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The Great Wall of Money

Power and Politics in China's International Monetary Relations

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Whether the Chinese state will choose to be a taker, maker, or breaker of the existing international monetary system remains very uncertain. This volume reveals, however, how China's priorities and decisions will be shaped by political influences stemming from the domestic, state, and external levels. By analyzing the distinctive nature of those influences, the contributors pioneer the study of the *politics* of China's international monetary relations. In so doing, they shed new light on Chinese foreign economic policymaking, the future of the international monetary system, and the trajectory of China's continuing emergence as a great power in the coming decades.

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The China Question

Can Its Rise Be Accommodated?

Benjamin J. Cohen

Whether measured by the size of its reserves, the role of its exchange rate, or the use of its currency, Beijing's growing influence in the international monetary system is unmistakable. The issue to be addressed in this chapter is: Can the proverbial Middle Kingdom be smoothly absorbed into the leadership ranks of the global system, or could it instead become a force for instability or even conflict? Call it the China question.

The answer to the China question depends, in particular, on two critical factors. First is the issue of systemic flexibility. How adaptable are the institutions and procedures of global monetary governance? How easy is it for the monetary system to adjust to significant changes in the distribution of power? And second is the issue of China's intentions. What do the Chinese want? Can Chinese preferences be successfully accommodated? Both factors are essential, and much rides on the outcome.

Happily, historical analysis suggests that there is little problem on the first score. Other emergent powers in the past have been effectively absorbed without lasting disruption or irreparable damage. On the second

score, however, there may be more cause for concern, since we know so little about China's strategic priorities. As several contributors to this volume note, Beijing repeatedly sends mixed signals about its intentions. To say the least, its ultimate goals remain shrouded in mystery.

Analytical Framework

The China question confronts us with two analytical challenges. First, how do we know when a newcomer is big enough to challenge the system's status quo? And second, how do we know when the emergence of a big newcomer has been successfully accommodated? Both challenges call for historical interpretation, which is inherently subjective. Each, therefore, is an issue on which reasonable people might reasonably disagree. Interpretation will be more persuasive if it can be grounded in a systematic analytical framework with well-articulated standards to provide an acceptable basis for judgment.

Monetary Power

Begin with the notion of "big." This of course is an issue of power. How do we know when an actor has gained sufficient power to challenge the established order?

Measuring monetary power is notoriously difficult. Until not long ago, the very concept of power in international monetary relations was, as Jonathan Kirshner noted in a seminal work, "a neglected area of study."[1] More recently, considerable progress has been achieved in parsing the meaning and uses of monetary power.[2] Yet for all the insight that has been gained, we still have no easy way to distinguish scales or levels of power in the monetary system.

For the purposes of this chapter, monetary power will be equated with *influence:* an ability to shape the behavior of others. This approach is in keeping with the conventions of mainstream international relations theory, as highlighted in a recent survey by David Baldwin—a tradition

1. Kirshner 1995, 3.
2. Lawton et al. 2000, Andrews 2006.

stretching back to the early work of Robert Dahl, who argued that "A has power over B to the extent that he can get B to do something that B would not otherwise do."[3] The focus here is on the effects rather than the sources of power. An actor will be considered "big" if its actions (or inactions) can have systemic consequences, altering or controlling the outcome of events. Influence will be considered synonymous with authority or leadership.

How would we know when monetary influence is at work? The exercise of power is not always self-evident, particularly if it is indirect or passive. Power does not regularly announce itself. The most practical approach is to focus on specific roles—identifiable functions that can be considered as tangible manifestations of power. A "big" actor is one that is seen to act with authority or leadership in monetary affairs.

And what might those roles be? For inspiration, this chapter will look to the work of the late Charles Kindleberger, who wrote a great deal about monetary power. In his justly celebrated book, *A World in Depression,* Kindleberger suggested that a monetary leader would be expected to play three distinct roles: (1) maintaining a relatively open market for distress goods; (2) providing contracyclical, or at least stable, long-term lending; and (3) acting as a lender of last resort at times of crisis.[4] In later work, he added two additional functions: (4) policing a relatively stable system of exchange rates; and (5) ensuring some degree of coordination of macroeconomic policies.[5] All five of these roles clearly imply a measure of influence. Together, they define the *scope* of monetary power.

Accordingly, this chapter will look to these five roles as tangible manifestations of monetary power. A newcomer will be considered big enough to challenge the system if it has become: (1) a major, if not dominant, import market; (2) a sizable capital exporter; (3) a significant influence on exchange rates; (4) a substantial influence on macroeconomic conditions; and/or (5) a potential source of crisis financing. Some combination of these five roles will be considered sufficient to qualify an actor as a major influence on the distribution of monetary power. The greater the number of the roles played, the larger is the scope of the actor's power.

3. Dahl 1957, 202–3; Baldwin 2013.
4. Kindleberger 1973.
5. Kindleberger 1981, chap. 21.

Accommodation

So how, then, do we know when the emergence of a big newcomer has been successfully accommodated? That too is a difficult question. The emergence of a new pole of influence is hardly apt to be frictionless and will certainly not occur overnight. Authority in human affairs is not readily shared, and that is particularly true of relations among sovereign states with their distinct and often divergent political and economic interests. Some resistance on the part of incumbents is naturally to be expected, at least initially.

Broadly speaking, three alternative outcomes are possible. At one extreme, resistance to a newcomer might remain adamant, leading to rising tensions and the risk of serious policy conflict—hardly a denouement to be desired. Second, the newcomer might be co-opted by existing powers, persuaded or coerced into aligning its preferences with the prevailing rules of the game—in effect, into acquiescing with the status quo. Or third, opposition could eventually give way to some measure of acceptance of the newcomer's priorities, with space carved out for the rising power to join in playing a leadership role. The last may be considered the meaning of accommodation: a successful transition to a new sharing of authority with due deference to the interests of the newcomer. For the purposes of this chapter, three criteria will be used to judge whether a big new actor has been or can be successfully accommodated in this sense.

The first criterion will focus on the nature of the actor's impact on the overall stability of the system. Effects may be transmitted via the trade balance or the capital account and will be felt in exchange rates, payments balances, and general macroeconomic conditions. The emergence of a new power, determined to assert its own interests, is often destabilizing—at least at the start. The question is: Does its impact remain disturbing, or do priorities eventually come into alignment? A gradual movement toward a new overall balance in the system, while respecting the preferences of the newcomer, will be taken as a sign of successful accommodation.

A second criterion will have to do with crisis financing. Emerging powers usually accumulate a sizable stock of central bank reserves; in time, as well, their currencies may begin to play important international roles in trade, financial markets, or the reserves of other economies. Both ample reserves and an internationalized currency enable a country to act, if it wishes, as a lender of last resort in time of crisis—a source of liquidity for others. Voluntary acceptance of the role of crisis lender may also be seen as a sign of successful accommodation. Has the actor willingly become a recognized credit source when others get in trouble?

The third criterion has to do with governance mechanisms. Has the actor been formally incorporated into prevailing leadership councils? Governance of the global monetary system is famously complex, if not obscure, comprising not only the formal structures and rules of the IMF but also the more informal decision-making procedures of regularized negotiating bodies like the G7 and the G20. A third sign of successful accommodation would be effective inclusion into some or all of these governance mechanisms. In short the newcomer would be accepted, implicitly or explicitly, as a full member of the club.

The Rise of China

Judging by these standards, there seems little doubt that China has now become a big player in monetary affairs. The signs of the country's newfound monetary power are unmistakable, as the editors of this volume emphasize in their introduction. After three decades of double-digit growth, the Middle Kingdom has emerged to become the second largest economy in the world, surpassing the former number two, Japan, in 2010. As a voracious importer of raw materials and energy, China has become the dominant market for a wide swath of commodity producers, from close neighbors in Southeast Asia and Australia to South America and Africa. At the same time, as the "world's workshop" manufacturing or assembling vast amounts of goods for export, the country has enjoyed trade surpluses that have exceeded even those of Japan and Saudi Arabia in their prime. China today sells everything from textiles and apparel to wind turbines and solar panels. In the mid-2000s, the Middle Kingdom's surpluses on current account amounted to as much as 10 percent of GDP.

Correspondingly, these surpluses have cumulatively made China one of the world's greatest creditor nations, with external claims far exceeding liabilities. For many years most foreign earnings went directly into the currency reserves of the People's Bank of China, the Middle Kingdom's central bank, reaching a new high of some $3.5 trillion in mid-2013—the

greatest stockpile of reserves for any one country in history. Even today, the PBOC's reserves account for as much as three-quarters of China's international claims. More recently, as Yang Jiang notes in this volume, some of these assets have been deployed in the form of foreign aid, often quite obviously for politico-strategic purposes. Additionally, an increasing emphasis has been put on economically profitable forms of overseas placement. This can be seen in the country's rising level of outward direct investment, led by state-owned enterprises, which since 2005 has accelerated rapidly to as much as $70 billion a year in 2010 and 2011. More than 80 percent of the total involved minerals or energy projects.[6] It can also be seen in the creation of the China Investment Corporation, a sovereign wealth fund, with an initial endowment in 2007 of some $200 billion. By 2012, CIC's assets had more than doubled, to some $440 billion. The value of China's accumulated claims abroad is still small as compared with those of the United States or other mature economies, with their much longer histories of foreign investment. But even with its late start, the Middle Kingdom clearly is well on its way to becoming a major capital exporter.

China's massive reserves have also put the country in a position to act as a key source of crisis financing for others. In this regard, the Middle Kingdom's new capabilities were signaled as early as 2000 when Beijing signed on to the Chiang Mai Initiative (CMI), a regional framework for the provision of emergency liquidity assistance negotiated by the so-called ASEAN + 3 group—the ten members of the Association of Southeast Asian Nations plus the three Northeast Asian countries of China, Japan, and Korea (the "Plus Three" countries). CMI established the basis for a new network of bilateral swap arrangements between the Plus Three countries on the one hand and members of ASEAN on the other hand. The Plus Three countries promised to make dollar resources available to ASEAN members, when needed, in exchange for equivalent amounts of local currency. More recently, in 2010, the network of BSAs was formally transformed into a new common facility dubbed the Chiang Mai Initiative Multilateralization (CMIM), with resources now totaling $240 billion. China's share of commitments to CMIM was set at 32 percent ($76.8 billion). Although Yang Jiang dismisses Beijing's "currency swap diplomacy" in her chapter here as a "shallow form of monetary cooperation," it is nonetheless useful in helping to consolidate Chinese influence in East Asia.

6. Scissors 2012.

Finally, it is clear that China is beginning to have a noticeable impact on exchange rates and macroeconomic conditions, at least in its immediate neighborhood. Historically most nations in East Asia, like many countries elsewhere, have chosen to shadow the US dollar in targeting their exchange rates, a practice that Ronald McKinnon has long described as an informal "dollar standard."[7] More recently, however, China's yuan—also known as the renminbi (RMB, or "people's currency")—has begun to play a substantially larger role as an anchor for regional currencies. According to econometric estimates by Randall Henning, four of the main economies of Southeast Asia—Malaysia, the Philippines, Singapore, and Thailand—now place more weight on the yuan than the dollar in the management of their exchange rates, forming what amounts to a nascent "renminbi bloc."[8] And through these links to the yuan, local monetary and fiscal policies are being influenced as well.

With all these signs of China's newfound monetary power, it would seem evident that a major new player has burst onto the scene, disrupting the status quo. No one knows, of course, whether the Chinese juggernaut will continue on its course. Debate rages over whether Beijing's economic model can long sustain the momentum of the last three decades.[9] But for now at least, the Middle Kingdom's rise seems real. What is less clear is whether China's emergence can be successfully accommodated. As indicated, the outcome will be determined by two factors in particular—the flexibility of the monetary system in general and the specific intentions of Beijing's leadership.

Systemic Flexibility

This is not the first time in living memory that the entrance of a big newcomer has significantly altered the distribution of power in monetary relations, challenging the system's status quo. At the end of World War II,

7. McKinnon 2005.
8. Henning 2014.
9. Beckley 2011/12.

when the Bretton Woods regime was established, the United States bestrode the system like a colossus. The system could fairly be described as unipolar. But in the decades since, several new powers have successively emerged to challenge US dominance, including West Germany, Japan, and most recently Europe's Economic and Monetary Union (EMU) with its euro. To this list some might also add a fourth, Saudi Arabia. New poles of influence have emerged. In each case, the emerging actor achieved a level of capability sufficient to pose a significant challenge to the status quo. But in each case existing institutions ultimately proved flexible enough to absorb the newcomer without undue stress. The modern monetary system has demonstrated a remarkable capacity to accommodate rising powers.

The Starting Lineup

One could go back further, of course—to the interwar period, for instance, when the United States first surpassed Britain as a monetary power; or even further to the nineteenth century, when the British faced emerging rivals in France and Germany. But those freewheeling eras had little in common with the more institutionalized regime that began with Bretton Woods. For serious comparative analysis, it seems best to begin with the system as it existed in 1945.

At that time, the starting lineup was clear. It consisted of one heavy hitter, the United States, and a motley cast of supporting players—Gulliver and the Lilliputians. American leadership was unquestioned. The United States was the world's biggest import market and, through programs like the Anglo-American Loan Agreement of 1946 and the Marshall Plan, the only major source of both long-term lending and crisis liquidity. The US dollar, universally regarded as being "as good as gold"(if not better), was enshrined as the anchor of the new Bretton Woods system of pegged exchange rates, and monetary and fiscal policy in Washington overwhelmingly set the tone for macroeconomic conditions elsewhere. The system was about as unipolar as it could get short of formal empire. Hegemony did not seem an unfair description.

Clearest evidence of America's dominance could be found in the initial allocation of IMF member quotas and seats on the Fund's Board of Executive Directors. Quotas are the main determinant of voting rights at the IMF. Though in principle set according to strictly objective formulas,

quotas in practice are intended to be a rough reflection of the monetary pecking order: a measure of each state's relative standing on the scale of monetary power. In 1946, when the IMF formally came into existence, the United States was assigned nearly one-third (31.68 percent) of all member votes. The only other country to come close was Great Britain, with 15.12 percent, and even that was considered rather generous. Though the pound sterling at the time still enjoyed some status as an international currency, at least within the sterling area, Britain itself was plainly a wounded nation, unable to play any of the roles normally associated with monetary leadership. At best, London could be regarded as Washington's feeble junior partner.

For the Board of Executive Directors—originally known simply as the Executive Board—the Fund's Articles of Agreement specify that five seats are to be appointed by the members with the largest quotas, with the remainder, normally, to be elected by diverse constituencies. At the start, the five appointed seats, in addition to the United States and Britain, went to France, China, and India. At best, these additional three could be regarded as not much more than courtesy appointments. None of the three was in any position to exercise much authority in monetary affairs. France had been occupied during World War II and had lost much of its industrial capacity. Its currency was weak and its reserves exhausted. China was in the midst of a debilitating civil war, eventually won by the Communists in 1949. And India, newly independent, was preoccupied with building state institutions after the Great Partition with Pakistan. The distribution of global monetary power was radically skewed in favor of the United States.

West Germany

The first serious challenge to American dominance came, unexpectedly, from a defeated World War II foe. This was the Federal Republic of Germany, otherwise known as West Germany, formally created in 1949 through amalgamation of the US, British, and French zones of occupation. At the end of hostilities in 1945 the former Third Reich lay in ruin, its cities and industries largely destroyed. The Deutsche mark (DM) did not even come into existence until 1948, and even as late as 1950 the reborn country's balance of payments was in severe crisis, requiring outside assistance. But then the German economic miracle began, generating rapid growth

and persistent export surpluses. By the end of the 1950s the Federal Republic was firmly ensconced as the leading economy of Europe and its preeminent monetary power.

The reach of West Germany's newfound influence could be best seen in its impact on macroeconomic conditions, not only in Europe but even in the United States. The German public's well known aversion to inflation was fully reflected in the hardline policies of the Federal Republic's central bank, the Bundesbank. Across Europe governments felt driven to match the DM's high interest rates in order to avoid downward pressure on their own currencies—a pressure only modestly relieved by two small revaluations in 1961 and 1969. In the 1970s, when a common intervention system known as the "snake" was created to bind together exchange rates in the European Community (succeeded in 1979 by the European Monetary System), the centrality of the DM was universally acknowledged. Though West Germany did not actively seek an international role for the DM, for fear of losing control over its own monetary policy, its well-respected money soon came to be broadly accepted as the anchor for other European currencies.

Across the Atlantic, meanwhile, the United States struggled throughout the 1960s to stem the flood of dollars pouring into purchases of the DM, severely complicating Washington's efforts to cope with swelling external deficits. For domestic reasons tighter monetary policy in the United States was resisted, giving rise to headline stories about a burgeoning interest rate war with the Germans. I recall a prominent US economist at the time tartly saying to me that we now imported our cars from Japan and our interest rates from Germany. Though resisting pressure for a substantial revaluation of the DM, which could have hurt German exports, the Federal Republic did what it could to help keep the policy conflict from getting out of hand. As a close ally of the United States in NATO, West Germany had no wish to ruffle Washington's feathers. Hence in a famous letter from the Bundesbank to the US Federal Reserve, a pledge was made to keep German reserves in dollars rather than convert them into gold. Likewise, West Germany agreed to make significant payments to the United States to "offset" the cost of maintaining American troops in the Federal Republic. But in the end these and other concessions proved insufficient to forestall the Nixon administration's dramatic decision in August

1971 to suspend the gold convertibility of the dollar, effectively introducing a new era of floating exchange rates.

Already by that time, however, it was clear that West Germany's emergence as a monetary power was being successfully accommodated. As early as 1961 the Federal Republic was given a quota at the IMF equal to that of France and received its own appointed seat on the Executive Board. West Germany took the place of China, whose quota had been frozen following the Communist victory in 1949 (and remained frozen until the mainland government replaced Taiwan in the China seat in 1980). And three years later, when the so-called Group of Ten was named to negotiate the first reform of the IMF since Bretton Woods (leading to the creation of Special Drawing Rights), no one questioned that the Germans should be included. The Federal Republic clearly had become part of the inner circle. This was by no means a co-optation. West Germany's tenacious defense of its tight monetary policy amply demonstrated the extent to which German priorities were now to be part of the international conversation. Rather, this was simply confirmation that the Federal Republic had, in a sense, "arrived."

Indeed, some sources wanted to go even further, to promote West Germany formally to a position of peak leadership in exclusive partnership with the United States in a sort of monetary "bigemony."[10] But that was more than other key players, such as Britain and France, were willing to accept. Instead, the Federal Republic was folded into a new Group of Five or G5 (alongside the United States, Britain, France, and Japan) that was created in 1975, soon expanded with the addition of Canada and Italy to become the G7. For years thereafter the G7, representing nearly half of the world's economy, functioned informally as the center of governance of the monetary system.

Japan

Ironically, the next major challenge also came from a defeated World War II foe—Japan. Like Germany, Japan experienced a postwar economic miracle, an export-led boom starting in the mid-1950s that by the 1960s was generating growth rates in the double digits. In 1968 Japan became the

10. Bergsten 1975.

world's second largest economy, enjoying record payments surpluses and a rapidly growing stockpile of international reserves. During the 1970s the yen became one of the most popular currencies in global financial markets. By the 1980s Japan was the world's biggest creditor nation, clearly a monetary force to be reckoned with.

Unlike Germany, though, Japan played a relatively limited role as a direct influence on exchange rates or macroeconomic conditions. For the Federal Republic, fully committed from the start to the project of European integration, a leadership role in monetary affairs came naturally once economic recovery took hold. However much the Germans may have resisted internationalization of the DM, others nearby could not be prevented from following. Japan, by contrast, had made no such commitment to regional reconciliation. Hence Tokyo had no willing followers in its own neighborhood, where memories were still fresh of Japan's wartime atrocities. On monetary matters, most governments in the region preferred to take their cue from Washington.

Nor, prior to the 1990s, did the Japanese show much interest in playing a more direct role. Like Germany, Japan was long inclined to resist internationalization of its currency for fear of losing control over monetary policy. The Japanese did see their successful economy as an exemplary model for Asian neighbors to emulate, an idea popularized as the "flying geese" theory of economic development. But it was not until the bursting of Japan's "bubble" economy in 1989 and then the Asian crisis of 1997–98 that Tokyo began to take a more proactive role in regional finance. Now currency leadership in East Asia became a central element of policy, largely as a defensive measure intended to reduce the domestic economy's exposure to external volatility—what William Grimes has called "internationalization as insulation."[11] Success in creating anything like a "yen bloc," however, has proved elusive. For the most part, the reach of Japanese monetary power continues to be felt primarily in the country's prominence as a capital exporter and secondarily as a potential source of crisis financing.

In any event, postwar Japan had little appetite to challenge the monetary dominance of its political patron, the United States. With Japanese national security directly dependent on American military might, Tokyo

11. Grimes 2003, 186.

elected to maintain a passive, low-profile stance in its overall foreign policy. Japan had no wish to make waves and acquiesced frequently, albeit unhappily, to American priorities—such as when Tokyo agreed to engineer a revaluation of the yen in 1971 and again in 1978 and 1987. Accommodation of Japan's monetary ascent, therefore, could take place with comparative ease. In the 1960s the country was welcomed as a member of the Group of Ten and later to the G5/G7. And in 1971 Tokyo gained an appointed seat on the IMF Executive Board, replacing India. Though Japan's share of voting rights at the Fund was not to match Germany's for another twenty years, it was nonetheless clear that by the 1970s the Japanese too had "arrived."

Saudi Arabia

A third challenge, of a quite different order, came from Saudi Arabia after the dramatic oil shock of 1973, when world oil prices quadrupled. The Saudi kingdom was the world's largest exporter of crude petroleum and at the time sat atop nearly a third of known energy reserves. Unexpectedly, a country that had not even become a member of the IMF until 1957 found itself a major player in monetary affairs, with a huge surplus of revenues and a rapidly rising stockpile of foreign assets. With scant resources other than oil and a population under fifteen million, Saudi Arabia could hardly be compared with Germany or Japan in broad economic terms. The country did not even have a national currency until 1961. But in strictly financial terms, the Saudis were now in a position to exercise major influence.

The oil shock was clearly destabilizing. On the one hand, energy importers were forced to scramble to find ways to cope with much higher import bills. The suddenly huge transfers to the Saudis and their partners in the Organization of the Petroleum Exporting Countries had the dual effect of accelerating inflation (through the higher price for oil) and retarding growth (by diverting spending for other purposes), ushering in a new era of prolonged stagflation around the world. On the other hand, energy exporters were now endowed with a mammoth accumulation of wealth, which many feared might become a kind of doomsday "money weapon." Oil revenues were paid in dollars, and in the United States in particular there was much concern that the Arab members of OPEC, led by Saudi Arabia, might be tempted to use their new riches as an instrument of linkage to pressure Washington on Middle East political or military issues.

The Saudis alone were thought to account for anywhere from one-half to three-quarters of Arab holdings of greenbacks.[12]

In practice, however, accommodations were quickly found. In return for critical concessions from Washington—including, in particular, informal security guarantees against possible threats from enemies within or without—Saudi Arabia gave assurances of continued support for the dollar. The kingdom was promised top secret confidentiality for its holdings and was even provided a separate "add-on" facility to handle its purchases of US government securities outside the normal auction process.[13] On a broader scale Saudi Arabia began lending funds to the International Monetary Fund, then strapped for cash, to help support the Fund's recycling of so-called petrodollars to energy importers. By 1979 the kingdom had become the IMF's second largest creditor after the United States, qualifying it for an appointed seat on the Fund's Executive Board alongside the established monetary powers of the G5. Saudi Arabia's quota was also rapidly raised, moving it from fifteenth place among members in the mid-1970s to sixth place in 1981.

Since the 1980s the kingdom's monetary star has dimmed somewhat, despite the fact that it has continued to pile up financial assets. In more recent years, Saudi Arabia's share of Fund quotas has slipped from sixth place to twelfth, falling behind the rising BRIC powers (Brazil, Russia, India, and China) as well as Canada and Italy. Moreover, having lost its position as the IMF's second largest creditor, the kingdom was deprived of its appointed seat on the Executive Board in 1992. In recognition of their continuing importance, however, the Saudis were instead accorded the rare privilege of electing their own exclusive executive director—a de facto equivalent of an appointed seat. Though Saudi Arabia may no longer qualify as a top player, the country clearly remains a member of the world's monetary elite.

The Euro Area

Finally, there is the euro area, Europe's Economic and Monetary Union, which formally came into existence in 1999. From the start EMU was

12. Cohen 1986, 126.
13. Spiro 1999.

expected to pose a formidable challenge to the monetary status quo. The birth of the euro, it was thought, would create a new power in international monetary affairs. Even without the participation of Britain and some other European Union members, the euro area would constitute one of the largest economic units in the world, rivaling even the United States in terms of output or share of global trade. Consequences for the monetary system thus promised to be momentous. EMU would become a major rival to the United States. Europe's new money, building on the widespread popularity of Germany's old DM, would pose a serious threat to the long-standing dominance of the greenback. According to one celebrated forecast, the euro might even overtake the dollar as a reserve currency by as early as 2015.[14]

Experience, however, has defied expectations. Unquestionably, the newborn euro did begin life with many of the attributes needed for competitive success, including a large economic base, deeply rooted political stability, and an enviably low rate of inflation, all backed by a joint monetary authority, the European Central Bank, that was fully committed to preserving confidence in the currency's future value. Yet in practice, after a fast early start, cross-border use of the euro for most purposes appears to have leveled off by the middle of its first decade, and under the pressure of Europe's sovereign debt crisis more recently may even have begun to slip back a bit. Overall, the euro has done little more than hold its own as compared with the past aggregate market shares of the DM and EMU's other "legacy" currencies. Moreover, it is well known that while the dollar continues to be used virtually everywhere, the euro's domain is still confined mainly to a limited number of countries with close geographical and/or institutional links to the European Union. Strictly speaking, we would be closer to the mark speaking of a "one-and-a-half currency system" rather than genuine rivalry.[15] The outcome to date has been decidedly anticlimactic.

Partly, this disappointing result has been due to the natural incumbency advantages enjoyed by the greenback; and partly also to the European Central Bank, which has studiously maintained a hands-off policy toward

14. Chinn and Frankel 2008.
15. Cohen 2011, chap. 8.

the issue of euro internationalization. But most of all the outcome would seem attributable to inherent defects in EMU's ambiguous and decentralized governance structure, which has left ultimate authority mainly in the hands of its largest members. Germany, France, and Italy continue to participate separately, on their own behalf, in the G7; and there is no unified EMU representation on the Executive Board of the IMF, where the euro area's seventeen members are scattered across no fewer than eight different constituencies. Accommodating to the creation of EMU, therefore, has proved easier than many had anticipated. Business among the major players can go on much as it has done in the past, and the distribution of power in the system remains relatively unaffected.

Lessons

Looking back, what do we learn from this brief history? Admittedly, the sample is small—just three big newcomers to date (Germany, Japan, and Saudi Arabia), plus a more or less inconclusive fourth (EMU). Yet even so, the narrative is instructive. Three lessons stand out.

First, it is clear that when push comes to shove, the monetary system does not lack the flexibility needed to adjust to the emergence of significant new poles of influence. Not surprisingly, the rise of new powers tends, at least initially, to be disruptive. Germany, Japan, and Saudi Arabia, in their time, all started with export surpluses large enough to stress the overall system. The global community had to scramble to find constructive ways of coping with the pressure of counterpart deficits without ignoring the priorities of the newcomers. Could the necessary finance be mobilized? Could interest rate wars or other destabilizing policy conflicts be avoided? Could room be found for a new actor in prevailing leadership councils? In each case accommodations proved possible. Rather than rigidly resist newcomer interests, threatening stalemate or even systemic failure, existing powers managed to carve out space for a new sharing of authority. By adapting, the system endured.

Second, it is clear that accommodations by the newly emergent powers were essential as well. It takes two to tango. Stabilization also required a spirit of compromise on the part of newcomers—a willingness to play within the prevailing rules of the game rather than to fundamentally challenge the existing order. Each had its own ideas about how the system should be governed. But to borrow a phrase long ago coined by John Ruggie, their preferences tended for the most part to be "norm-governed"—that is, consistent with prevailing principles and understandings, not seeking radical transformation.[16] In their time each newcomer was content to accept admission into existing leadership councils rather than to push for new institutional arrangements. All seemed more interested in being accepted into the inner circle than in starting a new club.

Finally, it is difficult not to notice the underlying geopolitics in all this history. In every episode, including the birth of the euro in 1999, there was clearly a strong security dimension to the relationship between the aspiring newcomer and the still dominant incumbent, the United States. Germany and Japan both have long been close political and military allies of the United States, as are the members of EMU today; while the governing elite of Saudi Arabia continues to depend on an American defense umbrella for protection against potential adversaries. Economic and financial interests may for a time have diverged sharply. But in the end, differences were never allowed to jeopardize broader geopolitical relationships. As Kirshner has noted, "conflicts took place exclusively between friends, and beyond that the high politics . . . served as an 'emergency brake' that placed a limit on just how far monetary squabbles . . . could go."[17] In short, politics trumped economics.

China's Intentions

Now, once more, the monetary system faces a major emergent power, so again some manner of adaptation seems called for. Can the Chinese be successfully accommodated, as others were in the past, or is the Middle Kingdom somehow quantitatively or qualitatively different? This time, in contrast to previous experience, absorption of the newcomer may prove to be a far more daunting challenge.

Accommodation

Certainly, the door has been thrown open. As in the past, when faced with a big newcomer, existing powers have looked for accommodation rather

16. Ruggie 1983.
17. Kirshner 2009, 196.

than reacted with rigid resistance. Consider China's massive trade surpluses, for example, which have been painful for many countries. As both Andrew Walter and Hongying Wang note in this volume, commercial imbalances have prompted considerable external pressure on Beijing, especially from the United States, to revalue its currency. Yet in practical terms reactions have been restrained. Though the Chinese have obviously long manipulated the yuan's exchange rate to maintain a strong competitive advantage, there have been remarkably few direct retaliatory measures. Responses have been limited primarily to loud, but largely futile, verbal complaints.

China's interests have not been denied. Rather, existing powers have actively sought to make room for the Middle Kingdom in prevailing leadership councils. At the IMF, as Eric Helleiner and Bessma Momani meticulously describe in their chapters, a place was quickly found for the newcomer once the mainland government replaced Taiwan in the China seat in 1980. Chinese voting rights were rapidly increased; and like Saudi Arabia, China was soon allowed to elect its own exclusive executive director. After the latest quota review, anticipated to take effect in 2014, China will have the third largest quota at the Fund, behind only the United States and Japan, and its own appointed seat on the Executive Board. Similarly, China's new global influence was implicitly acknowledged by the decision in 2008, after the start of the worldwide financial crisis, to transfer leadership authority from the G7 to the broader G20, where Beijing plays a prominent role. Some sources, reminiscent of earlier calls for a German-American "bigemony," would go even further, to formalize a newly dominant G2 "partnership of equals" between the United States and China.[18]

Response

But will an open door be enough? Ultimately, the outcome will depend on the attitude of the newcomer, which is not at all certain. Making room for China will not suffice if Beijing is unwilling to play within the prevailing rules of the game. To repeat: it takes two to tango, and it is not at all clear that the Chinese are ready to dance. In the words of this volume's

18. Bergsten 2008.

introduction, we do not know whether Beijing wishes to be a "taker," a "maker," or a "breaker" of the existing order.

To date, the signals from China have been mixed. With the country newly embarked on a once-in-a-decade political transition, it is far from clear what Beijing's preferences in coming years may actually turn out to be. Much will depend on the outcome of struggles among key domestic interest groups, as emphasized by several contributors here, including David Steinberg, Andrew Walter, Hongying Wang, and Yang Jiang.

On the one hand, the Chinese seem happy to be accepted into the inner circle both at the IMF and in the G20. Beijing gains face by being seen as a member of the club. Moreover, China has benefited enormously from the prevailing rules. The country would appear to have no interest in undermining a system that has allowed it to achieve such rapid rates of economic growth. This is the view of Helleiner and Momani in their chapters, who see Beijing's efforts to gain a leadership role at the IMF as little more than an effort to garner respect from the international community. It is also the view of Yang Jiang, who views Beijing's monetary diplomacy as notably limited in ambition. Policy initiatives, she contends, tended to be limited in scope and motivated mainly by considerations of political symbolism or pragmatic commercial gain.

But on the other hand, in both words and deeds, the Chinese have appeared to underscore a dissatisfaction with the status quo that goes well beyond anything expressed by earlier newcomers. There are many in the Middle Kingdom, it would appear, who would like to fundamentally change the way the monetary world works. In this volume, both Gregory Chin and Jonathan Kirshner stress Beijing's ambitious agenda for international monetary reform. Both see in recent experience a marked determination to enhance China's structural power at the expense of the United States, the incumbent monetary leader.

Consider, for example, the notorious 2009 essay by Zhou Xiaochuan, governor of the PBOC, which called for a new currency system "that is disconnected from individual nations . . . thus removing the inherent deficiencies caused by using credit-based national currencies."[19] In plain language, this was a frontal assault on the "extraordinary privilege" long

19. Zhou 2009, 2.

enjoyed by the United States as a result of the global dominance of the dollar. In the years since, as Chin reports in his chapter, Beijing has actively promoted a wider role for alternatives to the greenback such as the euro and the IMF's Special Drawing Rights.

Beijing appears to be working hard to tilt the global balance of monetary power as much as possible in its favor, quite unlike anything attempted at a comparable stage by Germany, Japan, or Saudi Arabia. For example, in addition to its commitment to the CMI/CMIM, Beijing has also moved quickly since the 2008 financial crisis to negotiate a series of local currency swap agreements designed to provide RMB funding to other central banks, when needed, for use in trade with China. In just under five years, as Yang Jiang notes, pacts were signed with some twenty-three jurisdictions adding up to a total value of more than $450 billion. Ostensibly, the aim of these agreements was to insure against the kind of risks that could come with another financial crisis. But the facilities were also designed to supply yuan, when desired, for use in bilateral trade on a more regular basis—in effect, to provide indirect encouragement for commercial use of the Chinese currency in lieu of the dollar.

More broadly, as Chin and Kirshner both emphasize in their chapters, it is apparent that China has embarked on a deliberate program to promote the widest possible use of the "people's currency" as an alternative to the greenback. The aim, it would appear, is to gain even more influence in monetary affairs. In addition to its growing role as source of crisis financing, Beijing has gradually widened the range of trade transactions that may be settled in yuan, further encouraging the money's internationalization. By 2013 as much as 14 percent of Chinese trade was being settled in RMB, up from essentially zero in earlier years. Meanwhile, in the autonomous region of Hong Kong, new markets have been created for yuan deposit accounts and yuan-denominated securities (so called dim-sum bonds). Most observers agree that it will be a long time before the RMB can truly match the appeal of the greenback as an international currency.[20] Above all, successful internationalization will require the development of a sophisticated and open capital market, which at a minimum could take a decade or more. The Chinese, however, are no strangers to the demanding rigors of a Long March.

20. Cohen 2014.

Ultimate Goals

On balance, therefore, we just do not know what to expect. At issue, most fundamentally, are the ultimate goals of China's overall foreign policy. Analysts have long argued about the Middle Kingdom's long-term ambitions in international affairs. Are the Chinese prepared to continue working within a global system still dominated by the United States, or does Beijing aspire to replace Washington in a new "Chinese Century"? Put bluntly, is China a status quo power or a revisionist state? Do the Chinese accept the legitimacy of the existing world order? Are they willing to limit their priorities to "norm-governed" changes? Or, *par contre,* are they looking for a more radical transformation of the international environment? Is their goal fundamental change at the level of basic principle—a new global system, in effect, based on "Chinese characteristics"?

Many analysts dismiss the risk of Chinese revisionism. For Nathan and Scobell, for instance, the main goals of Chinese foreign policy are strictly defensive, driven by multiple and enduring security threats. China, in their words, "is too bogged down in the security challenges within and around its borders to threaten the West."[21] For John Ikenberry, any danger to the status quo is moderated by the very nature of the United States–dominated system, which is more institutionally embedded and functionally articulated than past international orders. China is constrained in two ways. "On the one hand, [the system] will provide attractions, incentives, and opportunities for China—thereby encouraging Beijing to integrate further into the existing order. On the other hand, it is a deeply rooted and expansive order that is difficult to undermine or circumvent—thereby making it difficult for Beijing to oppose it or offer a viable alternative vision of international order."[22] In short, China has every reason to limit its priorities to "norm-governed" change.

The Chinese themselves, however, seem to be of two minds, torn between conflicting goals. As one informed source suggests, there are in fact two Chinas—an "economic China" concentrated on economic development and modernization; and a "political China" determined, above all, "to achieve and maintain power in an asymmetric power relation to

21. Nathan and Scobell 2012, xi.
22. Ikenberry 2013, 55.

Western superpowers."[23] While economic China would be content to continue enjoying the material benefits of the current system, political China would be more inclined to regain the rights and privileges that have long been regarded as the Middle Kingdom's natural due. Deeply rooted in Chinese political culture is the notion of *tianxia,* literally "under heaven," with its sense of power centrality expressed in a traditional tributary system. China has long felt entitled to the mantle of regional, if not global, leadership. The Chinese also still harbor deep resentment over what they perceive as a "century of humiliation" at the hands of the barbarian West. In a society with a very long historical memory, we cannot lightly dismiss the salience of such sentiments.

Moreover, as Thomas Christensen has aptly pointed out, China does not have to be able to mobilize an overwhelming preponderance of force in order to threaten the status quo.[24] The system may be deeply rooted, as Ikenberry contends. But that does not mean that Beijing is without points of leverage, should it choose to use them. Likewise, the material costs of destabilizing the existing order could be considerable, but they are unlikely on their own to be decisive. To argue otherwise is to recall the unfortunate Norman Angell, who shortly before World War I argued that the growth of trade ties in Europe had made war in the region impossible.[25] The risk of Chinese revisionism cannot be dismissed so easily.

In the end, therefore, the China question is likely to hinge on considerations far beyond the realm of monetary affairs alone. As noted, geopolitics has always played an important role in such situations. There is no reason why the same should not be true today. Once again, politics can be expected to trump economics. The difference is that in previous episodes tensions were between friends—all in the family, as it were. China, however, is not a military ally like Germany or Japan, and certainly not a client state like Saudi Arabia; but rather is a global rival and potential strategic adversary. In this sense, the Middle Kingdom is indeed qualitatively different from all the other big newcomers to the monetary system since World War II. A smooth path to accommodation cannot be taken for granted.

23. Li Xing 2010, 13.
24. Christensen 2001.
25. Angell 1910.

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The Hidden History of China and the IMF

Eric Helleiner and Bessma Momani

China's growing monetary influence has generated much speculation about the future of the international monetary system. In this volume, Benjamin Cohen recalls how other emerging monetary powers in the postwar period were all successfully accommodated within the existing system. Like many other analysts, however, he is less sure about the consequences of China's rise because of uncertainties about "the attitude of the newcomer." In particular, he wonders about the extent to which Chinese policymakers may be more inclined to challenge both US leadership and the system itself.

This chapter offers a historical perspective on Chinese official attitudes toward the institution at the core of that system: the International

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