should still primarily been seen as a reaction to the top-heavy and Western-dominated institutions that ruled the international institutional realm for the past decades. Concretely, the AIIB's voting structure entails that 75% of all the votes are reserved for members of the Asia–Pacific region to allow smaller developing Asian countries a say too. (Sun, 2015)

One of the main challenges for the AIIB to achieve this efficiency will be standards and regulations. The bank has previously pledged to use its members' experience and knowledge learnt when with the WB and implement the high-quality standards and operations characteristic to Western multilateral development banks to comply to the international norms by increasing transparency and claiming legitimacy. However, this will likely compromise its aim to be more efficient as it is exactly these standards that often delay decisions. (Sun, 2015)

By initiating this bank, China boosts its institutional power but also increases soft power in the region. First of all, it proves China's willingness to work not only bilaterally, the more practical, efficient way of interaction, but also multilaterally. China is prepared to take into account its members' interests and shows willingness to take up international responsibility that comes with its growing role in global economy by, for example, participating in international climate accords, ending its system of currency manipulation, etc. (Renard, 2015, pp. 3 - 4) Major challenges to gain legitimacy need to succeed in reshaping the system will be to construct a governance and decision-making body with a high degree of transparency, integrity, compliance to international standards and political independence. (Biswas, 2015, p. 9)

4.3.3 BRICS New Development Bank & Contingent Reserve Arrangement

In July 2014, the agreement was signed by the BRICS to set up the NDB with initial capital of 50 billion USD. The bank would be supplemented by the CRA of 100 billion USD. (Biswas, 2015, p. 5). The NDB's aim is, like the AIIB and WB, to provide development finance for infrastructure while the CRA is an institution supplementing the IMF in providing balance of payment support to BRICS countries in need. Both the NDB and CRA will be based in China (Shanghai). Besides moving away from an international financial architecture based in Washington, this indicates China's significant influence in the institution. While the NDB's capital provision is equally divided amongst the five establishing members, China has already provided 41 billion USD to the CRA. (Robert, 2015, pp. 8 - 10)

By initiating and participating in these new IFIs, China, establishes itself as a rule maker, a role it has adopted since early 2000 and strengthened after the global crisis of 2008. With this newly adopted role, China may not be capable of challenging the US yet but does intend to increase its presence in the global arena, as any growing power would, by deepening its already broad influence. China has done so in several ways, economically, culturally, military but of importance here is financially. Feeling entitled to an increased say in the international sphere, China has turned its long discontent with the international financial architecture into real actions aimed at fundamentally changing a long established Bretton Woods tradition. Although challenges lie ahead, this change in attitude, accelerated by the crisis, indicates China's increasing assertiveness in and commitment to an international institutional environment reflecting its right to a louder voice. (Biswas, 2015, p. 8)

5. Conclusion

At its most basic foundation, the aim of this paper was to shift scholarly focus away from the West, towards the East and China when analyzing the effects of the recent, and indeed *global* crisis. Moreover, the paper aimed to include China's *financial* power in its overall economic analysis. While acknowledging that finance and economy are inevitably linked, it is still useful to analyze one separate from the other to paint the most complete picture. Knowing that China's real economy is facing difficulties, this research focused on China's rising international financial power. More concretely, it used the global economic crisis as a benchmark in time to examine this power. By using the theoretical framework of previous scholars and dividing financial power up in three different sources, China's changing position in the international financial system was analyzed at its core, taking into account *all* aspects of this power.

The paper has first explicated why the global economic and financial crisis is taken as a suitable period in time for an assessment of China's financial power. It deduced two relevant realizations brought about by this event:

(1) As a result of the crisis, internal flaws of the international system of governance that has been rigidly in place since, at least, 1989 have been exposed. This Washington Consensus, often described as neoliberal, is now doubted in most political circles across the world, including the US. Such time of turbulence creates room and opportunities for world leaders and scholars to seek and defend alternative models of governance. The belief that the world should no longer be centered around one hegemonic player is strengthened and replaced by one reflecting a new geopolitical reality where emerging market economies like China play an increasingly important role, creating an environment that encourages changes and initiative.

(2) Due to a huge drop in demand of the Western consumer for cheap Chinese manufactured goods as a result of the crisis, experts realized the unsustainability of Chinese economic model. While this has been predicted before, the rebalancing of the domestic economy to include the private consumer has become not simply advisable, but necessary and urgent will China keep up its growth rates. The crisis meant a true appreciation of the urgency of this matter and the new environment as a result of the first realization (1) has allowed concrete forms of action to take place by the government.

These two realizations as a result of the crisis have impacted China and its decision - making in different ways. What was specifically examined here is how this shaped China's position in the international financial system, based on three types of power.

Concerning China's *structural* financial power, the process on internationalizing the Chinese domestic currency was of primary focus. Initiatives have significantly increased since the crisis and the benefit of an international system no longer centered around one domestic currency, USD, but one based on a multitude of different currencies or a basket one like SDR was voiced by party members in China. The crisis made sure that, although there is still fragmentation within, the chief party leaders no longer denied the need to liberalize and their commitment to the cause is clear, including the need to continue internationalizing the RMB's use. Relatively speaking, it is still true that China's power is nowhere near that of the US and that there are many obstacles to overcome yet that is not the point made in this paper. Important is that the crisis has served as an important event in history for China to boost its structural financial power.

Secondly, China's *relational* power, derived from its large pool of foreign reserves and enormous capital at its disposal, too has proved to be very useful in the past 8 years. China has bought its influence in the international system through its relational financial power.

In fact, China's *institutional* financial power was largely dependent on its relational financial power since financial contributions to international institutions such as the IMF and WB have helped China increase its say within. In addition, China has also been very active and taken initiative to diversify away from an institutional environment dominated by Western powers by initiating some of its own institutions such as the AIIB or contributing to the establishment of others such as the NDB.

When solely looking at China's structural financial power, one could argue that China's international financial power is relatively weak,. However, when combining this with the other sources of power, it becomes hard to entirely negate China's increasing international financial might. It is exactly this theoretical approach that lies at the foundation of this analysis that makes this research paper relevant. It combines the different aspects to draw a balanced, more nuanced picture of China's position in the international financial system.

In this respect, this paper too has acknowledged the fact that there is definitely a long way ahead for China to achieve the rebalancing act and continue its way along the path of rule-making. Obstacles linked to its current developmental state model remain to be resolved in order to keep boosting this international financial power. Mainly for its structural might, fundamental reform to allow free movement of capital and further liberation of its exchange rate management is required. This path will likely be inefficient due to the party's inner fragmentation slowing these inevitable liberalization processes. That the global crisis marks a shift in attitude within the Chinese ruling party remains true, manifested in the many initiatives undertaken by the government. The desire to play a lead role in the global financial system of the 21st century is sky-high and rising. The final goal has not (yet) been reached but, as the Chinese have said for millennia: "If you want to get rich, you have to build roads first."

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