The Impacts of Rising China on Global Economic Governance

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In assessing the impacts of China's rising economic power on global economic governance, this essay argues that domestic politics and international pressures will be two determining factors of China's future preferences toward global economic governance. In this essay's first part, I discuss the mechanisms by which great powers influence global governance, while in the second I address two policy issues: financial supervision and macroeconomic surveillance.

Why Great Powers Matter

The capability of great powers is a crucial determinant of international regulatory outcomes. Drezner (2009, p. 33) has stated that superpowers matter because they can translate their market size into bargaining power in order to affect other counties' material incentives and perceptions. Superpowers can also use coercive power to alter other actors' payoff structure (Drezner 2009, p. 33, 57; Simmons 2001). Since great powers have more market and coercive power, they are more capable than other actors in influencing international regulatory bargaining outcomes.

For great powers, preference is another important factor affecting international regulatory outcomes. These preferences are determined by the domestic political equilibrium of actors and institutions; if the adjustment cost outweighs the benefits of regulatory harmonization, then coordination is a less likely outcome. Accordingly, Drezner (2009) has typologized global governance processes based on convergent or divergent interests both among great powers and between those powers and other international actors (Table 1).

Table 1: A Typology of Regulatory Coordination

Divergent interests between great powers and other international actors Divergent interests among great powers **High Conflict Low Conflict High Conflict** *Sham Standard Rival Standard* **Low Conflict** *Club Standard Harmonized Standard*

As mentioned, we can predict that as China's economic power increases, it will accumulate market and coercive power with which it can affect other international actors' behaviours. Moreover, since a great power lacks a bargaining advantage over another great power, it will be difficult in this case for other great powers to coerce China into changing its behaviour (Drezner 2009, p. 58). China's preferences, as determined by the domestic status quo, will thus be the most important factor affecting the possibility of convergent interests among great powers.

Since China's preferences vary by issue, such difference may affect current global economic governance in different ways. To analyze such variation, this essay discusses two different issues to evaluate how China's economic rise affects global economic governance.

Financial Market Regulation and Supervision

Existing Global Economic Governance

The major global economic framework of financial supervision is the Basel Committee on Banking Supervision (BCBS), established by G7 countries in 1974. To resolve problems of competitive inequality, the instability of high leveraged loans in transnational interbank markets, and the regulatory "race to the bottom," the BCBS aims to contribute voluntary standards on minimum bank capital rules (Foot & Walter 2011, p. 232). In December 1987, central bankers from the G10 agreed to adopt the Basel Capital Adequacy Accord (Basel I), which requested that Basel Committee member countries hold capital equal to 8% of their risk-weighted assets (RWA) until the end of 1992. Basel I is widely accepted by many non-G10 countries (Simmons 2001, p. 604). However, the Basel I framework was challenged by big global banks, which asked for an internal risk management model to enhance their competiveness. With these global banks' lobbying and support from the U.S. and U.K., the BCBS provided a revised capital framework—Basel II—that included the market self-regulation mechanisms (Foot & Walter 2011, p. 237). Yet, Basel II was not widely accepted by developing countries, which claimed that Basel II favored more sophisticated banks in advanced countries and increased their lending to developing countries (Foot & Walter 2011, p. 237). After the financial crisis in 2008, the norm of market self-regulation in the Basel framework was criticized for underestimating risks. Since then, many proposals have called for the reform of the Basel framework, and in 2009 the G20 established a new institution, the Financial Stability Board (FSB), to manage international regulatory standard-setting.

China's Existing Preferences

China's preferences support Basel I and Basel II, since it considers that the positive benefits of this international framework outweigh the cost of domestic adjustment. First, as Chinese banks import regulatory and managerial technologies from abroad, such internationalization can increase their competitiveness (Foot & Walter 2011, p. 265–266). For state-owned Chinese banks (SOCBs), internationalization can facilitate overseas branch expansion and increase their international reputation for joining international banking organizations (Foot & Walter 2011, p. 266, 269). Second, the China Banking Regulatory Commission (CBRC) and People's Bank of China (PBOC) can use this international standard to overcome domestic resistance to bank reform (Foot & Walter 2011, p. 266-267), yet third, not reduce their control of the banking sector while being applied both gradually and pragmatically. Such a low level of politicization can reduce adjustment costs (Foot & Walter 2011, p. 267-268). Fourth, that the Chinese political system, which suppresses public objection, can also reduce domestic adjustment costs (Foot & Walter 2011, p. 268). Lastly, since China does not rely on external borrowing, it does not share the concerns about Basel II held by developing countries.

Since China's current preferences still converge with other great powers and since other countries remain skeptical about Basel II, global economic governance of financial regulation and supervision could be harmonized with a club standard.

Prediction of China's Future Preferences

This trend could be changed only if China's domestic political equilibrium changes. For one, if SOCBs continue to grow and ultimately become powerful international banks, then they may gain lobbying abilities powerful enough to challenge CBRCs' and PBOCs' deeper regulations by supporting specific factions. Furthermore, if the FSB strengthens its peer review mechanism, such could reduce the reality of China's gradualist approach and increase domestic adjustment costs. International pressures and powerful domestic lobbyists may raise the domestic adjustment cost to outweigh the benefits of the international framework. When China's preferences do not support the Basel framework, then what was the club standard could become that of the rival standard.

Macroeconomic Policies and Exchange Rates

Current Global Economic Governance

To solve the problems of beggar-thy-neighbor currency devaluations, the International Monetary Fund (IMF) since

1944 has been expected to act as the chief international macroeconomic surveillance agent in order to prevent large international payment imbalances. IMF's first core norm is that national macroeconomic policies should be coordinated by international peer-based surveillance (Foot & Walter 2011, p. 82), while the second is that countries running current account surpluses are obligated to contribute to the international adjustment process (Foot & Walter 2011, p. 84). In practice, the IMF has a formal framework that is, however, not the most effective framework. For great powers, they still prefer to use networks, such as the G10, the Working Party 3 of the Organisation for Economic Co-operation and Development (OECD), the G5, and the G7, to coordinate surveillance (Foot & Walter 2011, pp. 85–92). After the global financial crisis of 2008–09, G20 leaders promised to strengthen IMF surveillance, though many developing countries criticized the IMF framework for continuing to impose fewer constraints on developed countries (Foot & Walter 2011, pp. 94–95).

China's Current Preferences

China agrees to gradually adjust its exchange rate policy, yet does not totally accept the IMF framework. Instead, Chinese leadership prefers RMB appreciation that can reduce inflation, prevent disruption in trade relationships with the developed countries, and rebalance its own economy away from investment- and export-driven growth toward growth driven by domestic consumption, which can reduce regional inequality and sustain long-term growth (Foot & Walter 2011, pp. 117–118; Hofman & Kuijs 2008). Because China benefits from rebalance, it accepts the first IMF norm: that international coordination of macroeconomic policies is crucial. However, domestic adjustment costs for China are high. Tradable industries have opposed RMB appreciation, since they worry that such will hurt their competitiveness (Steinberg & Shih 2012; Foot & Walter 2011, p. 117). RMB appreciation may also cause inflows of hot money, slower growth, and unemployment, all of which may trigger economic and social instability. Hence, Chinese leadership prefers a gradualist approach for RMB appreciation in order to balance domestic interests. When the U.S. and the IMF use the second norm to pressure China to appreciate RMB rapidly and on a large scale, Chinese leadership remains reluctant to accept that it should bear such a responsibility for international adjustment to global imbalance.

Since the benefits of RMB appreciation still outweigh the domestic adjustment costs, Chinese leadership has partly accepted IMF norms and rejoined the IMF's bilateral surveillance in 2009. However, this club standard has not maintained its linear trajectory, since China does not share the convergent preference of rapid RMB appreciation with other great powers and continually complains about the IMF and G20 surveillance framework (Foot & Walter 2011, pp. 120–121).

Prediction of China's Future Preference

The current club standard of macroeconomic surveillance could be changed by China's rising economic power in the following ways. First, if China continues to rely on the investment- and export-driven model, Chinese tradable industries would retain a considerable ability and preference to block or even reverse RMB appreciation. Tradable industries' lobbying may increase the domestic adjustment cost and make international coordination less attractive for Chinese leadership.

Secondly, if China reforms its inefficient economic institutions in order to sustain economic power, then redistributional policy outcomes may increase social instability, since the Chinese political and justice systems will remain unable to effectively coordinate conflicts of interest among social groups (Göbel & Ong, 2012). As the overall chance of social instability increases, domestic adjustment costs for RMB appreciation increase and incentives for Chinese leadership to harmonize with international surveillance decrease.

Finally, if the U.S. and other developed countries continue to pressure China to uphold the second IMF norm, China may seek to promote IMF reform with other developing countries in order to establish a new norm of symmetrical responsibility for adjustment. For example, China may ask for a greater voting share for developing countries, which would increase China's ability to translate the IMF's club standard into a rival standard.

Conclusion

Given its rising economic power, China's preferences have become an important factor in determining the type of global economic governance. By reviewing the issues of financial supervision and macroeconomic surveillance, this essay argues that China's current preferences are still harmonized with global economic governance under a club standard. However, if Chinese domestic political equilibrium changes with its rising economic power or the possibility of its gradualist approach decreases, then its future preferences could shift toward the rival standard of global economic governance.

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