History Matters: China and Global Governance

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Paper presented at PAFTAD 34: China's Role in the World Economy

Beijing, December 8, 2010

Abstract: This paper focuses on the two-way relationship between China and the international economic system. China's embrace of the global institutions and their rules and norms helped guide its spectacular economic growth and integration into the world economy.

China's impact on the global economic order is still an open question, however. Its sheer size and dynamism makes it a force to be reckoned with. So far its influence has been largely constructive but recent signs of assertiveness raise questions about the future. History matters to the answer. Memories of both historical pre-eminence and humiliation drive nationalism and assertiveness at the same time that China identifies with developing countries as a counterbalance rather than as a leader or enforcer of the global norms and rules.

The paper evaluates China's role in the regional and global economic institutions by applying this criterion of economic cooperation: is China willing to modify national policies in recognition of international economic interdependence? The evidence presented is mixed reflecting the complexities of China's modernization and re-emergence. China actively supports the order in some forums, shows passivity in others yet in still others increasingly asserts its own interests regardless of the global rules. The paper draws conclusions and future implications of this new 'normal'.

The profound transformation underway in the world economy passed another milestone in August 2010 when the Japanese government released its second quarter GDP numbers. These indicated that China's economy had overtaken Japan's in size to become the world's second largest economy after the United States. With India, the two most populous countries on the planet are successfully integrating into the world economy while the large advanced economies struggle with what is likely to be years of below-potential growth following the global financial crisis. So far, this shift in the center of economic gravity is remarkable in that, while not without bilateral tensions, relationships among the world's major states are both peaceful and collaborative in promoting common interests and collective action.

China's sheer size and dynamism are moving it to the top of many rankings (Box 1). It is the world's largest creditor and accumulator of foreign exchange reserves, the largest goods exporter and the largest importer of iron ore, copper, potash, timber products and Saudi crude oil. Some Chinese companies are now the world's largest by market capitalization. For thirty years it has been the world's fastest-growing economy, advancing more rapidly than anyone anticipated to parity with the United States.[1] It is at the heart of the globalization of production with all major manufacturers of consumer goods and durables located there. Significantly, Chinese see themselves as returning to the center of the world economy, a position China held for centuries between 1300 and 1820 (Maddison 2006).

[Box 1 here]

China's size creates external expectations of its global leadership role which are frustrated by factors that every Chinese economist knows well (Box 2). China is still poor, measured by per capita income; its population is aging and the number of new labor market entrants is already shrinking. Thirty years of rapid growth has generated serious income and regional inequalities and environmental degradation is a rising public concern. The dash for jobs generated by industrial growth cannot be sustained. Correcting the imbalances is not an easy task since powerful interests will have to compensated which have relied on underpriced factor inputs (energy, land, capital and the environment).

[Box 2 here]

Underlying these challenges is a unique mix of state and market institutions. The 120 central state owned enterprises are huge conglomerates with complex ownership structures interlinked with state power, for example. And the financial sector is bank-dominated and government-owned while its monetary system is shaped by a strong political commitment to exchange rate stability.

We have therefore a complex tapestry to apply to consideration of the subject of China and global governance. The relationship is very much two way. Looking back, China's remarkable development was inextricably tied up with decisions to rely on the norms and rules as well as the advice and technical assistance from the institutions. China's embrace of the global institutions and their rules helped guide its economic success in pulling millions of people out of poverty, creating millions of modern sector jobs and deepening its integration into the world economy. Tackling its relative poverty is a key driver in the story of China's economic ascent. Located in the neighborhood of the 'Asian miracle' and facing a Malthusian crisis in the 1970s following the upheavals of Mao's class struggles, the communist party leadership moved pragmatically to restore balance between population and economic production. Jobs became a central objective. As local experiments with decentralized rural production showed success governments moved to reform incentives throughout the country to draw in potential opponents who benefited from the status quo. Domestic institutions were then changed in ad hoc fashion that continues to this day. Industrial production benefited from foreign knowhow and capital, particularly from China's diaspora and East Asian neighbors. In the late 1990s the radical restructuring of the state production sector opened the way for non-state firms which now account for more than 80 percent of industrial production. The World Bank became involved following Deng Xiaoping's meeting with Robert McNamara around 1980 (Kent 2007; Zoellick 2010). The 15-year negotiation to join the World Trade Organization was instrumental in China's acceptance of the global rules of the road and a major driver of domestic policy reforms to change the planned economy, its institutions and its managers into more market-oriented ones. The strategy has had a spectacular payoff.

Looking forward, China's impact on the global economic order is still an open question. Its economic size and dynamism make it both 'systemically significant' and increasingly a political force to be reckoned with. Will that reckoning be peaceful? The Chinese people are strongly supportive of China once again taking its rightful place in the world and reversing two hundred years of conflict and humiliation by foreign powers. How will China participate in the world's economic and political institutions as it integrates into world markets? As its size and confidence grow will its behavior influence their goals and operations, for worse or better? More in its own image?

We are reminded by historians that earlier economic transitions caused upheavals. Although peaceful, in the transition from British to US hegemony after the First World War US economic policies took advantage of liberal UK trade policies. Japan's rapid investment- and export-led growth after the Second World War caused major economic imbalances in the 1980s as the economy achieved greater systemic significance. The way these imbalances were dealt with by Japan and its major economic partners echoes in the minds of policy makers in addressing the international imbalances underlying the global financial crisis. The tendency to blame yen appreciation as the cause of Japan's decades-long stagnation is to misread history. The real culprits were mistakes in monetary policy, weak regulatory institutions (Corbett and Ito 2010; Posen 2010) and failure to implement the 1986 Maekawa report on economic restructuring.

China's economic and security relationships with the United States, still the pre-eminent power in both hard and soft power terms and the architect of the post-war global order, is central to China's conduct in the global order. The hard power relationship both drives and is constrained by the realities of economic interdependence. Even as they cooperate they mistrust each other. As we see in a later section the United States accommodates China's rise but what will happen if China does not support the rules and norms of the system of which the United States is the architect?

The next section explores the prevailing framework of global economic governance, how it might change to accommodate China and how these ideas accord with those expressed in Chinese discourse and analysis. The third section examines China's approach to the provision of key public goods in the G20, the World Trade Organization (WTO), International Monetary Fund (IMF) and the World Bank, the Financial Stability Board (FSB), as well as related regional institutions and the climate change framework negotiations. China's behavior towards its Asian neighbors, which until two hundred years ago it dominated peacefully through political and commercial relationships, will be a factor shaping the global order. The final section draws conclusions based on the evidence and examines both the reasons for and future implications of China's growing assertion of its own interests.

Perspectives on Global Governance

What is the meaning of global governance, as established by the western countries? What changes are contemplated to accommodate China? What are Chinese perspectives on these issues? At its most abstract global governance is the rule making and exercise of power on a global scale by entities working within organizations functioning on democratic principles and accountability (Keohane 2002). These entities include governments, corporations, individuals, civil society organization and other non-state actors. Joint action in these institutions is based on common interests and values; members agree to abide by common rules and shared work of the institutions. The institutions in turn are accountable to their members.

Global *economic* governance, the main focus of this paper, was established in the post-war period through the Bretton Woods institutions (IMF and World Bank), WTO, the Basel financial institutions centered at the Bank for International Settlements and the G7 leaders' summits established by French and German leaders in 1975. In these institutions governments cooperate to produce non-rivalrous 'international' public goods from which no one can be excluded and which no government can produce by acting on its own. More broadly these public goods include peace, law and order, open and efficient markets, economic and financial stability, freedom from poverty or communicable disease and a clean environment.

As economies have become more interdependent, governments have cooperated in promoting and maintaining economic and financial stability -- even coordinating economic decision making -- in theory to modify national policies in recognition of international economic interdependence. This definition of economic policy coordination can be used as a benchmark to evaluate the extent to which governments alter policies either in response to peer pressures or in recognition of the consequences of spillovers. This does not mean governments give precedence to international over domestic goals. But coordination or cooperation is a way of expanding choices available to national policy makers because it gives them influence over policy choices of other cooperating governments. Further, while collective action involves ceding some national sovereignty, in deciding to cooperate governments exercise sovereignty (Dobson 1991).

[Box 3 here]

Relations among national governments can be seen as ranging along a spectrum from conflict to supranational integration where governments set common policy in a forum to which they have ceded significant authority (Box 3). In between, independent policy setting reflects purely national objectives, while cooperating governments act on enlightened self interest, taking potential spillovers beyond national borders into account – even engaging in policy bargaining with their peers and coordinating policies. In its broad sense, economic cooperation characterizes the Bretton Woods institutions, created by the western alliance after the Second World War and observing principles of governance common to the founding democracies: market competition, transparency and the rule of law and respect for human rights. Since the end of the cold war in the early 1990s, however, these institutions have come to be regarded as exclusive clubs suffering from democratic deficits; representing a shrinking share of economic activity and slow to respond to the growing systemic significance of China, India, Russia and Brazil whose policies and performance increasingly spill over onto their neighbors and trading partners.

Nevertheless these principles are still the reference point in external views of China's participation in the international order. Some optimists who are persuaded by China's historical role and the size of its economy predict a powerful China acting independently and reshaping the order. China asserts its own values, returning to the tributary system in East Asia, inevitably challenging the United States for global pre-eminence (Jacques 2009). Others see China's future transformation into an urban, green and innovative society as having a similar impact: an assertive China securing natural resources, building soft power, taking a higher profile in international organizations and changing the rules of the game (Economy 2010).

Pessimists discount China's future influence because of the exigencies of rising economic inequality, environmental degradation and the weak financial system which will preoccupy it at home for the foreseeable future, just as domestic preoccupations have caused it to turn inward in the past (Friedman 2009; Pei 2009; Bardhan 2009). Intermediate positions argue that most modern societies now accept that a stable world order is based on key western principles of democracy, the rule of law and social justice. The challenge in the post-unipolar world is to apply these principles in pragmatic ways through partnerships with emerging powers that recognize cultural differences (Mahbubani 2008). China accepts and participates in this world order, seeing itself more as a counter balance to other major powers and primarily focused on its huge domestic economic challenges (Dobson 2009a).

Too often the popular debate is framed in zero-sum terms. Political and security analysts tend to conflate economic with hard power and assume relationships among great powers are zero-sum. Yet economic power is not simply the absolute size of an economy but the ability to get others to change their positions through persuasion and economic threats such as freezing bank accounts, distributing bribes and exerting other forms of influence that others emulate (Nye 2004). Political analysts also think in euro-centric historical concepts of empire, primacy and imperialism and predict conflicts with zero-sum outcomes in which China 'wins' and the United States 'loses' (as do China's two huge Asian neighbors Japan and India, which are also assumed to compete for domination). China's search for new sources of natural resource commodities adds to these perceptions (China's rising FDI and government aid to producing countries in Africa and Central Asia, for example). Calls from nationalists within China advocate more assertive behavior in the region and the greater exercise of power in the world commensurate with its growing size. Some Americans predict inevitable bilateral conflict (Kagan 2008).

The official American view is both pragmatic and positive sum as expressed by President Obama's November 2009 Tokyo speech:

> …in an interconnected world, power does not need to be a zero-sum game, and nations need not fear the success of another. Cultivating spheres of cooperation – not competing spheres of influence will lead to progress in the Asia Pacific.
>
> … .America will approach China with a focus on our interests…. important to pursue pragmatic cooperation with China on issues of mutual concern, because no one nation can meet the challenges of the 21st century alone, and the United States and China will both be better off when we are able to meet them together. That's why we welcome China's effort to play a greater role on the world stage -- a role in which their growing economy is joined by growing responsibility. China's partnership has proved critical in our effort to jumpstart economic recovery. China has promoted security and stability in Afghanistan and Pakistan. And it is now committed to the global nonproliferation regime, and supporting the pursuit of denuclearization of the Korean Peninsula. So the United States does not seek to contain China, nor does a deeper relationship with China mean a weakening of our bilateral alliances. On the contrary, the rise of a strong, prosperous China can be a source of strength for the community of nations (US White House 2009).

Secretary of State Hillary Clinton in her September 2010 *New American Moment* speech (Clinton 2010a) and elsewhere has elaborated this view, emphasizing that US leadership will rely on partnerships based on principles of shared responsibility.

Reforming the Global Institutions

While there is consensus on the need to reform the international institutions there is no consensus on what to do. The WTO and IMF are seen as flawed in their mandates and operation. The WTO's single undertaking approach to multilateral negotiations makes the rounds increasingly difficult to manage with such a large and diverse membership. The Asian economies' trust in the IMF as manager of balance of payments crises was shredded during the Asian financial crisis and countries have since moved to self-insure by building their foreign exchange reserves. Views on what to do include: improve the status quo, create new centralized institutions suggestive of global *government* and decentralize the existing institutions.

A number of transformations in the world economy are putting pressures on the existing institutions. The nation state is the central player but diverse interests and players (corporations, individuals, civil society and social organizations, criminal networks and terrorists, and cross-border coalitions) are now interconnected by information technologies and project voices they expect to be heard. At the same time the sources of rivalry and instability are changing. Armed conflicts of the nineteenth century over military rivalries and territorial ambitions have been replaced by globalization, by aspirations to higher living standards, pressures on the global commons, migration pressures and concerns such as market access, treatment of foreign investors, access to technology and industrial espionage.

The effectiveness of the traditional top-down approach is declining in effectiveness and legitimacy in this more diverse world of changing threats. The Bretton Woods institutions are being pressed towards universal membership and consensus decision making, similar to the

United Nations, to increase their legitimacy. But the fallouts of consensus decision making are reduced ability to undertake internal reforms, let alone take effective and timely action.

As well, global leadership is in flux. American leaders' commitments to continued global and regional leadership notwithstanding, the United States must become a 'frugal' superpower as it addresses it huge long-term fiscal imbalance. On climate change, the most important collective issue of our time, it is 'missing in action' as its response is driven more by domestic than global interests. With no other power moving to fill the leadership vacuum other nations must grapple with a power 'disequilibrium': the need for strong leadership to deal with rising pressures on the global commons is widely recognized but there is no single dominant state willing or able to deliver. As Secretary Clinton argues, partnerships, networks and mini-lateral agreements are parts of the way forward. The US role in the outcome will be crucial, but not decisive.

There have been calls for reform of the global financial institutions in the wake of the global financial crisis. The UN Commission of Experts on Reforms of the Monetary and Financial System (2009) proposed new organizations based on the universal membership of the United Nations. French President Sarkozy advocates more centralized financial regulatory institutions. But most governments are unwilling to cede sovereignty to a global super-regulator in the belief that good regulation begins at the national level by strengthening the prudential oversight of financial institutions to ensure their safety and soundness. The size and reach of global regulators cannot make up for the local knowledge and judgment of national regulators who must be very knowledgeable about the institutions they oversee.

The other reform option is to decentralize the institutions either by making them into global hubs for more decentralized networks of member countries with common interests or by creating regional sub-entities.

Robert Lawrence argues that a more decentralized WTO will better accommodate the diverse membership, better achieve the central mission of deeper economic integration and alleviate its growing institutional problems (Lawrence 2006). His club-of-clubs proposal sees the entire membership involved in rule making but they would not have to join agreements that groups of members with similar interests might negotiate. All members would still use the dispute settlement mechanism but any penalties would apply only to the 'club' agreement which was violated. Eichengreen (2009) suggests a World Financial Organization analogous to the WTO but with a decentralized structure with obligatory membership by countries whose financial institutions wish to engage in cross-border activities. The organization would set standards and rules for supervision and regulation with each member having room to tailor regulation to the structure of their financial markets. An independent body of experts analogous to WTO dispute settlement panels would monitor whether countries have met their obligations and impose penalties for poor performance.

Kawai and Petri (2010) argue that while provision of the public goods supplied by the WTO, IMF, World Bank and Financial Stability Board would still be global these institutions would coordinate the supply of related services by regional institutions in which countries in the region are the decision makers. This innovation implies the principle of subsidiarity by which activities are carried out at the level at which they are most effectively produced but accountability is to the global rules. It also supports the concept of competitive supply and evolving membership in arrangements according to common interests.

Little movement is discernible in either direction, although in regional finance the multilateralized Chiang Mai Initiative (CMIM) is a step towards an Asian Monetary Fund and the European Central Bank has created the European Financial Stabilization Fund to mitigate sovereign debt crises. The central issue is that while these mechanisms address the democratic deficit, questions of effectiveness remain. Regional decentralization is particularly interesting in Asia where, as home to three of the world's largest economies who mistrust each other, members have hedged against Chinese domination by retaining US engagement in the region, but where the production of well-defined regional public goods could provide a foundation for cooperation and trust building.

In sum, there is a willingness to accommodate China in the global institutions, a few ideas for further reform – all of which come from the west. What are the Chinese perspectives on these matters?

Chinese Perspectives on the Global Order and China's Role

There is no single 'China Inc' voice on China's role, rather many voices in both the security and economic spheres. There are many fewer voices on global governance. One evident cleavage in Chinese debates is between the military, intelligence and security communities and the economic managers and internationalists. The former are increasingly vocal about China's growing clout and favor more assertiveness, particularly at home and in the region. There is also public support for the proposition that the Chinese economy is sufficiently robust, demonstrated by its successful navigation of the global crisis, that China should be more assertive in pursuing its own interests and reverse its history of humiliation in the region. Economic managers and internationalists are much more cautious. Yes, China's size and rise imply it should take more global responsibility but it does not yet have the capabilities to do so. It is still a developing nation with major modernization challenges and economic institutions that are still evolving.

In the early years after the founding of the People's Republic in 1949, China was hostile to global institutions and governance. Although a founding member of the United Nations, the existence of both Beijing and Taipei administrations caused a UN debate lasting until 1971 over who should take the seat. Membership in the scientific and technical organizations followed, including in the World Bank and the IMF. In all these difficult negotiations, China's self-interest and considerations of sovereignty (particularly with respect to Taiwan's membership) were front and center (Kent 2007:33-64). By 1978 when its economic transformation began the Chinese leadership recognized that in the age of globalization there was little choice but to integrate into the international economy – and its institutions – in order to modernize itself.

China is a member of the Security Council but its role in the United Nations reflects its multi-faceted view of itself: "back" as a major power, still-poor but pursuing its own interests which may include counter-balancing the United States on such security interests as Iran and North Korea.

This focus was not arrived at lightly. Since the 1990s the party leadership studied the benefits and costs of economic globalization before deciding to open up in ways that preserve Chinese autonomy. Joining the WTO in 2001 required China to conform to international rules and norms; accordingly, major changes were made in China's domestic regimes.[1] At the same time, changes were made to manage the perceived risks of greater openness to domestic economic security, national sovereignty and domestic political and cultural values that could weaken national governance. Foreign investors were denied access to the pillar industries (energy, transportation, communications, finance, education and the mass media) and the speed of change in key prices such as the exchange rate was to be gradual and controlled; China would also more actively promote its own cultural values (Yu Keping 2009). Expressing its sovereignty, the government signed more than a thousand bilateral and multilateral treaties between 1998 and 2002, participated in anti-terrorist actions, pushed negotiations along with North Korea, founded the Shanghai Cooperation Organization and proposed the strategy of harmonious development (Yu Keping 2009).

Chinese scholars also describe China as a regional power with limited global interests; one that will take on a greater cooperative profile in East Asia. There is an explicit acceptance in China of a central precept of East Asian development that regional political stability has made it possible to focus exclusively on economic development. Wealth, not bullets, is the route to power and influence. As a growing regional economic power it will exert its political influence there and open its markets to serve as the regional locomotive by making opportunities for its neighbors (Zhang and Tang 2005).

In 2006 President Hu Jintao set forth China's principles for scientific development in an *harmonious world* (*hexie shijie)* that include independence, self reliance and peaceful coexistence in which differences are respected and security is based on mutual trust, benefits, equality and cooperation. These principles were proposed as an alternative vision of global governance and imply several criticisms of western principles:

- The status quo order is "undemocratic"; the democratic deficit in international institutions, dominated by western nations and serving their own interests, (and tolerating US unilateralism) should be reduced;

- North-South economic disparities are growing; wealthy advanced nations practice double standards in which they expect concessions from developing nations that are not reciprocated. These disparities should be reduced through "shared development and common prosperity".

- Countries have differing histories and cultures and therefore differing political systems and economic models. The international system should observe diversity and tolerance and countries should not interfere in each other's affairs but seek "reconciliation amid differences".

- Cross border crises and conflicts should be resolved through cooperation rather than the use of force (Wang and Rosenau 2009).

The sub-text of these principles is that the United States should become a normal country, abide by international law itself, be more ‘democratic’ in treating China as an equal and, along with other large western economies, open its markets more to developing countries and rely more on the UN system in multilateral diplomacy. There is much in common with western reliance on international rules and understandings and respect for universal values of justice, fairness and mutual assistance. Yet China’s own perspective persists of itself as a developing country, lacking in the capabilities to lead in the world order (some call this a ‘small country mentality’) which frustrates expectations that as a major power it will observe, even enforce, global rules and norms and modify national policies in recognition of interdependence.

Global Economic Governance and China’s Role

The 2008-09 financial crisis highlighted this interdependence. When demand dried up in the OECD countries as households and businesses repaired their balance sheets the effects of the recessions cascaded through global supply chains to the export-led Asian economies. Asia’s financial institutions, having reformed since the 1997-98 crises, escaped the worst of the financial crisis but Asian producers suffered heavily from the disappearance of final demand in US, European and Japanese markets.

The severity and global spread of the crisis opened a window for a long overdue and pragmatic overhaul of global summitry. A meeting of G7 leaders in the depths of the crisis in November 2008 would have been irrelevant – and unthinkable. With G20 finance ministers and central bank governors having formed a G20 forum after the Asian crisis elevating G20 meetings to the leaders’ level was an obvious choice, and one supported by China. Significantly it was leaders who managed the crisis, using the international institutions to implement their decisions. At the Pittsburgh summit in 2009 leaders formalized their agenda around a macroeconomic framework for balanced and inclusive growth, financial regulatory reforms, resuscitating the global trade negotiations and inclusive growth extending to smaller developing countries.

At their initial meetings G20 leaders tasked the IMF with providing appropriate liquidity to requesting countries and reforming its governance better to reflect the changing shape of the global economy; the WTO was tasked with concluding the Doha round, while the World Bank was tasked with addressing poverty in developing countries. The Financial Stability Forum’s membership was expanded and upgraded to a Board.

The G20

With the G20 largely being created to include China as an equal partner what has been China’s role? As one of the world’s largest trading nations and the largest creditor it has been in the hot seat over its managed exchange rate and foreign exchange reserves accumulation far beyond prudent levels to cover import requirements (Figure 1 and Table 1). Since 2008 China’s role has been constructive. It has advanced a proposal for the SDR to become the world’s super-sovereign reserve currency, a reform that would serve its own as well as the global interest. Exchange rate policy, which re-pegged the currency to the US dollar in the depths of the 2008 crisis, moved modestly in 2010 towards greater nominal flexibility in the face of intense external pressure which continued through to the November summit in Seoul.[2] China’s effective response to the pressure was ‘no, now would not be in our interests’. But China remained engaged in the rebalancing issue, participating in the 'enhanced' Mutual Assessment Process to promote external sustainability,' a process with a collective goal but which gives each government discretion in how it contributes to that goal.

[Figure 1 and Table 1 here]

At the Toronto summit President Hu Jintao outlined his views of G20 priorities in words that imply support for the existing global institutions and a desire to see them work better:

- a "guiding role in shifting international economic cooperation towards "…long-term perspective…from coordinating stimulus measures…to promoting long-term governance and from passive response to proactive planning."
- "…accelerate(s) the establishment of a new international financial order that is fair, equitable, inclusive and well-managed...." and "…that is good for the growth of the real economy"; and
- Builds "…an open and free global trading regime….reject all forms of protectionism and unequivocally advocate and support free trade" (Xinhua 2010a).

China has also pursued its main interest in gaining greater voice in the international institutions by joining dialogues organized by other large economies, Russia and Brazil, which called for "democratic and balanced global governance" giving developing countries an active voice in defining their own futures; dialogues that trumped any regional initiatives.[3]

The WTO, Trade and Investment Liberalization and Dispute Settlement

While the G20 was founded to include it as an equal player, China had to work long and hard to join the WTO in 2001. It had to accept designation as a non-market economy in antidumping and safeguard cases and agree to annual compliance reviews. Yet China has been a huge beneficiary of the rule-based international trading regime. Almost 80 percent of industrial production now originates in non-state firms; trade accounts for nearly 40 percent of GDP; it is the world's largest merchandise exporter, a major importer, the leading emerging market destination for foreign direct investment (FDI) and an increasingly important source of outward FDI. It is an active participant in the WTO dispute settlement mechanism, where it is complainant in seven cases, respondent in 18 cases and participant as third party in 69.[4]

The role of the WTO in China's emergence as an economic titan is indisputable yet China is a relatively passive player in WTO governance. The Doha Development Round has languished far beyond its targeted 2005 completion date because its centerpiece is difficult issues left over from previous rounds while new concerns like green protectionism, rising commodity prices and financial instability have marginalized its agenda. The single undertaking adds to the difficulties of concluding an agreement among the large and diverse membership. Business interest in the round is difficult to find. Powerful farm lobbies in the United States and India played roles in the breakdown in July 2008. Instead of using its superstar status to push back at such foot dragging and its potential impact on the round and the institution, China sided with India's demands based on its own interest groups.

At the outset of the Doha Round China argued that it had 'already given' in the accession talks; this was a reasonable position at the time but now a decade has passed. As a major beneficiary of the regime it is reasonable to expect China to provide a new offer such as its recent proposal to join the government procurement agreement, nine years after it promised to do so.

Instead China has focused on regional trade agreements (RTAs). Most of China's regional trade is in goods and much of the liberalization is tariff reductions; difficult non-tariff barriers receive less attention yet they matter to services trade. [5] Studies also show that sub-regional agreements produce outcomes that are inferior to region-wide RTAs or to agreements among the large countries (Park and Cheong 2008). Quantitative studies have shown that the liberalizing gains increase with the size of the agreement (Kawai and Wignaraja 2009).

With the exception of its bilateral FTA with New Zealand, China's RTAs reveal more of an interest in foreign policy objectives than economic liberalization (Table 2). The China-ASEAN agreement (CAFTA) was a friendly initiative aimed at increasing bilateral market access with East Asia's "core" economies. It took effect on January 1, 2010 and covers an estimated $4.5 trillion in trade volume with 90 percent of goods to be traded tariff-free. Problems lie ahead, however. Usually the gains from trade are realized through specialization, differentiation and increases in intra-industry trade. But the structure of China's two-way trade, particularly with Indonesia and the Philippines, is very similar and therefore competitive rather than complementary. In contrast, these countries gain through complementary trade with Japan, South Korea and the United States.

[Table 2 here]

The plethora of regional and trans-Pacific agreements on the drawing boards was acknowledged by APEC leaders in their 2010 Yokohama summit communiqué. They committed to "take concrete steps toward FTAAP" which should be "pursued as a comprehensive free trade agreement…." APEC will act as an "incubator of FTAAP" and play a "critical role in defining, shaping and addressing the next generation trade and investment issues FTAAP should contain" (APEC 2010). Proposals for ASEAN plus 3 and 6 agreements were already on the table and the United States (with Australia, Peru, Malaysia and Vietnam) is now negotiating to join the Trans-Pacific Partnership (TPP), a comprehensive high-quality free trade agreement spearheaded by New Zealand, Chile, Singapore and Brunei Darassulam and open to any country wishing to join. The resulting 9-country negotiation will figure prominently in the lead up to the US-hosted APEC leaders' meeting in 2011 in Honolulu when President Obama has committed to complete the negotiation. This negotiation is also envisaged to create a baseline in its standards and comprehensiveness with which other applicants will be expected to comply. The ultimate benefits of the TPP will depend on other large Asian economies joining (USTR 2009) and it remains unclear how the TPP or the other proposals for a regional FTA will play out.

Thus China is a major beneficiary of the open world trading regime but is doing little to maintain the system. It could re-energize the Doha Round by joining the government procurement agreement, engaging in sectoral liberalization agreements and pushing the services liberalization talks (services now account for 40 percent of GDP). In return, the United States and the advanced economies should respond to China's desire to be recognized as a market economy and end the humiliating annual compliance reviews (Hufbauer and Lawrence 2010). Within the region, China also faces contradictions between its economic size and dynamism and its domestic preoccupations. Developing countries feel the competitive pressures of its managed currency; it is foot dragger on region-wide liberalization which all studies show provides the largest overall benefits. This issue is made more complex because the smaller economies benefit from access to the US market and see its presence as a hedge against Chinese dominance.

Investment Liberalization

Compared to the trade regime China is asserting its interests more strongly with respect to direct investment and the treatment of foreign nationals in China, raising questions about whether domestic interests will trump international rules. In the absence of an international investment regime countries negotiate their own agreements for non-discriminatory treatment of foreign investors and the treatment of foreign citizens. China's policies have explicitly encouraged FDI inflows since the special economic zones were set up in the 1980s. China pre-committed in the WTO accession talks to open its service industries, particularly financial services, to foreign entrants after a designated phase-in period. Since the 'Going Out' strategy was introduced large enterprises and the main sovereign wealth fund, the China Investment Corporation, have become active international investors both as acquirers of real and financial assets and investors in greenfield projects. The shock of the global crisis, which saw many foreign investors lay off millions of Chinese workers or even abandon their investments, strengthened the Party's resolve to reduce reliance on foreign technology and diversify sources of commodity supply. The 2015 S&T strategy encourages innovation and patenting and imposes new requirements on foreign multinationals, weakens IP protection and relies on discriminatory government procurement policies, all of which have fanned fears of a new nationalism in Chinese policies.

The conviction and imprisonment of two foreign nationals, one Australian and the other American, on charges of bribery (the first case) and violating laws on state secrets (in both cases), have raised questions about the inter-relationships among business, politics and the Chinese legal system. In both cases foreign governments have argued that the lack of transparency in the legal process violated China's own bilateral consular agreements and its own laws about consular rights (Cohen 2010). China's frustrations with the international iron ore cartel helps to explain the first case because the cartel has shown little price flexibility in recent negotiations with China, its largest customer. Two other factors are also at issue: frustrations with the Chinese Aluminum Company's (Chinalco) lack of success in acquiring certain assets of Rio Tinto, an Australian cartel member, and frustration with alleged activities in China by Rio Tinto employees which undermined the authorities' attempts to consolidate the fragmented steel industry's position in the negotiations. Chinese actions were a pointed warning.

What does this new assertiveness imply about China's observation of global rules? In the natural resources industries China's behavior needs to be viewed in the larger context both of its interests in attracting foreign know-how through FDI and extending national champions' business strategies abroad – and how these firms are treated abroad. Given China's state-led business model are Chinese state-owned enterprises driven by strategic rather than market factors in their decision making?

The evidence is mixed. Resource-seeking FDI is one of the least-sophisticated forms of FDI; resource companies invest upstream in exploration activities to expand available supplies or they make acquisitions to access existing sources of supply for their own uses. A recent study of sixteen cases of the outward FDI in natural resources industries concludes that less than 20 percent of the FDI cases (in Angola, Nigeria and Russia) were intended to tie up sources of supply for Chinese use (Moran 2010). Another study of the 2005 CNOOC bid for Unocal (Steinfeld 2010) asserts that CNOOC's main objective was commercial; the negotiations were carried out along commercial lines and the involvement of bureaucrats was minimal. China did not even have an energy ministry at the time. The fragmented bureaucratic structure does not suggest China Inc. Rather company behavior suggests intense competition within a domestic oligopoly; one that is struggling to master the international rules of the mergers and acquisitions game whose rules are set by international stock exchanges.

But the record in the telecommunications industry is less clear. China's national innovation strategy provides fiscal and other incentives for high tech products, encourages a patenting drive, requires foreign suppliers of IT security products to reveal source codes and other proprietary information, and uses government procurement to favor Chinese products. Despite charges that such policies are mercantilist and encourage technology theft the impacts on indigenous innovation are mixed: the authorities have back tracked on some measures and have actually improved their offer to the WTO's government procurement agreement. Foreign producers have gained from new spending on the shift to third generation mobile technology while losing market share in wind power and second generation telecoms equipment (Kennedy 2010).

This evidence suggests a lack of coordination *within* Beijing among economic policy makers, industry ministries and other political interests. Such a lack of coordination has unintended consequences. First, missteps and misjudgments at home required the government to back track on some aspects of the techno-nationalist innovation strategy and to improve its WTO offer on government procurement. Second, it encourages suspicion abroad, with other states moving to block Chinese producers. For example, Huawei, now a leading global telecom equipment supplier, faces suspicions that Chinese-made equipment will be used to compromise national security. Such suspicions have prompted authorities to block both trade and FDI in some countries. The Indian government temporarily blocked imports of Chinese equipment causing procurement problems for its rapidly expanding mobile phone network. Huawei resolved the issue by agreeing to demands to deposit source code in escrow. US politicians have also claimed that Huawei is a company under the direction of the Chinese military and should be blocked from entering the supply chain of US military, law enforcement and the private sector.[6]

International Monetary Cooperation, Exchange Rate Regimes and the IMF

China's role in the international monetary system is clearly internationalist; so far it has worked within the system to advance its interest in voice consistent with its economic size. Conceived by Bretton Woods architects as the next best thing to a world central bank the IMF mandate was initially based on a system of fixed exchange rates which collapsed when major reserve currency countries were unwilling to change policies to maintain exchange rate equilibrium. Fixed and flexible exchange rate regimes proliferated and the IMF's role evolved to promote international monetary cooperation necessary to maintain orderly exchange rate arrangements and expand world trade. It conducts regular surveillance of members' macroeconomic policies, provides technical support and provides short term liquidity to members with balance of payments difficulties. Yet when official capital flows were overtaken by private flows by the mid-1990s the IMF's resources shrank in relative terms and the nature of its borrowers changed. The advanced countries continued to dominate its decision making and determination of conditions on borrowers (who increasingly were smaller developing countries with little say in how the Fund was run).[7]

These issues came to a head during the 1997-98 Asian financial crisis when rightly or wrongly the IMF was perceived to have deepened the crisis by treating Asian borrowers with liquidity problems as if they were insolvent with structural problems (Ito 2007). Resentful borrowers repaid their loans early and began self-insuring by accumulating foreign reserves larger than those needed to cover imports and short term liabilities.

By the time of the 2008-09 crisis the IMF's reduced resources and credibility problems were such that it was not a significant player. Its resources, at around $250 billion, paled in comparison with Asia's central banks whose foreign exchange reserves totaled nearly $5 trillion in 2010 (Table 1) and sovereign wealth funds who managed more than $2 trillion in 2006 (Truman 2007). Central banks led by the US Federal Reserve Board were also active in bilateral swap arrangements to address short term liquidity problems.

G20 leaders resuscitated the Fund by restoring its resources to $1 trillion and encouraging it to set up new facilities to help countries solve credit problems.[8] The IMF streamlined its lending framework and conditionality, providing adjustment support through short term lending facilities through which countries qualifying on an ex ante basis can access loans immediately as well as other credit lines on precautionary bases without conditions. [9]

IMF governance reform agreed at the Seoul G20 summit in November 2010 will make China the third-largest shareholder. How will China use this increased clout? As it assumes more power in governance will it support enhanced IMF staff objectivity in surveillance of members' economic performance? Will the United States and China be willing to move discussions of their macroeconomic interdependence into the IMF? Or will China favor a regional institution, possibly with different rules, where it has even more clout?

China has both dragged its feet and proposed reform. The slow adjustment of its nominal exchange rate (Figure 1) has drawn strong US criticism with some arguing that 'rejection of a flexible exchange rate' is a direct challenge to the international monetary order (Bergsten et al 2008:17). China was also one of the last (along with the United States) to agree to an IMF evaluation of its financial system through the Financial Sector Assessment Program. In contrast, China actively pursued governance reforms to raise its voting strength and adopt the SDR as a super-sovereign reserve currency to provide an alternative way to reallocate its foreign exchange reserves. Central bank governor Zhou Xiaochuan (2009) argued that current arrangements relying on a single national currency are flawed because of the potential for conflicts between domestic goals and international responsibilities. As the dollar-based system has become more volatile, developing and emerging market economies have diverted foreign exchange reserves from more productive uses to self-insure. Using the SDR in this way would allow large holders of US government securities to diversify their holdings within the IMF thereby avoiding exchange market volatility (Bergsten 2009). But the proposal has gained little traction because of the entrenched position and convenience of use of the US dollar for both market participants and governments.

Regionally, China has been active in multilateralizing the Chiang Mai Initiative (CMIM), the regional emergency financing mechanism set up in 2000 as bilateral currency swap agreements among the members of ASEAN+3. The 1997-98 crisis crystallized awareness that much of East Asia's high savings were intermediated in the world's financial centers rather than in the region. Initiatives to address this issue include regional bond markets for local currency issues and pooling foreign exchange reserves by central banks to increase liquidity. In 2010 the CMI swaps, which now totaled $120 billion with 80 percent contributed by China, Japan and South Korea, were pooled into the CMIM common fund, supported by governance and voting structures to make it accountable to its members. Like the IMF, CMIM will provide short term emergency financing to its members. A surveillance unit is to be in place by early 2011. Whether its methodology will be consistent with that of the IMF remains to be seen. If it is, governments will share information about their economic policies and performance with the surveillance unit and agree to an early warning system to prevent future crises.

Within China, changes are in train for domestic reasons that will bring about some alignment with the global rebalancing objective. China's investment-driven export-led growth is unsustainable. The economy needs to rebalance towards greater reliance on domestic demand. The heavy emphasis on investment is supported by under-priced inputs for energy, land, capital and the environment (Kuijs 2009; Huang 2010). Capital is priced by the central bank which manages interest rates to support exchange rate stability for exporters and which provides the government-owned banking system with generous and riskless spreads (Dobson and Kashyap 2006; Dobson 2009a; Prasad 2009). At the same time the "disinterested authoritarian capitalism" that has delivered China's material prosperity has entrenched interest groups that could block reforms to transfer wealth, undermine the impartiality and block reforms to respond to popular demands for greater political pluralism (Yao 2010).

The 12th Five Year Plan proposed in October 2010 signaled the Party's collective awareness of the need to restructure the economy. Changes in domestic policy are expected to increase imports and the weight of consumption relative to investment and exports in total GDP with policies to boost employment and household incomes through higher wages, more labor mobility, higher public spending on rural infrastructure, health, education and pensions, better access to market finance for employment-creating SMEs and deregulation of service sectors currently dominated by large state monopolies.

There is recognition that such key prices as the exchange rate and interest rates cannot be managed indefinitely and that more flexibility is required. The central bank characterizes abandoning the US dollar peg as a continuation of the managed exchange rate regime adopted in 1994 (Hu Xiaolian 2010). A more flexible exchange rate (assuming it would appreciate) would facilitate domestic economic rebalancing. Rebalancing is also necessary to ensure the safety of China's accumulated reserves which will lose value as the US dollar depreciates or if US inflation picks up and US bond prices decline (Yu Yongding 2009). In real terms, the exchange rate has strengthened against the US dollar by almost 50 percent since 2005 (*Economist* 2010a) as Chinese prices have risen much faster than those in North America. Change in the nominal rate, however, will be gradual and controlled, according to China's needs. Gradual internationalization of the yuan by liberalizing instruments available through Hong Kong, swap agreements with other central banks, increased foreign access to the interbank bond market, and greater use of the yuan in trade finance will facilitate more RMB-based international transactions. Eventually the RMB could become an international reserve currency. For this to happen, however, the capital account must be fully convertible which will open China to global capital flows from which it is now protected, and loosen control over monetary policy (Dobson and Masson 2009).

In summary China is not only engaged in IMF governance but has proposed a fundamental reform. It has said 'no' to outside pressures for exchange rate appreciation but has participated in the G20's enhanced surveillance process which relies on IMF analysis. There are two tests of China's recognition of the external impacts of its domestic policy choices: one is its willingness to be transparent in the regional surveillance within the CMIM where it is a major shareholder, and the other is political: will the 12th Plan focus on structural reforms survive the onslaught of vested interests? Greater exchange rate flexibility would facilitate the structural shift towards consumption. A market-determined exchange rate is also essential to the development of the deep and liquid market-based financial system and the more efficient use of capital that are necessary if China's is to become an economic power with international influence commensurate with its modern and complex economy.

Development Finance and the World Bank

The World Bank and the regional multilateral development banks provide development finance through loans and grants and technical assistance to developing countries to promote poverty reduction and economic development. The network of banks is more decentralized than the IMF system and the regional banks are largely run by countries in the regions. The World Bank is governed by its shareholders but developing countries criticize it for reflecting the development priorities imposed by the advanced countries rather than those of the developing countries themselves. Since 1980 China's relationship with the World Bank has been harmonious. China continues to borrow for projects ranging from energy efficiency and environmental projects to urban and rural development. In 2007 China became a net contributor to the World Bank's International Development Assistance mechanism and in 2010 its third-largest shareholder. A Chinese national is the World Bank's chief economist.

Financial Market Oversight and Stability

The global crisis highlighted the paradox between the national scope of financial supervision and the global reach of capital markets and institutions. While strong and modern national financial systems are essential to stable markets national regulators cannot prevent cross-border financial crises by acting on their own. They must coordinate and communicate among themselves. The Financial Stability Forum, set up by G7 governments after the Asian crisis, is based at the Bank for International Settlements and closely related to the Basel Committee, to facilitate such cooperation. But the institution lacked legitimacy and relied on voluntary implementation of its guidelines and recommendations. G20 leaders expanded its membership and changed its name to the Financial Services Board (FSB), charging it to work closely with the IMF in implementing its recommendations and guidelines through the Fund's surveillance and its Financial Sector Assessment Program (FSAP) which focuses on national financial systems and their prudential supervision.

China has been relatively passive in the financial supervisory debates and inactive in the region although a group of East Asian economists has recommended intensified supervision of financial institutions engaging in cross-border business and an Asian Financial Stability Dialogue to deepen regional financial integration (Asian Development Bank Institute 2009). It has yet to gain any traction however.

Climate Change

In 2009 China surpassed the United States to become the world's largest absolute emitter of greenhouse gases while ranking far down the list in per capita terms (Box 1). China is a charter member of the UN Framework Convention on Climate Change and participated in the Copenhagen talks in December 2009 which ended with a last minute non-binding accord. It sees itself as part of the developing world in the divisions over negotiating the measurement and verification of emissions reductions; it is an advocate of funding by the rich countries of funding for clean energy technology in developing countries and the Clean Development Mechanism and the establishment of offset markets.

Yet pushed by domestic pressures China is in important ways becoming a climate change poster child. It has unilaterally committed to 40-45 percent reduction in energy intensity by 2020. The 12th Plan will contain obligatory targets to increase renewable energy supplies to 15 percent of the primary energy mix. Industrial policies will encourage green production (such as hybrid and electric autos) and on the supply side an investment package of much as $740 billion in an energy development plan over the next decade is reportedly planned.

China claims and receives little credit for such initiatives. It also hesitates to lead because of its commitment to the developing country coalition. Its detractors decry the reliance on industrial policies and criticize its profile among developing countries as detracting from a global regime. Yet in many ways China's behavior is reminiscent of the sometimes eccentric views of French leaders that push a 'French' perspective and position on international issues. In China's case such a stance puts the advanced industrial countries on notice that they cannot always expect to have things their way.

Asian Regionalism

Within the Asian region China's charm offensive saw it play a relatively passive role in regional institutions while competing with Japan, India and the United States outside. It faces determined efforts by the ASEAN 'core' economies to divert this competition into regional cooperation in the nascent regional financial and trade institutions. But progress on the 2015 target for an East Asian community proposed by the 2001 Vision Group is slow; decisions rely on consensus and activity is focused more on members' interests than on advancing common rules or standards. Trading patterns are lop-sided in regional production networks with China a major importer from its neighbors but competing directly with some of them in final goods markets. The expansion of ASEAN+3 in 2004 over China's objections to include India, Australia and New Zealand to form the East Asian Summit (EAS) cuts two ways in that this and other cooperative institutions serve its objective of developing closer friendly relationships in the neighborhood but US and Indian inclusion provide a counter-balance.

Good relationships with the neighborhood allow China to concentrate on its many domestic challenges. When government representatives talk about China's "peaceful development" they are at pains to elaborate that this means no expansion, no hegemony and no alliances. The message has the implicit sub-text that if China gets its domestic development right its influence will automatically expand with its growing economic and political clout. The cooperative networks also help to address the ambivalence that many feel about China, summed up by the observations of some Asian neighbors who say, "Don't call China a threat," while others admonish, "Don't forget China is a threat."

China's recent more assertive behavior on resource and boundary issues has alarmed its neighbors. The tone and behavior toward regional partners appears to be motivated by growing confidence and a desire to reverse historical humiliation. The territorial dispute with Japan over the Diaoyu/Senkaku Islands suggests the two governments apply different frameworks; China uses historical evidence while Japan takes a more legalistic approach. The clash, characterized as "shock and awe" and a test of China's peaceful rise doctrine (Funabashi 2010), raised questions whether such disputes can be resolved. What does this mean? Is the long held conviction weakening that political stability is necessary for wealth and development as stepping stones to power and influence? Are we seeing jostling in the run-up to the 2012 leadership transition? China's next top leaders are largely from civilian ranks of new entrepreneurs and the communist youth league rather than the PLA or the foreign policy establishment. The resulting credibility vacuum on national security may encourage them to appear to be tough-minded; figures in defense and foreign affairs are also moving to fill the vacuum (Page 2010).

What will happen when the leadership transition is complete? Will there be a return to an harmonious equilibrium or more external tensions? The current uncertainty is potentially counter-productive for China in that its neighbors react by moving closer to the United States for reassurance. While China is driving East Asia's economic integration and its diplomatic influence is spreading it is unlikely that China will replace the United States as the region's guarantor of peace and stability. In an October 2010 speech (Clinton 2010b) Secretary of State Hillary Clinton made clear that the United States is increasing its participation in the region's institutions. Most likely we are seeing a new regional dynamic in which the United States must accommodate a more assertive and powerful China. Whether this will be a positive sum relationship depends on both governments and will presage their roles in the global institutions.

Conclusions and Looking to the Future

Is China willing to change its policies in recognition of international interdependence? The evaluation in this paper indicates that the answer varies with the forum:

- 'Yes' in the G20 where President Hu Jintao has played a constructive role. Even on the imbalance issue, whose formulation China does not accept, China has helped shape a broader cooperative process aimed at the collective goal while according flexibility to governments as to their contributions.

- 'No' in the WTO where despite the benefits of accession and now one of the world's largest trading nations, China has not offered leadership necessary to conclude the Doha Round; nor does it observe WTO principles of non-discrimination toward foreign investors and producers.

- 'Yes' in the IMF where China has pushed on governance issues and participated in the broad goals and approach to imbalances, but said 'no' on exchange rate adjustment pressures from peers.

- 'Yes' to the World Bank, as a supporter of the regime but increasingly competing for influence through parallel but bilateral aid programs in developing nations, particularly those with abundant natural resources.

- 'Shape the regime to reflect developing country concerns' at the United Nations Framework Convention on Climate Change. At home, China has taken major unilateral initiatives to define energy intensity reduction targets, develop renewable energy sources and push as a first-mover into green technologies and processes. Yet it receives little credit, in part because it has not leveraged these initiatives in the global forum where a vacuum has been created by the inaction of US congress, To provide leadership, however, is seen as breaking solidarity with the developing country position in the talks.

- 'Yes' in regional organizations where China has led the expansion of regional FTAs agreements and cooperated in trade and financial forums but is offended by the hedging strategies of its neighbors in both the economic and security forums; recent assertiveness on border issues has also been counter-productive as noted earlier.

In this summary the pattern is 'Yes, but….' Yes, there is little evidence that China undermines or reshapes the global order where its behavior now has consequences – footdragging in the Doha round, blocking (along with others) OECD country positions in the climate change talks and aggressively trying to frustrate price setting of key commodities in international markets. It has largely played by the existing rules of multilateralism and its role is largely constructive. In the Asian region China has been receptive to its neighbors' economic initiatives.

But…there is a significant contradiction between China's continuing ambivalence about assuming a role commensurate with the world's second-largest economy and leveraging its economic strength as powerful internal interests are pushing to do.

Why the more assertive and shrill behavior in the past two years? What has changed? First, China successfully escaped the global economic crisis; its economy boomed while the largest market economies struggled. The rise of its economic weight in the world is considered by some to coincide with the relative (and long term) decline of the United States. They see the crisis as proof of the weaknesses of the market-based system and commending China's unique mix of state and market institutions (overlooking the fact that the Canadian and Australian economies also avoided the crisis because of strong, deep and liquid market-based financial systems, prudent regulation and flexible exchange rates). Second, there are difficulties in coordinating policies within Beijing itself, particularly industrial policies – a problem familiar to officials in other large economies. Third, China is undergoing a major leadership transition in which competition for influence among multiple factions makes it difficult to take strong and well-defined positions.

Should we conclude that things will go back to 'harmonious development' in 2012 when the leadership issue is settled? The answer is no. A more assertive China is likely to be the new normal just as it is reasonable to see it develop new capabilities in international bargaining.

What might be the consequences of the new normal for the global economic order?

History matters. China has little historical experience of cooperating with peers. China is accustomed to pursuing its goals independently and is highly sensitive to direct external pressures and to milder forms of surveillance and peer pressure. Even so, examples of China's willingness to modify its own economic policies in recognition of international interdependence include resisting nominal exchange rate appreciation in the 1997-98 Asian crisis which reaped much goodwill; undertaking the large stimulus package in 2008 which was good for China and good for the world; and helping to connect the poorer ASEAN economies with large infrastructure and other investments in region. In each example there is a clear congruence of domestic and collective interests. The test of China's willingness to engage in closer economic cooperation with its regional neighbors will come in the next few years as the ASEAN+3 Macroeconomic Research Office (AMRO) develops its surveillance role in CMIM.

Chinese economists argue that China still lacks the capabilities to take more responsibility for the system from which it has drawn such benefit. China is uncomfortable with multilateralism and prefers bilateral diplomacy or small groups, where it is quite active. Thus, one possible outcome of the new confidence may be less attachment to the multilateral institutions. Will they be seen as having served their purpose in providing frameworks useful to China's growth and modernization but of limited relevance to a booming state-led Chinese economy?

There are several risks in such a scenario. One is that China might overplay its hand. This is not the first time the United States has been in apparent decline before rebounding because of its economic flexibility and political resilience. This time may be different but it is too soon to count the United States out. At the same time, China should not under-estimate its domestic economic challenges. Continued reliance on the Plan could be its Achilles heel. So far the outlines of the 12^{th} Plan seem to rely heavily on the proven interventionist capabilities of the Chinese state to bring about structural change rather than on market forces. Will intervention work in encouraging people to consume more? The answer is far from clear. Further, China's goals for international financial influence and economic power will depend on opening the capital account and greater exchange rate flexibility. Before either can happen, China needs a modern financial sector and an independent central bank, neither of which seems to be in the cards. Still, for different reasons China, too, could surprise us.

These questions spill over to the second risk -- for the global economic order. Politics matter, too. It has been argued that the recipe for a peaceful transition in the global power structure is for the incumbent to accommodate the newcomer and for the newcomer to adhere to the existing rules. Mutual trust is necessary for this proposition to be realized. The Chinese fear that a declining United States will block China's rise. US interests mistrusts China's intentions. Will a more confident China change the rules by pushing its state-led economic model in the global institutions? Will it tip the balance towards more government intervention in price setting and ownership? Put more emphasis on relationships than transparency? Yet each has a strong common interest in globalization, open markets and a stable political world. The suspicions on both sides must be addressed through communication, confidence building and cooperation. One menu includes greater openness in the bilateral security relationship, less competition and more cooperation in maintaining Asian security, greater collaboration on human security in the region and greater emphasis on people-to-people contacts (*Economist* 2010b). If this mutual mistrust is not addressed there is the danger a deep antagonism will develop. It would help if the United States were to allow itself to be constrained by observing the global rules in order to constrain China.

In conclusion it should be no surprise that the spectacular speed and magnitude of China's rise disturbs the global status quo in unexpected ways and creates external expectations of China that it is not yet prepared or capable of satisfying. Nevertheless, a more assertive China creates a new, more complicated, normal that replaces the relative simplicity of America's 'unipolar moment'. The established global framework has much to commend it to China's leaders but their adherence or contributions to strengthen the global order will for the foreseeable future depend heavily on US behavior and, more importantly, on US investment in confidence building that is essential to a stable long-term relationship with an ancient civilization which has returned to global pre-eminence.

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Box 1 China in the World Economy

1. Real GDP Growth (%)

	1990	2000	2007	2015
China	3.8	8.4	13	7.9
Japan	5.2	2.9	2.4	1.7
US	1.9	3.7	2.1	2.3

2. GDP Relative to US (millions 2009 US$)

	1990	2005	2020
China as % of US	6.4	30	66-82

3. Share of World Merchandise Exports (%)

	1990	2009	2014
China	3	9.6	12
Japan	8.3	5	
US	11.4	8.5	
Germany	12.2	9	

4. Gross Capital Formation (% GDP)

2000	35
2007	43

5. China is the world's largest importer of iron ore, potash, Saudi crude oil, copper, timber products.

6. By market capitalization reported in Forbes Magazine (May 7, 2010) the following Chinese companies rank in the top 20 globally: ICBC (#5), PetroChina (#13), CCB (#17).

Sources: Kuijs 2009; http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG; http://stat.wto.org/StatisticalProgram/WSDBViewData.aspx?Language=E; WTO State of Trade 2009

Box 2 China's Challenges

1. Per Capita Income (end-2007, US$)

China	2,430
Japan	34,310
US	39,932

2. Median Age

	2010	2020	2030
China	34.2	37.1	41.1
Japan	44.7	48.6	52.2
US	36.6	37.9	39.5

3. Number of 15-24 year olds

2000	**197 million**
2010	229 million
2020	**180 million**
2030	178 million

4. Income Inequality (GINI Index)

	2007
China	41.5
India	36.8
Canada	32.6
US	40.8

5A. CO_2 Emissions (total kilotons)

	2005	2007
China	5,609,477.7	6,533,018.3
US	5,836,473.5	5,832,194.0
World	29,205,744.0	30,649,360.0

5B. CO_2 Emissions (metric tones per capita)

	2005	2007
China	4.3	5.0
US	19.7	19.3
World	4.5	4.6

Sources: http://hdrstats.undp.org/en/indicators/161.html; http://esa.un.org/unpp; http://data.worldbank.org/indicator/EN.ATM.CO2E.PC&countries=CN-4E-XN; united nations: World Population Prospects; The 2008 Revision Population Database.

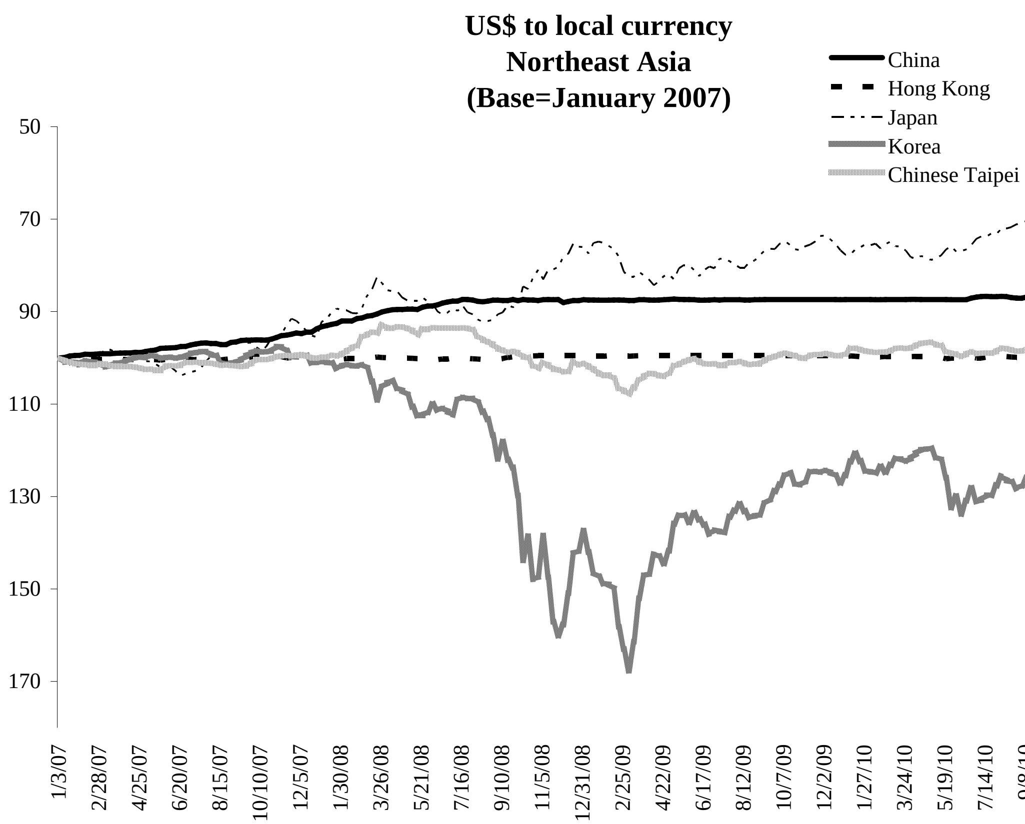
Box 3. The conflict-independence-integration spectrum

Conflict←--------------------------]--------------------------]--------------→Integration

Independence Coordination

[----Cooperation-------]

Figure 1. Currency movements, US dollar to local currency (base=January 2007)



Source: Pacific Economic Cooperation Council (PECC), 2010.

Table 1

Foreign Exchange Reserves minus Gold (billion US $)			
	May 2010	**% of Nominal GDP**	**Months of Imports**
Australia	33.21	3.3	2.1
China	2,456.19	49.3	28.6
Hong Kong	256.10	121.6	8.3
Indonesia	71.75	13.3	8.1
Japan	1,011.61	20.0	18.8

Korea	270.14	32.4	8.5
Malaysia	94.11	48.8	7.7
Singapore	198.36	108.8	8.6
Thailand	140.22	53.1	11.1
United States	113.13	0.8	0.7

Source: IMF

Table 2. China's Bilateral Trade Agreements

Implemented	**Under Negotiation**	**Feasibility Study**
China-ASEAN	China-Australia	China-India
China-Chile	China-Gulf Cooperation Council (GCC)	China-Japan-Korea
China-Costa Rica	China-Iceland	China-Korea
CEPA-Hong Kong	China-Norway	China-Switzerland
China-New Zealand		
China-Pakistan		
China-Peru		
China-Singapore		

Sources: China Ministry of Commerce; Schott 2010.

Endnotes

Acknowledgements: This paper has benefited from valuable comments by my discussants, Peter Petri and Zhang Yuyan, PAFTAD conference participants and Joseph Caron and Peter Harder. The responsibility for the final version, of course, is mine alone.

[1] To join the WTO thirty central ministries and departments were directed in 2002 to change 2300 laws and regulations (eliminating many of them) and 100,000 local laws and regulations at the provincial and automous region levels (Yu Keping 2009:153).

[2] While accelerating the pace of nominal appreciation just prior to the summit.

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[3] China participated in BRIC meetings and the BASIC talks consisting of Brazil, South Africa, India China, and in dialogues including India, Brazil, South Africa and Mexico (Xinhua 2010b).

[4] Details can be found at http://www.wto.org/english/tratop_e/dispu_e/dispu_by_country_e.htm accessed July 16 2010.

[5] More than half of Asia's merchandise exports are now shipped within the region. But it remains heavily dependent on external markets for final demand. Analysis of Asia's intraregional exports in 2006 shows that while 48.2 percent of Asia's exports were shipped to Europe and North America when parts and components were taken into account the share rose to 67.5 percent (Asian Development Bank 2008:71).

[6] Since 2008 three Huawei bids have failed (for 2Wire, a Motorola unit, and 3Com) due to fears the bids would not secure regulatory approval. A supply contract with Sprint Nextel is also being challenged. Huawei is now trying a route used in the past by the Japanese: divert FDI to Canada and invest in R&D in Canadian telecoms to develop acceptable *bona fides* in the US market (Sturgeon 2010).

[7] Even so, small countries have repeatedly indicated they find Fund surveillance and advice helpful even though large countries have tended to ignore it.

[8] In April 2009 leaders authorized a one-time SDR allocation of $250 billion and $500 billion in new borrowing from Fund shareholders under the New Arrangements to Borrow (NAB). Japan and the EU each agreed to lend $100 billion and China indicated its willingness to provide $40 billion in other ways.

[9] Including (the short-term liquidity facility, or SLF, and the flexible credit line facility, or FCL, and the Precautionary Credit Line, or PCL.