A Rising Giant in the East?
Disaggregating China’s Contemporary Economic Power

Tianruo Gao

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Abstract

To what extent are the foundations of hegemonic power present in Contemporary China? This thesis addresses the question through the application of a two-pillar structural power framework. Prominent IPE scholarship on hegemony tends to privilege the internal or external foundations of hegemony and to privilege production and trade or financial development as its subject of analysis. Through the two-pillar framework, the thesis presents a comprehensive analysis of the internal and external dimensions of power in the realms of production and trade on the one hand and financial development on the other. Overall, this holistic account allows for a disaggregated and nuanced account of the partial rise of China to be presented. The thesis found that, in relations to the finance pillar, although having undergone a series of reform which have deepened its financial capacity domestically, China’s external engagement and influence within international financial institutions remains limited. In relations to the production structure, China has proactively engaged with resource-rich regions to secure a stable supply of key inputs but remains heavily reliant on external demand within its unbalanced domestic economy. Overall, the thesis suggests that uneven foundations of structural power present a constraint on the rise of China.
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Declaration

I declare that this thesis is a presentation of my own original work and I am the sole author. This work has not previously been presented for an award at this, or any other, university. All sources of quoted information have been acknowledged by means of reference.
1. Introduction

Napoleon once described China like the ancient sleeping giant (Kumar, DuFresne, and Hahler, 2007). Having gradually recovered from the trauma of war, it is widely acknowledged that this giant is now waking up and has the capacity to exert increasing influence over global events. This thesis examines China’s rising power using a two-pillar approach developed from Susan Strange’s theory of structural power. Strange’s original theory introduces four dimensions of primary structural powers and four secondary structures, whereas this research focuses on the economic components of China’s structural power. By conceptualising hegemony and evaluating China’s structural power from the finance and production dimensions, this thesis provides a systematic analysis of the empirical case of China’s rising economic strength. It also engages with the latest statistics on several economic indicators and primary materials in Chinese, such as relevant governmental documents, to critically examine China’s economic performance and its hegemonic foundations.

Deep social and economic changes have occurred in China over the past few decades, and a range of social and economic forces manifest evidence of growing unrest. The country’s political leadership is aware of the significance of its foreign policy, as a growing source of increasing global power. The overall aim of this thesis is to present an evaluation of the extent to which domestic transformation and external engagement constitute the foundations of China’s hegemonic power.

There are reasons to view China as an increasingly active agent in world politics. As a rising power, China may be gaining the greater capacity to challenge obligations attained under rules and regulations set up by the West. The government of China is quite often ‘being accused of intransigence, resisting to respond to global crises proactively and innovatively’ (Chan, Lee, and Chan, 2008:15-16). It is also pointed out that tensions might arise if China acquires a certain ‘soft power’ to bend the pre-existing Western norms. The question of how an ancient power may be re-established as a globally significant figure in the contemporary global political economy is a fascinating and important topic. By drawing on concepts and themes from within the field of international political economy (IPE), this thesis aims to shed light on this question.
China’s rising power also reflects upon its relations with others, especially the existing great power. For example, when considering the context of hegemonic transition, some scholars have concluded that the relationship between China and the US can be termed as involving the ‘frenemy’, a subtle description of being friends and enemies at the same time (Chaban, Bain, and Stats, 2007; Sverdrup-Thygeson, 2017). Since WWII, the US has established a dominant position via the worldwide financial regime. The Marshall Plan and abundant dollar output to Europe and Japan are able to safeguard a strong alliance between these countries and the US, while US troops in the Middle East and Africa also lead to the prime status of the dollar through providing security (Kindleberger, 1985; Helleiner and Kirshner, 2009). After the collapse of the Soviet Union and the political dynamics shifting drastically within a short period of time, the future of US hegemony becomes a lingering myth (Nye, 1990b), although some scholar believes the power and influence are ‘still without peer’ (Agnew, 1992:8).

With China joining the list of top economies, it can now be assumed as a potential threat to the US. Due to the progress of globalisation, countries are becoming more connected and interdependent. From the monetary perspective, for example, if China dumped all the US treasury bonds it possesses, this would cause a huge impact on the US economy and the dominant role of the US dollar (Drezner, 2009). In this case, the US hegemony established on the widespread use of the dollar becomes vulnerable in the face of the growing Chinese influence. However, the debate asks whether China would take such actions and, if it would, under what circumstances? (Hung, 2013).

Meanwhile, other players in the global arena are reacting differently toward China’s growing power. Developing countries, some affected by the competition caused by China’s exportation, and some benefitting from China’s economic development, may choose to join the US to counterbalance China’s power or to form a comprehensive alliance with China. The US could possibly provide certain Asian countries that experience territory disputes with China, with military support, thus putting pressure upon China; whereas, China has been economically allied with Pakistan and Iran, thus tensing the nerves of the Western regime.
1.1. Research Puzzle

Discussion of the rise of China is often framed according to very broad questions. The popular commentary features reflection and prediction in relation to questions like ‘Can China change the world?’, ‘Is China becoming the next hegemon?’, and ‘How China will change the world?’. In order to gain analytic traction over these ‘big picture’ questions, it is necessary to be clear about the focus of analysis and the core concepts being used as foundations on which to evaluate China’s rising power.

As Kang (2003) having pointed out, China cannot be explained by simply adapting existing Western mainstream approach because of its unique trajectory of social, economic, and political development. To understand this peculiar rising power, there is a need for an analytical framework suitable for the case of China.

Kang’s opinion is confirmed by reviewing a vast range of literature on China’s rising power. As presented in Chapter 2, existing literature has drawn disparate conclusions regarding the rise of China, especially because of its highly ambiguous and hybrid character. This ambiguity stems from a lack of theoretical consensus about what ‘power’ actually is and how it can be measured. Besides, empirically, it is also because China’s development is highly uneven between outward and inward-oriented sectors. As it is demonstrated through this thesis, by adopting a disaggregated approach to the study of power, it can be clarified that the rise of China is highly variegated across different sectors. While China’s trade becomes increasingly intensive and influential, its structural power stemmed from internal economic development remains inadequate; and while China’s financial sector has been expanding rapidly since the late 20th century and achieved significant outcome compared to its old self, its capital market capacity and global influence are limited as a potential hegemonic power.

This thesis addresses two simple questions:

1) How to gain analytic traction over the foundations of China’s rising power?
2) What is the status of the foundations of China’s rising power?

The first question is approached in the light of existing literature on the rise of China and hegemonic power. As is reviewed in Chapter 2, the existing literature presents contradictory
evaluations and points toward a variegated interpretation of China’s development. Chapter 3 demonstrates that Strange’s conceptualisation of structural power can usefully disaggregate the foundations of hegemonic power and allow for a nuanced analysis on the foundations of China’s structural power under a hegemonic context. The second question is addressed through the empirical analyses in Chapter 4 to 7.

1.2. Thesis Outline

The thesis proceeds using the following structure. Chapter 2 reviews the state of the art of literature on the topic of ‘the rise of China’. This body of scholarship is organised around sub-strands that prioritise the economic, security, and ideological dimensions of the rise of China. Overall, this literature remains quite disparate with divergent opinions on the rise of China due to China’s variegated and uneven development through different sectors. This shows that there is a lack of a systematic framework for analysing China’s rising power and potential move toward hegemony. There is broad agreement that the economic attraction posed by China represents the most potent component of China’s foreign relations, and it is repeatedly suggested that political hostility has become less important due to the mutual benefits to be gained from economic cooperation. This thesis aims to extend this literature by explicitly incorporating and extending Susan Strange’s concept of structural powers to the internal and external dimensions of China’s hegemonic foundation.

Chapter 3 establishes the framework for this research by conceptualising hegemonic power and defining an analytical approach for this thesis. Predominant IPE literature has focused on hegemonic theory and power shift between big states, with studies having been conducted via both theoretical arguments and empirical case studies. These have given many explanations of the phenomenon of hegemony through their respectively different viewpoints. As these theories presents, hegemonic power is related to, for example, military strength, international stability, international cooperation, and ideology and cultural influence. These theoretical writings and existing studies on hegemonic transition have attempted to explore the phenomenon of hegemony, with relative economic performance often being located as a foundation of hegemonic position.
However, as is clarified through the review of existing literature in Chapter 2 and 3, the literature lacks a systematic understanding of the components and conceptualisation of power. By adapting Strange’s disaggregated conceptualisation of structural power and adding the analysis on internal and external dimensions, this thesis clarifies and explores the pattern of variegated development that is underpinning the rise of China.

Susan Strange defines power as a compound of four dimensions, including finance, production, security, and intelligence. The original theory of structural power was expressed in the late 1980s. As is noted in Chapter 3, Strange in her own analyses privileged the finance and production dimensions. In line with the predominant view within literature review in Chapter 2 that these economic foundations represent the most salient components of the rise of China, through an analytic framework developed in Chapter 3 these finance and production dimensions are privileged.

After reviewing existing literature on understanding hegemonic power, Chapter 3 then presents the two-pillar approach and the methodology of this research. The two pillars of finance and production structures are taken as the primary structures from Strange’s theory. Through the main body of the thesis, each of these two structures will be analysed from the aspects of internal development and external influence. Notably, the aim of the thesis is not to directly answer whether a hegemonic transition is indeed taking place between the US and China. Instead, it looks at the capability of China in terms of becoming a hegemonic power.

To open the more empirically focused components of the thesis, Chapter 4 summarises the major changes that have happened since the late 1970s and the impact they have brought internally on the strength of the Chinese financial system. Through long-running financial reformation, the structure of China’s financial sector has changed drastically.

In 1949, the Chinese Communist Party took over from the Nationalist Party (the KMT) and thus put bureaucratic capitalism to an end. After suffering the Great Leap Forward and Cultural Revolution, China started a series of socialist transformations under the rule of Deng Xiaoping. A long-term financial reform was put on the agenda and this is still running today. The reform resulted in a rapid increase in national wealth. In theory, the increasingly diverse means of financing, alongside the development of this sector, is able to greatly boost the emergence of all sized enterprises. So far, reform has included the transformation of the banking system, the
opening of the stock exchange, and a number of changes in monetary policy, as well as other related instruments such as credit rating.

Chapter 4 concludes that on balance, China’s financial structure requires further reform and perfection of relevant laws. Through this chapter, new insights are presented in particular into China’s ability of generating credits and its ability of promoting the use of national currency, following Strange’s approach of examining finance structure. China’s financial reform focuses on an approach of Socialism with Chinese Characteristics. It has a limited degree of openness in terms of the market, thus limits the credit generating ability; but on the other hand, relatively high central control helps with monetary stability and could avoid some critical situations that the Western neoliberal regime once faced. The series of internal development greatly promoted China’s economic power from the finance perspective but does not evidence that China has moved into a hegemonic position.

Chapter 5 extends the analysis of China’s financial structure to the external dimension, specifically by exploring evolving interactions with international financial institutions. The People’s Republic of China became part of the IMF and World Bank in 1980 as a result of its reform and opening up. Gradually integrating with the international financial system, China’s status in these institutions changed over time as it became more capable of taking responsibility for development and stability. As well as joining these existing organisations, China initiated a series of institutions with its developing allies, comfortably taking the lead.

Overall, Chapter 5 concludes that while China remains a relatively marginal figure within the ‘old’ international financial institutions of the World Bank and IMF, it has taken up a clear leadership role within the ‘new’ institutions of the CMIM, BRICS Contingent Reserve Arrangement, the New Development Bank, and the AIIB. However, given that these new institutions remain broadly aligned to the goals and procedures of the old institutions, this leadership role does not constitute a clear move toward an alternative hegemonic order. Through this chapter, new insights are presented in particular in relations to the formal governance structure and China’s informal influence within the selected institutions.

Chapter 6 looks at the developments in China’s production structure and makes a relevant evaluation. Whereas the financial reform started in the late 1970s, major progress in production started to materialise around the early 1990s. Since then, China has made a quantitative and
qualitative leap. Under the guidance of Deng Xiaoping’s theory and relevant policies, which encouraged the founding of small and medium private businesses, China’s sector composition was reshaped dramatically as the booming manufacturing industry led to intense GDP growth. Many reports and news articles have attempted to reflect on China’s rapidly multiplying productive capacity.

This chapter seeks to systematise this body of work by evaluating China’s production in relation to sectoral composition, productivity, and export dependency. Overall, Chapter 6 suggests that China’s production structure is relatively backward in terms of sectoral composition and productivity when compared to the standard of contemporary hegemonic power; furthermore, a heavy reliance on exportation can potential hinder China’s pursuit of fast-paced development in the production structure.

Chapter 7 explores China’s resource diplomacy as the external aspect of production. To sustain rapid production progress, securing raw materials is the initial task. Meanwhile, the domestic overcapacity issue has forced China to transfer capacity beyond its border. When China’s GDP took off in the 1990s, so did its exportation. Importing natural resources and exporting manufactured goods has been one of the key strategies for China’s production structure. More recent evidence shows that the focus of China’s resource strategy is shifting to investment, to create stable environments and advantageous conditions for transnational business. The creation of a stable environment can attract investment and cooperation, thus leading to more frequent importing and exporting of products as well as co-invested projects. As a result, such changes could enhance both domestic productivity and wealth generation within Chinese society, and an international mutual benefit shared with many others.

Overall, the findings of Chapter 7 show that China, demonstrating a good level of economic attraction, has been successful in developing trade partnerships and securing resources for the expansion of its production structure. New insights are presented in particular in relation to the institutional foundation of partnerships, trade volume, infrastructural development, and challenges to sustainability.

Building on the framework introduced in Chapter 3 and the insights generated in Chapter 4 to 7, Chapter 8 presents an overall reflection on the rise of China. It concludes that this thesis finds no sufficient evidence that China has constructed a solid economic foundation, despite
that a series of reforms of the finance and production structures since 1978 have directly led to China’s significantly strengthened economic power. China’s promoted status within global and regional financial institutions is based on internal development, but the incremental financial deepening means incremental global influence. The financial reform created new financing means for small to medium firms, private firms that boost production; but sectoral composition and productivity awaits improvement. Furthermore, the massive scale of production, especially manufacturing industry driven by the emergence of private firms, exposes vulnerability from external dependency, including reliance on overseas markets and overseas resource.

Reform in China’s financial structure boosted domestic production and material capacity. The growing material strength allows China to participate more actively in relation to trade and global governance, and hence promotes China’s global influence. Overall, it is argued that while notable transformations have occurred specifically in relation to the internal finance and production capacity, China’s finance and production structures require further deepening and modernisation. From the external aspect, China’s economic growth faces heavy external resource dependence and limited influence within global financial institutions. As such, it is suggested that the economic foundation of China’s power shows an unbalanced growth that restrains China’s hegemonic rise.
2. Understanding the Rise of China: A Survey of the Field

This chapter reviews the existing literature on topics on the ‘rise of China’, in order to situate the contribution of this study. The existing literature can be divided according to thematic and geographic focus. In terms of themes, significant reflections are provided on the economic, security, and leadership impact of the rise of China. In terms of geographic focus, existing literature explores the implications of these changes as experienced domestically and externally across East Asia, the US, and the rest of the world. Prominent discussion occurs regarding the power conflict between China and the US in particular, as is the impact on subordinate states and thus the balance of power throughout the global regime.

The literature review below is arranged by geographic locations in each of the three dimensions are systematically reviewed. Literature focusing on the economic dimension of the rise of China, as experienced domestically and externally, is first covered, followed by literature on the security and the ideological dimensions. Overall, many useful insights are generated by this large swathe of literature. However, despite the intensive discussion on the implications of China’s rising power, conclusions of this literature remain much disparate. Most studies do not offer a precise conceptualisation of the ‘rise of China’, with much of the literature remaining at a high level of abstraction. This is because of a highly variegated nature of China’s development, where power and growth can be sourced from various dimensions. Therefore, this research will bring together this literature and a conceptualisation of hegemonic power drawn from IPE scholarship, which allows for a systematic analysis that considers the disaggregate internal and external dimensions of finance and production structure.

Beyond this overarching incorporation of a clear conceptualisation of hegemonic power in the literature on the rise of China, there are additional components to the value-added from this project to the rise of China literature. This thesis provides a systematic analysis of both the internal and external dimensions of China’s evolved relationship with the production and financial sphere of the global economy. This is in comparison with the tendency in much of the literature to focus on one dimension alone.

The research also provides new empirical evidence into these dimensions. Specifically, this is to introduce a large range of materials, both in English and Chinese, as well as updated statistics,
to best explore the momentum of China’s growing power. Official documents, statistics, and reports by the Chinese government are used to provide detailed information on the internal development of China’s financial and production structures, while the latest statistics extracted from databases of World Bank, IMF, the OECD, and the Observatory of Economic Complexity illustrates China’s trade activity with resource-rich regions and China’s influence within international financial institutions.

2.1. Economic Transformation and the Rise of China

The preponderance of the literature that considers the domestic implications of China’s economic transformation attempts to identify the factors responsible for rates of economic growth over recent decades. Some literature has flagged up problems lurking beneath the apparent prospect of the Chinese economy. Another group of literature points out the impact of China’s economic rise, both positive and negative, on neighbouring countries, developing countries, and the US. Overall, this project builds on this foundation and adds value by linking explicitly to the concept of hegemony, thus examining China’s capability of becoming a hegemonic power. The paragraphs below provide overviews of the main strands of this existing literature.

China’s rapid economic expansion has become the foundation of many ‘hegemonic transition’ debates. Following market reform and opening up, China saw rapid improvement regarding many economic parameters. In 1995, its GNP was five times larger than at the beginning of the reform in 1978, and trade volume, which started from almost nothing, climbed to about a quarter-million USD for the same period. While population growth has gradually slowed down, life expectancy for the population has extended. China’s economic development also seems pleasing when compared to other countries during the same period of time, as never has a country been able to achieve so much in just a few decades. While the rise of China brings opportunities and prospects to both Chinese and foreign businesses, relevant literature has expressed worries about China’s huge demand for the raw resources and energy consumption that sustain this rapid economic growth (Kreft, 2006; Wang, Liu, and Qi, 2014).
A group of literature explores the result of China’s economic development and relevant contributing factors (e.g. Chen and Feng, 2000; Wang and Yao, 2003; Patten, 2010). Many studies in international relations summarise the early 1990s global pattern as trilateral or trilopar, as the US, Japan, and Europe took the leading position (Gill, 1991). Meanwhile, regarding market size and trade volume, China was seen to be becoming the fourth pillar. In the 1990s, the World Bank was already predicting that China would grow into the biggest economy in Asia (Kristof, 1993). It was also predicted that China could obtain 8-9% annual growth for the next 20 or 30 years if it became better at utilising resources and improving productivity (Lin, 2011, as cited in Wang, 2015:351). Although China’s economic development has slowed down in recent years, this is believed to be the ‘new normal’ rather than ‘the end’ of China’s power growth (Womack, 2016).

China’s growth is attributed to reforms over enterprise ownership – decentralising the economic system without losing political control of the CPC, and gradually shifting away from communism or socialism at the economic level (Breslin, 2007; Sun, 2000). Because SOEs were mostly making losses due to overloaded bureaucracy, and private enterprises were not politically in favour, collective ownership, specifically township-village enterprises, became the leading contributor of economic growth during the early stages of China’s economic transformation (Weitzman and Xu, 1994). Between 1980 and 1994, the percentage of industrial output by SOEs dropped from 76.1% to 34.1%, and the share of private enterprises grew from 0.4% to 25.1%; meanwhile, collective enterprises contributed 40.9% of the total output in 1994, in comparison to 23.5% in 1980. Later on, as economic reformation intensified, private and mixed ownership gradually took the lead as the mainstay of the national economy. While law enforcement awaited improvement and because political stability was at stake, the special township-village enterprises could not be less important to China’s economic reform and to the unprecedented economic rise of today (Bowles, 1998; Goodhart and Xu, 1996).

Another study by Rosecrance (2006) expresses worry regarding the early stages of China’s growth model. Here, the emergence of township-village enterprises and private firms boosted manufacture, first fulfilling China’s domestic need and then turning China from a major importer to a major exporter. China’s expanding manufacturing industry consists of a great number of subsidiaries and joint-venture firms. Even though the world economic system has flattened, meaning more players can participate, the end product can only be integrated by the few. For example, while Chinese manufacturers are responsible for producing parts, the final
product, the iPhone, is assembled in the US. The value-added for Chinese and American firms, in this example, differs greatly. In the long term, it cannot be considered an advantage for China’s pursuit of rising power. For Rosecrance, seeking expansion in the pure manufacturing sector is not healthy growth. It also means that China’s economic rise should contain other aspects than merely production and export.

Additionally, literature has developed critiques of the export-oriented and investment-driven economic growth of China during the late 20th century and the early 2000s. Hung (2008) noted that domestic over-investment and under-consumption consequently led to a new type of crisis, over-accumulation. Illustrated by the ratio between gross fixed capital formation and final consumption expenditure, China experiences a greater imbalance between investment and consumption than other Asian countries. The cause of this problem is the ‘debt-financed expansion of excess industrial capacity, asset inflation, and sluggish domestic demand’ (Hung, 2008:165). Therefore, a warning of an impending crisis, similar to the Great Depression in the 1930s US, lies behind China’s economic development. Nevertheless, since the 2000s, China, previously a major recipient of FDI, started to shift into the position of a leading investor. Chinese outflow FDI increases each year, pushing forward the globalisation of Chinese firms. Doing so eases the pressure of weak domestic demand and allows for more active engagement with the international market (Yeung and Liu, 2008). This literature hints the heavy external reliance of China’s production structure which can be explained more explicitly with updated numbers.

Much of this strand of literature flags the importance of China’s export and FDI to its economic growth. Surging exports were explained as being due to a series of institutional changes – that is, in terms of ownership and other policies, for example, reform of SOEs and the emergence of private enterprises boosting production (Liu and Li, 2001; Bai, Lu, and Tao, 2006; Sun, 2000; Putterman, 1995). However, the 1970s economic reform was far more than just about SOEs and ownership. The way that all types of firms finance their operations has changed alongside financial reformation; the role of commercial banks are also overlooked in work presenting China’s economic growth. In fact, while China’s financial structure is becoming much more mature than in the Mao era, the implication of finance to China’s economic growth has not been explored properly.
Furthermore, contributions to this body of literature suggest that further problems are embedded in China’s economic growth. A major one is poverty and underdevelopment, largely due to over-population. In 2001, 211.6 million people lived below the poverty line of $1.08 (1993 PPP) a day, while 593.6 million lived on less than $2.15 (1993 PPP) a day, from a total of 1.272 billion Chinese. Other problems have also occurred, for example, insufficient infrastructure in remote areas. Regional imbalance is another major institutional problem, with provincial governments adopting protectionism and blocking inter-regional trade, contrary to the picture of China as a whole nation embracing an international free trade regime. Despite the central government’s endeavour to redistribute wealth between regions, inequality between the underdeveloped and the more advanced east-coast provinces persists, causing further policy barrier (Bardhan, 2006). For China to further pursue rising power, the issues that stem from a socio-economic dimension must be tackled.

Overall, this body of literature highlights the factors of China’s economic growth, as well as critically evaluating the progress of China’s economic reform. While most literature focuses on the production structure, there lacks an explicit analysis of financial development as a major dimension of the rise of China. These themes are transposed into the analysis of China’s internal development in finance and production structures in Chapter 4 and 6.

Another strand of literature explores China’s relationship with developing countries on the basis of China’s economic performance. For China’s neighbouring states in East Asia as well as other developing countries, the most concerning factor regarding China’s economic implications is trade. The focus of the debate is to what extent is China’s economic growth beneficial to others?

China’s export surge began in the late 1970s, as mentioned previously. Overall, with the advantage of population size, China first emerged as a leading manufacturer of labour-intensive goods, and then soon extended its advantage to electronic and IT departments. Because of the cheap labour cost and increasingly open market, many multinational enterprises came to relocate their manufacturing units to China. Moreover, joining the WTO in 2001 granted China the ability to trade with further favourable conditions (Adhikari and Yang, 2002; Chen, 2009).

China’s economic surge would not have existed without its biggest trade partner ASEAN as its significant material supplier, besides establishing a partnership with other places like Latin
America and Africa. The relationship with ASEAN was built up naturally upon geographic conditions; meanwhile, China’s investment and trade in Africa and Latin America hugely impacted the latter and their connection with the international community.

Generally, with the process of political independence and economic development, China became the hub of trade, investment, and production in Asia (Bowles et al., 2016). While being the leading exporter in Asia, for example, taking over from the US, as the top trader with South Korea, China has become the most sought market for other Asian countries’ export goods since the early 2000s. During the same period, it also overtook the US and became the biggest attraction for FDI. As another instance, the China-Africa relationship can be dated back to the 1950s, starting from purely diplomatic rapport building to more intense economic cooperation, China is described as winning market, heart, and minds in Africa. Indeed, economic cooperation with China has been sought by these countries, and while some suggest that the ‘dumping’ of Chinese products harms other economies, others see opportunity in these circumstances.

There has developed a fear among countries in similar stages of industrial progress that Chinese products would ‘crowd out’ the global market and diminish the survival of the former countries’ manufacturing sector. As for developed countries, another kind of fear has started to accumulate, with protectionism emerging against ‘Made in China’. However, by exploring China’s trade pattern, economists conclude that China’s trade advantage is still in its labour-intensive industries, which affects mainly East Asian industrialised countries only. This is contrary to the most common belief that China took over market shares originally belonging to other developing countries; instead, the rise of China’s manufacturing industry has created a supply chain for the countries around it, with other developing countries able to become more specialised in terms of providing specific products and developing more advanced export advantages (Athukorala, 2009; Erturk, 2001).

Moreover, activities carried out by Chinese businesses have also gradually shifted from raw material extracting to developmental investment. China’s cooperation with ASEAN and Africa extend to its infrastructural development and joint ventures. This relationship is thought to offer valuable experience and lessons for China’s other new partners, such as Latin America (Roett and Paz, 2008). China’s trade partnership with these regions can be generally considered as an area of interest.
Apart from the direct economic impact China creates for other economies, there is some specific focus on China’s growth model as a reference for others. In general, China’s grand strategy can be concluded as ‘keeping a low profile’ and ‘striving for achievement’, as introduced by the government and discussed by many Chinese scholars. Keeping a low profile allows China to establish a social foundation for stable economic growth while the achievement part refers to its increasingly proactive foreign policy (Yan, 2014).

The implication of this strategy is two-fold as Li (2016) suggests. On the one hand, the rise of China and its global influence can be attributed to its top-ranking position in the global financial order as well as its ability to provide public goods for the international community; however, it is not a hegemonic power because hegemony should also contain social and political dimensions. As Chinese products face protests from Latin American farmers and manufacturers, the Chinese government must aim for socio-political development, and approach its trade partners with mutual interests beyond economic benefits, for example, value exchange and cultural communication. On the other hand, the model of China’s economic growth, its ‘keeping and striving’ strategy, can offer a valuable reference point for other developing countries who are also seeking an economic rise. This analysis hints the conceptualisation of hegemony as not only possessing material power but also having non-material influence, however, is unsuccessful in explicitly justifying such concept.

Although much attention has been paid to China’s trade partnership with others, financial cooperation between China and other developing countries is a much more recent phenomenon that awaits further exploration. While China’s economy keeps reforming into a more advanced form of industrialisation, from self-sustenance to leading manufactured goods exporter and then capital exporter, the pattern of China’s cooperation with others has also changed through time. Since there has been no synthesised study on China’s relationship with developing countries in terms of either trade and financial cooperation, and because circumstances keep changing across time, this theme remains an area of interest in terms of China’s rising economic power.

Existing literature also focuses on the implication of China’s economic rise on the US in the context of regional economic structure and balance of power by its Asian neighbours and out Asia-Pacific countries. The rise of China concerns scholars as much as it concerns politicians.
because of the discussion as to whether China will challenge the existing hegemonic regime, especially in the context of China-US competition.

In terms of economic conflict, both the US and China, according to their current economic modes, have advantages over each other as well as facing challenges and different targets. While the US possesses more high-value-added sectors and syncretic innovation, China profits from mass production. Economic competition is a long-term phenomenon rather than a tipping point when one takes over another. Most importantly, analysis of US-China economic competition should regularly take the framework of ‘US + China + X’ to explore the effect of US and China on specific countries. However, the US economy also relies on China’s growth to a great extent, with bilateral economic cooperation beneficial to both parties. Therefore, the US-China economic relationship is a sustainable form of rivalry (Womack, 2016). From the ‘US + China + X’, it can be inferred that the hegemonic competition between China and the US can be analysed through their economic implication to subordinate states, such as East Asian countries.

There is a suggestion that the US should be more positively engaging with China’s economic activity regardless of the alleged hegemonic transition and power conflict. Most specifically, for the Asia-Pacific region, its regional structure has gradually shifted from Japan-centred to China-centred, the predominant influence of the US notwithstanding. Although from the perspective of economic development, the Asian regime seems to be China-centred, regional cooperation still faces several obstacles. The biggest one is the China-Japan relationship where nationalism sets the key tone – while Japan denies China’s regional leadership, it also feels impuissant as its strongest ally, the US, is excluded from most Asian economic cooperative agendas like the ASEAN+3 regime. Nonetheless, China would enjoy America’s company as it would bring an even bigger market for trading; therefore, the future for the East Asian regime should extend to the north, with China’s international influence being less relevant in a list of mutual economic interests (Ahn, 2004).

By referring to Martin Wright, Clark (2011) argues that there is a distinction between hegemony and primacy – what China is pursuing may be primacy rather than hegemony, and military confrontation will be excluded from the rise of China. This view coincides with the ‘peaceful rise’ argument presented by many Chinese academics (e.g. Zheng, 2005; Yan, 2014). What was observed as the US hegemony includes unprecedented material power, such as GDP,
military expenditure, reserve, and trade volume; although China is closing the gap in terms of these economic parameters. However, this does not equal China closing in as the next hegemon because it still lacks significant soft power. Furthermore, the remaining heat of US dominance persists, meaning that the US will maintain its primacy for another half-century.

Overall, in this section above, the literature on the internal foundations of and external impact of the economic rise of China has been reviewed. Despite the intense discussion on China’s economic development and its implications, existing literature cannot decide in consensus what China’s development means to the world or how other countries should react to it. This may be mainly because of a lack of consistent understanding of the nature of China’s rising power. By framing my analysis of the rise of China in terms of core concepts from Susan Strange’s work on hegemony, themes and insights introduced through this literature are systematically brought together. While early work explored the factors contributing to the rise of China, such as manufacturing and trade, the increasing importance of financial aspects to continuing economic growth has not been stressed enough. Therefore, this thesis specifically develops a focus on China’s finance and production structures with a systematic analysis to provide a more up-to-date comprehensive understanding of China’s rising power in the context of hegemonic transition.

2.2. International Security and the Rise of China

A second prominent focus in the existing literature on the rise of China seeks to explore issues of international security. While most countries cut down military expenditure following WWII, China has been actively building up its arsenal, for example, independently researching and developing its own fighter jets (Ikenberry, 2008). The key debate in much literature over China’s growing military strength is what China intends to do next, and how others responded to this growing power. Against the backdrop of such mixed information, this thesis adopts the disaggregate approach to analyse the internal and external foundations of China’s growing power which its military and diplomatic strength rests upon.

Amongst this strand of literature on China’s security, two aspects have been developed to examine China’s rising power – one looks at the extent to which China and the US influence
subordinate states, such as East Asia countries, and the other considers whether a direct military conflict will occur between the two. Each of these aspects is also written from the perspectives of different actors around the world, among which the most involved are the US and East Asia. The overall insight is that economic factors have been playing an increasingly important role in other countries’ China policy. Although there used to be confrontation and although it is unclear what China’s intention now is, most contemporary scholars agree to emphasise the consideration of economic benefits over foreign policy and military action, both for great powers and subordinate states. Reviewing this strand of the literature reveals a relatively diminishing role of security in the study of hegemonic power and ambiguity in perceiving China’s rising military power.

The majority of the literature studying the rise of China writes from the perspective of US foreign policy. The inevitable decline of the US alongside the relentless rise of China has led to military tensions which could potentially hinder the US-China relationship. The core of the debate over the China-US security issue contains two themes, a direct confrontation between the two and conflicts via agents such as other Asia-Pacific states.

Looking back to the late 1990s, China’s military conflict with the US emerged as the People’s Liberation Army (PLA) carried out missile exercises in the Taiwan Strait and the US bombed the Chinese embassy in the former Yugoslavia. The two countries became bitterly hostile. The US government believed that rising China would be a long-term security threat to the hegemonic power of the US, and therefore, allied with Taiwan via arms transferring in order to check China’s forces. Publications by the Chinese PLA also showed that a plan was needed against the US (Johnston, 2003). He (2009) notes that despite the historical hostility, there is a dynamic balance between China and the US, with the US holding the initiative – because China is more concerned about internal unity and stability for economic development.

Chung (2016) summarises a few schools of thought on the US-China relationship that hold different opinions on China’s intentions and whether a US-China confrontation is inevitable. At the moment, believing China’s rising power is leading to a more assertive China in the Pacific region, the US is seeking more active and frequent military deployment with Singapore and Australia, as well as deepening defensive cooperation with others like Japan and the Philippines. The US is also putting more of its budget and investment into weapons and the
army for a potential air-sea battle. East Asian countries’ fear regarding China and the US is, in fact, largely due to China’s unclear presentation of its intentions.

As Chung (Ibid.) concludes, factors such as ancient China historically being predominant in Asia, China’s challenge over the South China Sea and Diaoyu Island, and China’s provoking projection of its military might, lead to the impression of an assertively rising China. Before China can prove its strategic intention and its official stance towards the international community, however, the future of Asia in the context of a rising China is uncertain. Yet, as the global environment is constantly changing, and with even greater potential economic interests at stake, the military conflict between China and the US is only part of the picture of the US-China relationship.

While China is situated around neighbours who are not completely welcoming due to territorial and economic interest conflicts, the influence of the US military is often introduced to Asia by these neighbours to counterbalance China’s growing power. Furthermore, the US prefers its role unchanged as both a Pacific and Atlantic power. It is unwise for the US and China to escalate economic competition into political hostility, as the Brzezinski (2013) criticises the formation of TPP without China and RCEP without the US. Both the US and China should see the rise of China as an opportunity for further mutual benefits rather than an arms race or military confrontation.

The fear that China will turn its economic growth into political and military power is reasonable. It can be explained by power transition theory and empirical studies on great power (Kennedy, 1988). However, since 2001, the consensus on the security issue of anti-terrorism has put China and the US in the same interest group, with the Western emphasis on the ‘China Threat’ no longer a major issue. Meanwhile, China itself has repeatedly stressed its firm choice for a peaceful rise. Most importantly, the case of China’s rising power exposes an ambiguity of concepts in the field of international relations – how to define power, status quo power, revisionist power, and the international community. Studies on the rise of China should thus be conducted impartially and practically (Callahan, 2005).

As for US foreign policy directed at the rise of China, offensive realist John Mearsheimer was criticised for his understanding of state behaviour and his suggestion that the US should try its best to prevent the rise of China because as soon as China gathers enough economic power, it
would transfer it into military might to dominant Asia (Mearsheimer, 2001). As it is difficult to determine China’s intention and to tell the difference between offensive and defensive military power, Mearsheimer (2010) insists that the US should spare the best effort to contain China’s growth. In response to his argument, Jonathan Kirshner (2012) stated that the theoretical foundation Mearsheimer based his argument on was fundamentally flawed – that is, offensive realism is merely normative, and the prediction does not match reality. The way great powers make choices is always uncertain and contingent, which allows room for manoeuvre. This means that the security strategy of great powers in the context of hegemonic shift can be extremely dynamic.

Furthermore, China and the US are economically interdependent. In the end, military conflict is always balanced out by economic interest. Preventing the rise of China would also harm US interests. Rather, ‘the key lies in channelling the burgeoning Chinese economic clout into paths consistent with U.S. goals in the region’ (Nanto and Chanlett-Avery, 2006:39). While most discussions focus on China’s exports and economic size, little attention is paid to the capacity and contribution of the Chinese import market. With all elements considered, a full-blown confrontation is a completely undesirable approach for the US to choose (Kirshner, 2012).

Some scholars particularly seek answers through theoretical writings, specifically by turning to Power Transition Theory and trying to identify China’s role and intention in the China-US relationship dilemma. With the intellectual development and more complicated dynamics involved in the issue of rising China, there is no definite conclusion as to whether China will or will not become a security threat.

In theory, if hegemonic war should take place, Power Transition Theory states that two requirements must be met – the emerging power’s growth should be driven by internal development and a global order that is shaped by the hegemon (Organski, 1958). These two conditions are questionable in the case of rising China. Furthermore, another prerequisite for war between hegemonic powers is the rising power being unsatisfied with the existing regime – a counterexample of this condition is the transition between Britain and the US (Lemke and Tammen, 2003), but it is unclear if China is a dissatisfied power, something which will be reviewed in the next section. Because ‘theories of hegemonic stability and power transition have been built on the largely unchallenged assumption that the United States acts as a global economic stabilizer in times of crisis’, the same theories may not be totally suitable for
analysing the case of rising China and its questionable hegemonic ascendance (Kim and Gates, 2015:223).

In addition, Chinese politician and scholars have stated that Chinese people rarely want to challenge the US for world supremacy; they merely hope that China can be rich and be respected by the international community, as is the US. The rise of China may make the Asia-Pacific region more peaceful (Wen, 2003; Xu, 2004). After all, China’s intention is peace, because a vibrant economy can only thrive in a peaceful international environment. Contrary to what is generally believed, that is, that China is a security threat, Yan Xuetong argues that since the collapse of the Soviet Union, it is the US that has become the unchallenged and uncontrolled superpower. The danger of this unipolar configuration is that the US is getting more impatient and want to solve things quickly by using military power, for example, is the 1998 Iraq War. Therefore, China is a growing power that can constrain the excessive power of the US and thus maintain peace (Yan, 2001).

Besides the discussion on US-China security conflict, the competition between China and other East Asian states composes another major interest in studying the rise of China, with some studies exploring security concerns over China from the perspectives of East Asia, including Northeast and Southeast Asian countries. The response from East Asia, as secondary states in the existing regime, towards China’s growing power can be very different from that of the US.

If war is inevitable, it is likely to occur between China and its neighbouring countries, and erupt over disputed territory, such as Diaoyu Island, the South China Sea, and the Southwest border. Furthermore, China has been suspected of irresponsibly selling weapons to countries that include Pakistan and Algeria, which could destabilise certain regions. On the other hand, it is understandable why China is behaving so assertively. China was once great and ancient, however, in the intervening centuries following the Qing Dynasty, it has suffered great losses in terms of lives, materials, and territory. Considering the social dimension, even if the Chinese leader decided to let go of all its territorial claims, the Chinese people are unlikely to swallow such bitterness (Kristof, 1993). The ambitious nation of China flags a destabilising future that follows the pattern of previous hegemonic transitions (Organski, 1958).

In theory, smaller states respond situationally to a rising power, according to traditional realist and neo-realist approaches, while others argue that secondary states are likely to balance any
rising power because of the archaic nature of international politics. There are also opinions on state alignment as a factor that affects secondary states’ choices, meaning that ideology, multilateral institutions, and common cultural influences, apart from economic and material interests, determine if secondary states perceive the rising power as a threat. Johnston (2008) notes that, following a constructivist approach, socialisation and social interaction can affect an actor’s interests and hence determine China’s behaviour.

Overall, although East Asian states are more dependent on China’s economy, countries like Japan, the Philippines, and Singapore, are strengthening military cooperation with the US (Ross, 2006). Furthermore, zooming in to regional power distribution, specifically in the case of Japan, capacity, referring to national power, and intention are the major two influential factors. This is because Japan, similar to the US, has a leadership conflict with China, existing at the regional rather than global level. Nevertheless, from the bigger global picture, the US-China relationship has emerged as a stabiliser for the China-Japan relationship (Lee, 2015).

The overall observation of East Asia is that, first of all, regardless of China’s intention, the Asian region undeniably engages with and relies heavily on China’s deepening market, looking for the equilibrium between economic gain from China and security gain from the US. Secondly, countries choose differently when determining where the equilibrium sits. For more advanced countries, like Japan, Taiwan and Mongolia, they are tactically allied with the US as balancing China’s growing power, whereas for some developing states, such as Laos, North Korea and Myanmar, ‘bandwagoning’ with an emerging power to challenge the existing hegemon seems to be a much more preferred option. There are also a number of nations staying delicately in the middle, like South Korea and Australia, adjusting their stances according to the actual circumstances (White, 2005; Kang, 2007).

This difference is due to the various extent of security concerns a country has in relation to China’s rising – those with long-standing territorial and political disputes often choose to ally with the US and those countries with fewer disputes but more trade dependency choose to cooperate. Lastly, the relationship between China and the US, whether turning more hostile or more cooperative, can greatly change the dynamics that exist between China and East Asian countries, even across the whole Asia-Pacific region (Chung, 2009).
Other articles see China’s growing military strength through the dramatic growth of economic capacity and are concerned with the security issues related to China. Banlaoi (2003) argues that China’s rising power is a threat to US national security, whereas some believe that it also has great implications for other countries and regions, such as Southeast Asia. For example, the relationship between China and ASEAN is described as one between partners in competition. China is deemed as a great economic opportunity for ASEAN, but on the other hand, is also believed by the ASEAN leaders to be seeking military expansion in Asia. Security concerns in Southeast Asia are mainly caused by ideological disagreements between China and ASEAN, as well as territorial disputes. However, this article does not explain in detail the competition surrounding influence and the military that exists between China and the US or local government over Southeast Asia, neither does it give clear implications regarding the rise of China to Southeast Asia security issues, instead merely stating that China plays a significant role in these issues.

As is evident from the volume of literature on the topic, the security and military dimensions to the rise of China has attracted significant scholarly attention over recent years. However, underpinning much of this literature there is a common opinion that economic interest can counterbalance concerns over military and security issues. With much more interests from multiple aspects involved, states tend to approach security with cautions, using diplomacy to avoid direct conflict (e.g. Brzezinski, 2013; White, 2005; Nanto and Chanlett-Avery, 2006). For the case of China, economic strength determines military strength, while, mutual economic and financial benefits reduce military conflict (Breslin, 2007). This study follows other work that privileges the economic foundations of the rise of China. Indeed, as is made clear in Chapter 3, this is a privileging that is present in IPE literature on hegemony, including in Susan Strange’s work around which the later analysis is framed.

2.3. China as a Global Leader

The third strand of literature on the rise of China explores the topic of hegemonic transition more critically by turning away from economic and military factors to identify China’s role in international regime building. Commonly, this literature explores the topic by offering a comparison between the government of China’s approach to global governance and ideology
on the one hand, and that of the US and contemporary Western-dominated system. This strand of literature shares a common interest in China’s participation in the international community and global governance, but the conclusions vary as different definitions of hegemony, implicit or explicit definitions, are adopted.

Overall, across this literature, it is suggested that there is a decreased emphasis on military power and the fading prospect of full-scale hegemonic war; this is because globalisation brings countries closer to each other via economic activities, such as trade, and capital flow. Other elements like communication, culture, and global challenges such as the environmental issues also urge countries, especially those competing for great power status, to cooperate for mutual interest through the structure of international institutions. Meanwhile, the hierarchy within international institutions reflects power conflicts and struggle between states – for example, the dominant state can often insert its universal values and ideology into the structure of an institution. This has especially caught academics’ attention as China has been intensively pushing its ‘belt and road’ initiatives in recent years (e.g. Ferdinand, 2016; Callahan, 2016; Li et al., 2015; Huang, 2016; Fallon, 2015). With these insights in mind, this research extends Strange’s original conceptualisation of structural powers to include the external dimensions where interactions among states, as well as between states and inter-state institutions, are examined.

Direct comparison between China and the US can often be found in many pieces of literature. For example, Hu and Men (2002) and Hu et al. (2015) put forward the concept of ‘comprehensive national power’ attempting the make a holistic evaluation. This approach included 17 elements from 8 general perspectives while each element is given a specific weight. The conclusion unsurprisingly stated that China is been increasingly closing the gap between itself and the US; however, the selection of elements leaves many open questions, as ‘comprehensive national power’ by Hu and his colleague focuses on strategic resources. It has not explored how efficiently and effectively a state can utilise the resources, what can be the performance outcome of such resources, and, most importantly, there is no theoretical foundation of IPE scholarship to validate this approach.

Some of the literature considers that China’s embedded role in the global economy makes the prospect of a peaceful transition highly possible. With China being an increasing heavyweight
in the global economy, its activities concern the whole international economic regime, especially in terms of its participation in many organisations.

As China’s intense trade and investment makes it highly influential in terms of the development strategy of almost all developing countries, Gu, Humphrey, and Messner (2008) analyse China’s engagement with the WTO to seek the patterns behind China’s behaviour within international organisations. It is concluded that China’s interest in the WTO is to access the global market, make use of the dispute settlement mechanism, and build its international image. It shows little interest in siding with anyone or contributing to the improvement of the regime, even though the WTO expects that China, as the biggest emerging market, could play a more active part in coordinating negotiations between developing and developed countries during the Doha round. Scott and Wilkinson (2013) drew to a similar conclusion that China shows little interest in altering the existing WTO structure; instead, it is an advocate of the status quo. Bishop and Zhang (2019) also pointed out that China is reluctant to lead the WTO, despite its assertive behaviour in other regimes. They added that this is because of the decline of multilateral trade system, and the fruitless Doha Round further disillusioned developing and emerging countries.

Nevertheless, the arena of the WTO is rather inclusive with countries of all levels cooperating for common institutional building. China’s participation in the WTO shows that the rise of China is inevitable, which is same as it is in other international organisations. In the context of globalisation, old and new great powers can align their interests and agree on the elements of a new international order (deLisle and Goldstein, 2017). The existence of international intuitions has now become a major approach in terms of coordinating between countries, especially between great powers.

Many others discuss China’s increasingly assertive foreign policy using the case of ‘One Belt One Road’ (OBOR) – Ferdinand (2016) comments that apart from securing trade relationship, the OBOR initiative is also an ambitious infrastructural development plan for the relatively poor west China and outside China, a ‘Marshall plan’ for China. Geopolitically speaking, the OBOR also establish rapport with strategic allies and promote China’s naval power. Callahan (2016) believes that the OBOR initiative is to integrate Eurasia, the South Pacific, and East Africa into a China-centred community of common interests, a supra-regional regime under Chinese hegemony. Sit et al. (2017) interpreted the OBOR initiative from a finance perspective,
suggesting that the founding of AIIB and the funding of infrastructural development abroad is China’s strategy of outputting excessive capital, resolving overcapacity, and establishing China-led international financial regime. Sit et al. also expressed worries on the similarity between OBOR and pre-WWI Europe where stronger states try to dominate others industrially and militarily.

However, according to the existing literature on OBOR, it is not completely clear what OBOR refers to – as the name indicates that it is an initiative, not a specific project. It is multidimensional, as existing literature tend to analyse it from production, trade, infrastructure, finance, culture, environment, and security aspects (Li et al., 2015; Swaine, 2015; Wang, 2016; Rolland, 2017; Du and Zhang, 2018). As a focal point of China study, the OBOR attracts attention from scholars and contributes to a vast range of literature. There is also more literature focusing on assessing OBOR – whether it is ‘successful’ from many different perspectives for different players (Casarini, 2016; Huang, 2016; Herrero and Xu, 2017; Lee and Kim, 2017). To unpack the multiple dimensions of OBOR and to truly understand China’s foreign policy under the Belt and Road initiative, it is necessary to look at the foundations of China’s structural power where the OBOR initiative is laid upon. As this thesis will study China’s power from the finance and production structure, the elements of the OBOR initiative, namely the AIIB and China’s trade and infrastructural development scheme, will be included in the corresponding chapter as part of China’s disaggregated power.

The literature on this theme also points out China’s allied role with developing countries in global governance and its capability to shape a new world order (Breslin, 2011; Kupchan, 2012; Lanteigne, 2005). For example, the formation of G20 creating a new balance of power between developing state and developed ones. During the mid-2000s, the term ‘Beijing Consensus’ was put forward against the backdrop of the disillusioning ‘Washington Consensus’, because when global crises occurred during the past few decades, China’s hyper economic growth mostly went uninterrupted. It is considered that China’s ability to withstand crises is attributable to its political and economic structure where a level of central control persists in order to avoid an over-liberalised economy (Hung, 2008; Bowles, 2014).

To raise the issue to a higher level, some scholars try to explore the world-system paradigm based on Giovanni Arrighi’s influence (e.g. Arrighi, 2005a; Arrighi, 2005b; Arrighi and Silver, 1999). It is concluded that China’s development follows a completely different set of values
than the West. Unlike in the US with hegemonic power rising from the capital and energy-intensive sectors, China possesses a historical ‘Industrious Revolution’ growth model. Although nowadays China actively engages in the global financial system, its market economy and initial rise of power were birthed through labour-intensive manufacturing. This fundamental difference in growth model determines that China’s rising power can never rest upon on the same value system as the West. Arrighi states that capitalism is a representation of a particular social class, but that a market economy is determined by the state, making it a political decision taken by the government. The type of economy does not definitely coincide with the ruling class. China is an example of a non-capitalist nation embracing market economy, without capitalists being the dominant social class (Robinson, 2011). This example shows that the choice of transforming into a market economy represents the interest of the state but not a particular class. While the West retreat from the predominant economic position, China’s development model can be referred to for other developing countries with a historically non-capitalism-oriented economy.

The ideological and social dimensions of China’s rising power have drawn significant attention. Shambaugh (2013) has argued that China’s hegemonic presence is paradoxical; although economic and military seem to spring up, its diplomatic influence is not growing correspondingly. When it comes to presenting leadership, China is self-interested, risk-averse, and reactive. As Shambaugh agrees that China is indeed a global economic power, conventionally evaluating from the aspects of China’s global trade position, its role in energy markets, its outward direct investment, and its development assistance, he attributed China failing to be a global leader to ideological factors relating to willingness to lead, and internal conflicts. Shambaugh’s studies focus more on the social-political dimension while overlooking the ever-changing foundational elements of China’s power. Furthermore, recent statistics prove that China’s economic power is, in fact, more vulnerable than what Shambaugh believed.

Shambaugh (2014) also argued that China’s rising power is merely a ‘paper tiger’ due to internal weakness. Similarly, another article by Shambaugh (2015) focuses on the ‘soft’ aspect of power and states that this area of development is very unbalanced which hinders China’s pursuit of big power status. Shambaugh’s approach is to examine China through overall five areas – international diplomacy, military capacity, cultural presence, economic power, and domestic elements; and in regard to each of this pillar, he argues that China is not demonstrating leadership. For example, one of these arguments on China’s cultural output failing to set global
cultural trend is not entirely true. As a matter of fact, big-name Hollywood productions are now being acquired or partially acquired by Chinese investors. When commenting on China’s economic growth, the article relies upon a broad-based claim that China focuses on low-end consumer goods manufacturing rather than technological innovation and investment. The argument lacks a degree of nuance in its treatment of the empirical subject. In addition, conceptually, we are not provided with a detailed framework for analysing power and power transition.

Shirk (2007) argues China is a fragile superpower. Heavily focusing on the ‘soft power’ dimension and social factors, she acknowledges the economic and military strength of China but considers the fragility comes from internal social stability. Chinese leaders have a deep sense of domestic insecurity. Echoing this opinion, Callahan (2015) suggests that China’s weakness as a global power is due to its negative soft power and people’s doubt in their identity. This argument is true in a way, however, does not capture the full essence of China’s leadership status. The Communist Party secure its leadership by buying people off with rapid economic development, meaning that as long as the economy goes on well, the regime would most likely remain stable (Dickson, 2016). As China keeps shifting, transforming, and reforming its economic policies and structure, one would have the reason to believe that this country is resilient and adapting quickly to contemporary conditions (Shevchenko, 2004). Therefore, the internal instability argument is only valid on the basis of China’s economy failing. This research will conclude in the later-on chapters that the economic strength of China is still the major reason China yet to reach its hegemonic peak.

While scholars mentioned above remain doubtful on China’s non-economic power, Beeson (2009) argues that China can add value to the existing global order by comparing China’s rising power with the nature of US hegemony. Beeson defines the key to US hegemonic success as American ideas and values, all widely distributed through the establishment of the global financial regime. It is the repeating emphasis on these values via formal and informal institutions, such as Bretton Woods institutions and the ‘Washington Consensus’, that consolidate US hegemony. Using a similar approach, China’s growth is not limited to its material power – it is also actively seeking influence through its foreign policy and regime building, although in a much ‘softer’ way. For example, China has engaged with ASEAN regarding agendas to establish a free trade network and partakes in other indigenous forums.
Yan (2011) compliments this opinion by arguing that China’s rise received an extra boost during the 2008 financial crisis because it showed superior ability in withstanding such a disastrous impact. If China keeps up the momentum for continuing economic growth, it will be capable of leading the world out of the current crisis (Bowles, 2014). Yan predicts that China may surpass the US in terms of economic size by 2025, and by 2050 catch up with the US regarding comprehensive national power; therefore, a change in international norms may happen between 2026 and 2050. However, Beeson still concludes that China has little impact on the current US hegemonic regime nor is a hegemonic transition likely to take place. This is because China has, in fact, abandoned ‘socialism in all but its name’ (Beeson, 2009:108) and instead adopted the capitalist economy, which marks out the US hegemonic power; the so-called ‘Beijing Consensus’ is merely a blurry vision without ideological or coalition support.

There is clear evidence that China is catching up with the US regarding technological advancement and GDP at an incredible speed. China’s predetermined agenda and intentions are shaped by the social group in power, and as China’s power continues to grow, its ambition will correspondingly expand. This means that the US should not only be concerned about China from an economic perspective but also from an ideological one, in terms of its foreign policy (Art, 2010). However, it is unclear if China is committed to Western liberalism – this is back to the discussion on ‘intention’. To get back to the basic elements, the rise of China does not necessarily mark the end of US leadership, as long as the US can work on strengthening the existing liberal global order and embrace globalisation. China may take over the US and eventually become the largest economy, however, it is much harder for China to overtake the whole Western regime on its own (Ikenberry, 2008). Similar literature also reflect on China’s participation in current international institutions, arguing that China should not be simply identified as a status quo or revisionist state due to insufficient conceptualisation. In some case, China is identified as reform-minded status quo country (Ferdinand and Wang, 2013). Neither is there clear evidence that China’s foreign policy endeavours to create a multipolarity international community to replace US unipolarity (Johnston, 2003). Ideas in this strand of literature conflict each other, yet again, due to the blurry definition of ‘hegemonic power’ and the conjecture of China’s ‘intention’, which, therefore, should not be considered as a reliable variable to measure China’s rising power.

Overall, literature on China’s engagement in constructing global order points out the role of international regimes and institutions in relation to the power conflict between China and the
US. The US still maintains its leadership on behalf of the West via the establishment of Bretton Woods institutions and liberal-capital values. The US has the ability to shape the global political regime, where the ascending China has to react and make strategic choices. Therefore, the US could manipulate the current international regime, making it ‘easier to join and harder to overturn’ through the building of institutions. By welcoming China into this liberal regime, the result could be that China shows great interest in accessing the global capitalist system as well as desires to maintain this system; this is because its own interests are protected by these norms, for example, trade rules and monetary policy. This theme is transposed into the analysis of China’s engagement with international financial institutions in Chapter 5.

2.4. Summary

The existing literature shows a complex picture of the rise of China with many mixed messages. Three areas of interest are explored surrounding this issue, with the scholarship focusing on economics, security, and global leadership. The general observation of this chapter is that there is widespread disagreement in the existing literature on the rise of China, with competing interpretations of the extent and nature of China's contemporary power.

The existence of these competing interpretations suggests that developments in China may be variegated, with differential patterns across different sectors and different aspects. Debates persist, exploring whether China’s economic growth is sustaining or worrying? Whether China is a status quo or a revisionist? Whether China challenges or commits to the existing global regime? Further to this disagreement, much literature develops arguments taking ‘the rise of China’ as a prerequisite, without clearly defining and evaluating relevant terms such as ‘power’, ‘hegemony’, and ‘leadership’. This lack of shared concepts and approach helps explain why these studies often reach competing conclusions. Hence, it is necessary to conceptualise hegemonic power in a disaggregated manner to construct a more comprehensive understanding as to what actually compose the rise of China.

Literature on economic rise usefully focuses on production structure, with individual contributions typically emphasising internal foundations (e.g. Wang and Yao, 2003; Patten, 2010; Putterman, 1995; Breslin 2007) or external impact (e.g. Adhikari and Yang, 2002; Chen,
2009; Bowles et al., 2016; Ahn, 2004). There is a broad-based agreement that China’s power initially rose from the economic pillar. This thesis develops these focuses by systematically framing the analysis using Strange’s approach of conceptualising hegemony and structural power. This thesis also introduces an extended focus on finance, which is driven partly by the gap in the existing literature and partly by the analytic approach of Strange on which this thesis draws. The analysis of China’s economic performance will also present updated statistics and information to accurately depict the current status of China’s rising power.

Literature on security points out that conflict and confrontation is not the key theme of China’s rising power. Shirk (2017) notes that provoking a trade war, an arms race, or even a military confrontation means a great loss to both China and the US. The significantly common opinion in this strand of literature is that the benefit of China’s rising economy can change other countries’ attitudes and foreign policy towards China (Brzezinski, 2013; White, 2005; Nanto and Chanlett-Avery, 2006; Kirshner, 2012). This strand of literature is more convinced of the idea that China is more an opportunity than a threat. Although China indeed poses a security challenge to other countries, contemporary IPE issues are privileging the effect of economic interests on foreign policy. This thesis incorporates this insight by refining Strange’s four-dimension structural power into a two-pillar approach which better serves the particular case of the rise of China.

Literature on global governance and leadership focuses on debating whether China will commit to or challenge the current Western-oriented international regime, without pinpointing the link between hegemonic rise and international regime (e.g. Robinson, 2011; Hung, 2008; Beeson, 2009; Ikenberry, 2008). While the topic of China’s participation in and influence on global governance remains an area of interest, this thesis incorporates the systematic analysis of this topic under the analytical framework of economic power with a clear conceptualisation of hegemony.

While much of the existing literature tends to focus on a specific dimension or theme of China’s rising power, this thesis adopts and extends Susan Strange’s framework of structural power to include a systematic study on the internal and external dimensions of the foundations of China’s rising power.
3. Understanding Hegemony and Hegemonic Transition: a Two-Pillar Approach

The issue of hegemonic transition has attracted much attention and debate in the field of International Political Economy. With early work focusing on hegemonic cycles associated with British and American leadership of the global economy, attention has recently begun to explore the issue of the rise of China. Although a vast majority of the existing literature has analysed US hegemonic decline, seeking evidence for hegemonic transition, until very recently, fewer have shed light on the other side, the growing power of China. The thesis overall aims to present a systematic analysis of the rising power of China, exploring the nature of China's economic power in the context of hegemonic transition. The main question asks, what, ultimately, is China’s rising power when put in the context of ‘hegemonic transition’, and applies an analytical framework based on Susan Strange’s approach.

This chapter presents a review of key literature on understanding what hegemony is and how to conceptualise power in a way suitable to study the rise of China. Overall, it is suggested that although there exists a vast range of literature on a hegemonic theme, the conceptualisation of the nature of power remains vague and ambiguous. There is a need to build up an analysis to refine the understanding of power, and hence, provide analytic traction over the ‘rise of China’ and to critically evaluate China’s hegemonic ascendancy. By building upon Susan Strange’s theory of structural power, this thesis develops a two-pillar approach and apply this to the case of rising China.

The structure of this chapter is developed through seven sections. The first four sections review the popular theoretical foundations for understanding hegemony through existing literature. This includes a basic introduction and interpretation of hegemony through the mainstream approaches of international political economy and corresponding empirical studies.

The first section is a review of the relationship between hegemony and military power, using Spanish hegemony and Pax Britannica during the Age of Discovery as illustrations. The second section looks into hegemonic stability theory that suggests hegemony has the power to provide stability, especially from an economic aspect. This section will include a review on literature
focusing on US hegemony as supplementary material. The third section discusses the liberal term of complex interdependency which stresses states’ freedom of choice to reach an optimal result. It also suggests that power is a combination of hard and soft, whilst hegemony is sufficient but not necessary to form transnational cooperation. A case considering Japan’s post-war reconstruction will be introduced to illustrate this liberal stance. The fourth section introduces the interpretation of power in critical theory. Scholarship in critical theory argues that power rests within ideology and values. Critical theory also advocates that states are not entities that possess power, but instead this is held by the social classes.

The fifth and sixth sections move on to discuss Structural Power Theory by Susan Strange and the analytical framework developed for this research which is based upon it. Although hegemony theories in the previous sections have identified several manifestations of hegemonic power, they cannot construct a practical approach to operationalise this study. Structural Power Theory is a more resilient and empirically focused approach suggested by Strange to analyse power where power is disaggregated into different dimensions for examination and evaluation. Strange also advocates that for every different case, there can be a different set of structures applied.

Adhering to this principle, this chapter introduces a two-pillar approach to the study of China’s rising power, which represents an operationalisation of Strange’s theory. This two-pillar operationalisation provides an analytic tool to comprehensively analyse and measure the uneven status of China’s power. This framework consists of an analysis of China’s finance and production structures which underpin the controversial status of China’s hegemonic rise. Each of these dimensions is examined via their internal aspects and their external implications. Finally, this chapter will offer an explanation of the methodology of this research.

3.1. Early European Hegemony and Military Predominance

A vast range of existing literature have put effort into exploring the issue of hegemonic transition; in particular, some have taken the example of major power shift cases to identify the component of hegemonic power, which provides a valuable reference for this research. Within literature exploring hegemony and international political economy, a prominent strand aims at using studies from the period of European expansion (from the 15th century) to draw
insights into the topic. These literature are briefly reviewed below. While usefully highlighting the destabilising consequences that can accompany hegemonic transition and pointing in general terms towards the importance of domestic capacity as a foundation of hegemonic emergence, the pre-eminent importance placed on military capacity reduces the direct relevance of this literature to this study of the hegemonic rise of China.

Paul Kennedy (1988) considers the fate of Spain as a hegemon was secured by two major reasons – one being the costly wars between European countries and the other that the Habsburg family had too many enemies. To further explain this argument, Kennedy suggests that the transition between Spain and its successor was determined by the economic performances of them both – and this applies to other rising and falling hegemons in history as well. This explanation quite obviously confirms the approach of a realist theory whereby economic and military powers, also known as hard powers, are the decisive factor (although Kennedy never claims himself to be a realist). The Armada was the key to Spain’s success against other European economies, and the silver plundered from the American continents continuously sponsored the expansion of the Spanish navy. Based on this interpretation of history, it is straightforward that Spanish hegemony was built upon military predominance and the subsequence accumulation of resources.

On the other hand, the reason for this hegemony transiting to Britain is also largely related to the military. Hegemons should be aware of the ‘imperial overstretch’ when excessive expansion overseas finally bankrupts the country. Excessive expansion brought about the heavy burden of maintaining both the empire’s internal and external structures. Signs of decline appeared when production could no longer keep up with the Spanish military operation, and royal-funded British pirates made the situation worse for the hegemon. Therefore, based on Kennedy’s justification, military strength, as well as the economic capability supporting it, is considered a key factor in hegemonic power during earlier centuries.

Geoffrey Parker criticises Kennedy’s suggestion, stating that Spain’s failure was ideological. The Spanish king was obsessed with religion and dynastic aims that were soon exhausted by the huge amount of wealth collected from the colonies (Parker, 1998). Adding to Parker’s argument, Tenace writes: ‘Philip II lost sight of the big picture and the Armadas became nothing more than unnecessary and wasteful diversions’ (Tenace, 2003:882). In contrast, the British monarch enforced more pro-capitalism policies which enabled the quick takeover of
the hegemonic position. It can be argued that it was strategic choices of the two countries that determined this transition, and the choices of that time were based on ideologies and the personal belief of the king or queen. Moving on to the present time, a new voice can be heard criticising Kennedy’s ‘realist’ analysis of the rise and fall of power, arguing that there should be more factors such as national identity taken into account (Nau, 2001). However, very little information could be found on this topic. Rather, most empirical studies on hegemonic transition show an interest in more recent shifts involving the US.

In short, it is fair to argue that, to a great extent, the success of both the Spanish and the British regime could be directly attributed to profound military strength, but military is not the sole factor to determine hegemony. More recently, as historians explore further into the social and political complexity of the era, other correlated factors have been discussed. Overall, as historical evidence of this period suggests, there were multiple reasons, including the acquisition of resources and advanced economic structure, that led to such rapid growth in military forces, and which ultimately resulted in the power surge of states (Glete, 2002; Bonney, 1995).

While some contributions direct attention to the underlying socio-economic foundations of hegemony, this literature on early European hegemony tended to privilege the military and security dimensions. However, along with the changing global order and the dynamic roles played by states and markets, the emphasis on the military as a decisive factor of state power has gradually shifted away with more consideration of economic and financial dominance, as hegemony appears in studies focusing on more recent times. This is not to say military strength is no longer an element to be taken into account, but it is always accompanied by factors such as economic strength; the emphasis on this aspect has reduced as other dimensions take more weight in the overall evaluation of power. As in the following section, attention on the economic dimension increases when considering the literature on later hegemonic.
3.2. Hegemony and Economic Stability: Pax Britannica and Pax American

Another strand of the literature conceptualises the role of hegemony in relation to the whole international arena in a more contemporary context, by examining the different natures of the post-war US hegemonic regime and its predecessor, the Pax Britannica. Initially suggested by Kindleberger and extended by a number of IPE scholars, this literature flags up the importance of a preponderant power as the stabiliser and provider of the international economic and financial order. It emphasises the relationship between the hegemon and the global order, rather than just focusing on hegemonic power.

Another value of this strand of literature is the strengthening the importance of financial structure to power analysis, which becomes one of the rationales this thesis used when choosing the dimensions to examine in the research. Yet, as is demonstrated below, this literature presents a rather static picture of hegemonic power. It shows how power can manifest as the result of established hegemony rather than the dynamics of a power shift. It does not explore what elements power consists of, and neither is it able to provide a feasible approach to evaluate power as per Strange’s approach.

To identify hegemonic power, this strand of literature first paves the way to understand the nature of the global system. As significantly flagged in neo-realist theories, hegemony is defined as the sole dominating power within the global economic system and is based on the realist belief that the nature of the international environment is anarchic. Here, states are the essential players in the system and they are always rational and self-interested, seeking the maximum benefit. States are also fearful of threats over being defeated and perishing. Therefore, the primary concern is surviving and self-helping (Baylis, Smith, and Owens, 2011). Kenneth Waltz (1979; 2008) believes there is no harmony under anarchy. In such an anarchic environment, it seems to realist's eyes that the difficulty of reaching agreement and cooperation becomes magnified. Thus, in the early 1970s, hegemonic stability theory, developed by Charles Kindleberger, suggested that hegemonic power is the key to the stability of the world economic system.
Kindleberger believes in a positive correlation between hegemony and economic order. When the hegemon becomes predominant, the economic order within the international system would also seem to be in good condition. By contrast, if hegemonic power declines, such a regime will become disordered and eventually collapse, with the eventual complete failure of hegemony (Kindleberger, 1981). Therefore, the existence of hegemony is vital to a global economic regime.

The more in-depth reason for the importance of hegemonic stability is that the hegemon is able and willing to take over certain responsibilities, for example, being the coordinator of an international system or regime as well as providing certain public goods for the system (Kindleberger, 2013). In order to achieve cooperation and stability, there needs to be a hegemon playing the role of coordinator and stabiliser. Kindleberger states that in order to create and maintain the stability of the international order, there must be one, but only one, hegemonic power. The hegemon can either positively or negatively make use of its influence, regardless of whether it forces other subordinate members within the order to obey.

Advocators of hegemonic stability theory believe that it is necessary for an international regime to have a hegemonic power because of the connection between hegemony and public goods (Wohlforth, et al., 2007). It is widely acknowledged that an open market economy contains a particular kind of goods known as public goods or collective goods, for example, highways, and lighthouses. Public goods are non-exclusive and non-rivalrous. One’s consumption of public goods does not decrease the amount of the same product that others can enjoy.

However, because the consumption of public goods is usually free of charge, the goods are often insufficient and scarce unless an agent is willing to be responsible for providing a greater share of the costs of such goods. Alternatively, some organisations, for instance, a governmental department that is able to force consumers to pay for public goods, can also avoid the shortage of public goods. In the context of IPE, public goods exist as well. The rules and regulations of economic organisations, such as free trade regimes based on the principle of Most Favoured Nation; stable international monetary regimes that benefit all transnational commercial activities; and international security treaties on chemical and nuclear weapons, can all be considered as public goods within the domain of the international economic system (Kindleberger, 2013). As long as there is a stable and peaceful international order, any country,
regardless of it contributing money and efforts to the establishment of this order or not, can enjoy a peaceful and favourable environment of foreign relations and domestic development.

According to Kindleberger, only a hegemon has the willingness plus the ability to provide public goods, including international security, a free trade regime, monetary stability, and so on. The country with hegemonic power prefers and guarantees to provide public goods that are considered as too excessive a responsibility for other countries to bear. Thus, the economic performance of the hegemonic country is of great concern to the functioning of the world economy.

The hegemon is able to use its prestige and reputation to set up rules and regulations within the regime, defining lawful and illegal behaviour while resolving the issue of free-riding (Pedersen, 2002). Both the Gold Standard in the late 19th century and the post-war Bretton Woods System are presented as powerful examples that support this explanation of hegemony. The existence of Britain and the US as hegemonic powers during those certain periods continuously provided the world with new public goods and maintained the stable liquidity of capital while forcing free-riders to compensate. With these efforts, hegemonic countries, performing as stabilisers according to this strand of literature, are able to maintain the stability of the world economy.

In the early 20th century, the US dollar joined the international financial system as the US ratified and became a member of the Gold Standard in 1900. President Taft implemented ‘Dollar Diplomacy’, pushing forward the strategy in competing for global monetary and financial hegemony across the whole American continent (Leuchtenburg, 1952; Rosenberg, 1998). While the US had surpassed Britain in GDP, the US dollar did not affect the role of sterling due to the large scale of trade settlement around the world.

During the interwar period, chaos and the Great Depression occurred due to Britain’s inability and the US unwillingness to maintain international financial stability (Kindleberger, 2013). After WWII, order had been restored when the US hegemony and dollar hegemony came into clear existence. By being geographical far away from the main battlefield, the US suffered much less damage from WWII compared to Britain. Moreover, by the end of World War II, the US accounted for producing half of the world’s manufactured goods and more than one-third of foreign trading, with around 59 per cent of gold reserves among all countries (Cohen, 1977).
The US had also become the biggest creditor in the world after WWII and finally established a solid foundation for the development of dollar hegemony. Backed by its economic strength, the US continued promoting the dominance of the dollar as an international currency and eventually built up the Bretton Woods system by the end of the World War II, initially taking it one step further and approaching world monetary and financial dominance.

In general, the hegemonic shift between Britain and the US after the Second World War occurred for complex reasons. Ikenberry (2001) suggests the war was a direct cause of this transition. Being at the frontline of the European battlefield, the British nation was devastated when materials and resources were drained. This was the same for most other European countries, and therefore no one was able to take the responsibility as a hegemon and to provide order. The advantage of the US became extremely obvious at this time. While the war could be perceived as a destabiliser, a state which was able to restore or rebuild global order can be considered a hegemon.

Meanwhile, the establishment of the IMF was in favour of the expansion of US foreign trade. The massive output of goods and capital led to a huge surplus of US payments with a deficit in other countries (Eichengreen, 2011). The dollar became extremely popular in the world resulting in a worldwide dollar shortage. This shortage symbolised the flourishing nature of dollar hegemony, and also marked the dollar as fully able to establish its hegemony within the world’s monetary and financial regimes.

Additional insights into the role played by the hegemonic state as a stabilising force is provided by Helleiner and Kirshner (2009). For these scholars, hegemony also requires military power as a way of safeguarding economic interests, especially when economic and financial interests are so vital that they become the basic national value. In other words, military strength somehow determines whether a country has control over all the tangible and intangible resources mentioned above. An example of the US launching wars against oil-exportation countries in the Middle East can illustrate this opinion. On the other hand, the US military protecting allies from the Soviet threat during the Cold War also enhanced and maintained economic cooperation between these countries; although this military strength does not necessarily need to extend to worldwide dominance.
Literature on hegemonic stability outlines the important role played by a hegemonic state and outlines some mechanisms of stabilisation. It stresses the significance of hegemony in the stable global order as a manifestation of hegemonic power, however, it fails to suggest factors that can contribute to ascendant or descendant hegemonic power. The stability theory itself focuses on explaining the function of hegemonic power and how power is manifested, but not what elements make up that power. Supplementary literature besides Kindleberger’s original theory add that profound economic strength, military power, and the establishment of institutions could be factors determining the dominant position of the US dollar which ultimately brought some financial stability to the global regime. However, this vast range of literature has not reached any agreement or formed a realist approach to provide an analytical framework for this research. Lastly, the foundation of hegemonic stability theory itself was questioned and challenged recently by liberal scholars, which will be presented in the next section.

3.3. Power and Complex Interdependence: Post-war Japan

The third strand of literature explores the interplay between markets and states as an important dynamic in the global economy, especially as globalisation progresses. It develops on the basis of a similar global environment as the neo-realist hegemonic stability advocator but interprets states’ behaviour in a different way, the liberal way. The main idea is that the coercive power of a hegemon is no longer the sole element shaping international regimes; instead, cooperation and coordination are the key factors due to interdependency between all types of states, hegemonic and subordinate. There is always a certain level of instability in the contemporary global structure regardless of the presence of a hegemon, and the parts played by emerging powers and small states should not be overlooked. This literature provides the rationale for a more dynamic interpretation of power, however, once again it fails to clearly identify its composition.

While Kindleberger was working on stability theory back in the 1970s, Keohane and Nye, in the liberal camp, introduced the idea of ‘complex interdependence’ for analysing power and interdependence in a global economy (Keohane and Nye, 2011). Complex interdependence is defined as containing three main features: multiple channels of communications, an absence of
hierarchy among issues, and a diminished role for military force (Cohen, 2008). In contrast to the approach used in hegemonic stability theory, liberals believe that there are multiple channels in an international system. Nye disagrees with realists by particularly noting that military strength is not so necessary among alliances due to the changing global environment, though he does agree that it is important in considering relations with a rival bloc (Nye, 1990a). The complex interdependence idea stresses the significance of the interaction between states. This opinion implies that the state power or the state-centred paradigm determines the pattern of the international economy. Thus, the correlation between hegemony and the international system is weak, or at least not as strong as the realists believe.

Hegemony, as previously introduced, is understood as a single dominating country. However, interdependence is not solely determined by state power. The sole hegemonic power, in fact, cannot always be decisive regarding everything within the global system. As to hegemony, Keohane does not deny that it can bring cooperation but argues that it is not a must-have in the system. Countries are like players in a game theory model. They can value the pros and cons of each option and make a decision. He argues that hegemony can indeed facilitate cooperation, but it is neither a necessary nor sufficient factor in terms of creating and maintaining that cooperation.

Pursuing mutual benefits or common interests, states are willing and more likely to cooperate. Even though a regime is created under the influence of a hegemon, it does not require hegemonic power to keep it running. Once the rules and regulations have already been set up, the regime can keep benefiting the members within it without much maintenance effort from the hegemon. Therefore, post-hegemonic cooperation is possible (Keohane, 2005). Specifically, Keohane uses game theory to explain why hegemony is not a vital component in achieving cooperation.

Following Keohane’s idea, Oye introduces more detailed examples by categorising international cooperation via four different forms, for example, two actors adopting strategies to either cooperate or not. Liberals believe that driven by the maximising benefits, players are more likely to collaborate. Taking the model of stag hunting, as an example, hunters collaborate
because of the tempting outcome that benefits all (Oye, 1986). Realists often oppose this idea by saying that due to an anarchic environment, the uncertainty of another player’s choice often leads to a self-interested situation. For instance, fearing the risk of betrayal, states rather go for a less beneficial choice but one with a guaranteed prize. Contrarily, liberals suggest that because the international environment is a multi-play model instead of a single round, states can learn from previous results, and thus be more willing to cooperate, with or without a hegemonic coordinator.

Keohane partially agrees with the realists who assert that states are essential players in the international system and are always rational, but he suggests a promoted position for international institutions. Cooperation and coordination can be achieved under a guild of institutions. That is also the reason some people think of Keohane as a ‘liberal institutionalist’. He considers that hegemon and cooperation are not alternatives, but instead hegemony may foster cooperation, while cooperation can make and enforce rules for the hegemon. Cohen, referring to Keohane’s ideas, writes: ‘States might still be central actors in international affairs, but with the expansion of the global marketplace they could no longer claim sole authority to determine outcomes’ (Cohen, 2008:28).

After all, during the post-war period, realist and liberal theories in IPE represented the majority in terms of understanding, when taking on Anglo-American hegemony as a role model; holding similar beliefs regarding many of the basic guidelines and sharing recognition of the international environment. The difference is that, while realists believe in mighty and coercive hegemonic power, liberals focus more on freedom of choice and the interaction between players. Hegemony is not the absolute decisive power – instead, if one wants to build up an international order, it should attract other players rather than coerce them. The significance of liberal theory in understanding hegemony is its suggestion that power can be made up of ‘soft power’, in contrast to the realist ‘hard’ version of power (Nye, 2004). By using soft power, states can reach cooperation using foreign policy as the method and benefit from a growth in state power. One example of this statement is the growth of post-war Japan.

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1 Stag hunting is a classic game theory model including at least two hunters as the players. If all the players spare their efforts on hunting stag, the outcome will be obtaining a stag in the end (the biggest achievement). If one hunter decides to hunt hare, he can obtain one hare in the end (still better than getting nothing) while other hunters will receive nothing at all (the worst outcome).
During the late 20th century, the title ‘hegemonic transition towards the East’ started to appear frequently, with the ‘East’ referring to Japan at that time. In the 1990s, some scholars questioned whether Japan was ‘an imminent hegemon’ (Taira, 1991). Many have described the development of Japan as ‘the Japan miracle’ because the country suffered a significant downturn after World War II. Though the ‘Japan hegemony’ myth was eventually busted, its dramatic rise in power was fearsome to many Americans.

The reasons that post-war reconstruction went so smoothly and quickly are mainly threefold: the setting up of a market economy system following the Western-style; giving priority to the development of basic raw materials including iron, steel and coal, as well as the power industry, as the breakthrough point for economic development; and the prosperity brought by the Koreans which allowed Japan to profit by selling wartime goods (Smitka, 1998). In other words, there were both internal and external factors that supported and enhanced the Japanese economic reconstruction, including a more dynamic relationship between economic factors and power.

Notably, in 1949, the Japanese government created the Ministry of International Trade and Industry (MITI) as a connection between internal development and the tide of globalisation. It was set up when Japan was facing increasing inflation and insufficient productivity. The purpose of setting up the MITI was, apart from dealing with exports and imports, to provide and implement guidance on industrial activities. It also filled in the gaps left by other business and economic related departments. Johnson describes the position of MITI as being equivalent to the Ministry of Defence, instead of any commercial related department (Johnson, 1982).

It is reasonable to think so, as the MITI was de facto concerned about strategic policies, which reflected in the domestic industry. It played a role as a bridge between foreign affairs and internal construction, for example, adjusting foreign exchange to enhance exportation and publishing over-loaning policy to control commercial banks. Johnson also points out that the uniquely formed social ideology adopted during wartime had also enabled Japan and its people to keep economic development as the first priority.

Besides the contribution of internal institutional architecture, the prosperity of Japan is inseparable from the assistance of globalisation and an international environment. The Japan-
US relationship is highly strategic and geopolitical. The US has given remarkable support to the recovery of the Japanese economy by providing large amounts of capital and material to Japan. The US troops stationed in Japan also insured local social stability (Krauss and Pempel, 2004). When Japan's economic strength continued to increase, the trade friction between Japan and the US-led Western countries also began to grow. In addition to the United States taking up a trade protection policy to suppress Japanese products, in 1985 it united other developed countries to jointly sign the Plaza Agreement, forcing the sharp appreciation of the yen. Nonetheless, this prompted Japanese companies to accelerate the pace of technological innovation, moving to an overseas production base, as well as improving the advantages of energy-saving, automobile, electronics, and other fields at the same time (Nakamura, 1981).

On the other hand, it was also Japan’s geopolitical and strategic reliance on the US that made it impossible for Japan to overtake as hegemon. Despite miraculous advancement and growth, Japan could not compete with the US on making and enforcing rules for the international economic system, not to mention its ability of replacing the dollar as a key currency or providing a last resort open market (Calder, 2005). Nevertheless, it is undeniable that Japan’s power surge can be attributed to its choice in transforming the domestic market and subsequent international market participation, as suggested by complex interdependency theory.

Notably, the complex interdependency argument has flagged the significance of the interaction between states using the market mechanism and foreign policy as major tools. This dilutes the role of hegemonic power, hinting that the foundations of power are complex and involve public and private dimensions. However, this perspective does not provide any insights into the composition of power. Despite its proposal regarding the concept of ‘soft power’, it fails to clearly identify what constitutes such soft power. A number of recent theorists criticise the ambiguity of early liberal literature on identifying the distinction between soft and hard power, as well as pointing to the impossible ‘complexity’ of interdependency. Overall, the complex interdependency still cannot provide a comprehensive analytic framework to operationalise this study.
3.4. Hegemony in Critical Theory: Social Class Struggle

Besides the mainstream approaches mentioned above, there is a particular strand of literature on the critical theory of international relations that also contributes to the study of power. Marxist dependency theory provides an alternative explanation of hegemony, moving away from the debate between realists and liberals. It develops a system-based analytic framework that explores the existence of stable hierarchies within the international political economy. However, although this literature generates a number of critical comments on the mainstream approach and suggests an alternative definition of power, critical theory is a marginal approach still under development. Furthermore, scholars advocating critical theory have also very divided opinions among themselves; therefore, critical theory will not be applied as the main guideline for this study.

The work of Gramsci informs the conceptualisation of hegemony within this strand of critical theory. In Gramscian theory, hegemony particularly represents the dominance of ideology that reinforces social orders. Putting such a term into the international environment, hegemony becomes one of the elements that impose global governance and international orders (Cox, 1983). For Gramsci and Gramscian scholars, there is a broad agreement that hegemony constitutes those ideological structures through which leadership is maintained. At different times and in different places, varying combinations of intellectual and moral leadership and more repressive forms of domination can be used by elites to maintain order (Litowitz, 2000).

Marxists and Gramscians suggest that the subject of power can be social classes, ethnic groups, or political parties, besides states. Therefore, Gramscian hegemony suggests there are various entities of hegemonic power. Hegemony is not only exercised as state power, and more actors and entities that should be taken into account (Hoare and Nowell-Smith, 1971). In fact, hegemony involves the ideology of the whole society. Gramscian hegemony is a cultural and institutional hegemony instead of a purely economic one, despite the fact that this form of cultural power could eventually exert influence on economic performance.

Along with the development of democratic politics, Stephen Gill argues that liberal governing receives pressure from the grassroots, as neoliberal leadership often adopts a ‘top-down’ approach and mainly emphasises market civilisation (Gill, 1995). Here, leadership represents
wellbeing and the need for stability by the wealthy and entitled members of society. However, Gill states that nowadays neoliberalism and the form of leadership under its control are badly in crisis (Gill, 2012). Hegemony, according to critical theory, is built upon the condition of material. A change in material condition thus changes the status of leadership.

Gill also points out that Kindleberger’s opinion on the significance of both the capability and willingness of hegemony is quite narrowly concerned. Instead, a Marxist explanation of hegemonic stability considers the US as the super-imperial power that facilitates global cooperation. However, the nature of capitalism deems to generate crises due to the excessive amount of capital and under-consumption. Sklair (2001) classified the causes of these crises into two, including a wealth-gap crisis and an unsustainable situation leading to social crises. Gill emphatically states that global leadership exists to serve history, because after all, as Gramsci argued, power is possessed by historical blocs, and conflicts over interests are conceptualised as clashes between classes.

As for the determination of transnational actions, Robert Cox (1981), a representative figure in this area, concludes that three factors are involved: material capability, institutions, and ideas. These factors decide whether states choose to cooperate or act against each other. Cox (1993) describes the international environment whereby the US and other Western states are identified as the core, operating heavily under a discipline of neo-liberalism, with the global periphery composed of non-Western or even anti-Western political economies. Gill compliments this opinion by explaining the trilateral relationship that exists between North America, Europe, and Japan (Gill, 1991). These new elements are considered social forces in Gramscianism and avoid the disagreement between realist and liberal schools. Critical theory also provides another angle and viewpoint on international relations by historicising the phenomena of power, agency, and structure (Cox and Sinclair, 1996).

Gramscianism and Marxism introduced the epistemology of historical materialism into the conceptualisation of hegemony and, more generally, international and transnational relations. Critical theories have proposed consideration of new elements when studying power. There is an increasing weight of intellectualism involved in the balance of interests and risks, thus determining all kinds of social behaviour and even international activities. Meanwhile, these theories have also weakened the natural role of states and government. For example, Marxism particularly failed to explain the internationalisation of international economic activities,
especially following the 1960s (Gill, 1994). Over-emphasising the capital and the material would not be comprehensive enough to allow for studying the contemporary issues of IPE.

Similar opinions are found in a range of literature. Many believe that global leadership is on the edge of a power shift, and there are certainly potential alternatives for the pre-existing US hegemony. However, the immaturity and limited acceptance of these critical theories fail to provide a clear and accurate evaluation of the actual conclusion of shifting power, despite the fact that critical theories are being used more frequently for particular case studies these days.

3.5. Strange’s Conceptualisation: Structural Power Theory

While others tried to conceptualise hegemony and power, Susan Strange brought forward the theory of structural power, providing the idea of analytical technique and the four components of power. Rather than being a formalised theory, Strange’s conceptualisation of structural power is a practical guidance and an approach. It provides a flexible and operational method for examining hegemonic transitions when compared to classic theories. Indeed, analytic flexibility is a central feature of Strange’s work, given her attempts to broaden the focus of the discipline away from an abstracted focus on states as unitary actors toward a consideration of the multiple and interacting foundations of power (Strange, 2015b).

Although Strange’s work advocates going beyond a focus on traditional forms of power such as military power and material capacity, Strange does not deny the roles played by the control of such resources. Rather, her opinion is that ‘the world has changed’; that is, with the competition between states becoming more about the competition over wealth and states’ choices of economic-related policies, indeed with these having begun to override foreign or defence policies (Strange, 1976). Power, therefore, should not be conceptualised in terms of diplomacy and balance of military power, as these aspects are thought to be of decreased significance within the contemporary international political economy and hence within the framework of structural power.

To answer, ‘Where does authority lie?’ and ‘What is the source of power?’, Strange suggests four primary structures: including finance, production, knowledge, and security. These four
primary structures each represent an aspect that examines power, together they form a pyramid-like power structure. This section will briefly review Strange’s rationale for these four structures comprising the composition of power.

Security is considered the most basic human need. In the definition of security given by Strange, security is one’s ability to protect citizens from both sudden and slow death (Strange, 2015b). Sudden death implies wars or any other form of direct military conflict as a kind of traditional security factor. More importantly, slow death signifies unnatural death caused slowly by underproduction, famine, and fatal diseases, although in most cases it is ignored or forgotten.

The stress in this dimension, apart from the traditional forms of direct violent conflicts, is that economic security should be considered in regard to the overall concept of security. Thus, the definition of security becomes the ability of states to protect citizens from any potential threat to life, as well as the ability to maintain social order; this is because stability is vital to persistent economic development. Although she points out that production might be the most important structure of all, Strange does nonetheless state that without the safeguarding provided by security it would be impossible to achieve development and improvements to production (Strange, 1987).

This production structure is the dimension of the wealth-creating process in the political economy. It includes both the objects and subjects of production activities. It is the continuous process of adding value to existing materials. Notably, production structures do change from time to time, and these changes have significantly impacted the way wealth is created and gathered in human society. Historically, as Strange concludes, two major changes to the production structure have happened worldwide.

The first one was when machines were invented, and mass production came into existence. The emergence of capitalists and the market greatly enhanced overall social production. More importantly, production activities were guided by the demand-supply relationship within the liberal market (Strange, 1987; Strange, 1996; Stopford, Strange, and Henley, 1991).

The second major change was the expansion of the market from domestic to global, as nowadays almost all giant businesses are multinational. Evidence shows that states’ policies can greatly influence the performance of international businesses. In addition, Strange
considers the dimension of production the most heavily weighted of all. As concluded, a stable production structure gives strong backing to security and prosperity in other structures because it is the most fundamental aspect of wealth generation and social construction.

Starting with the creation of credit, Strange stresses the significance of the financial structure to the contemporary IPE context. Compared to the production structure, finance is a more advanced and recently developed dimension. This structure consists of two subfields, including the capability to create credit between states and banks following the rules and regulations one makes for the other, as well as the communication between different governments, markets, and currencies, namely the exchange system. The existence of banks and credit allows for the industrialisation of production by providing loans and funds to companies.

Historically, a primitive economy shifting into an advanced financial structure reflects on the increasing use of currency and the prosperity of institutions such as banks and stock exchanges. As the financial market develops and matures, governments and states became more responsible for regulating domestic financial activities besides carrying out fiscal policies (Strange, 1975). Through such regulatory actions, states are able to provide public goods and welfare to society as well as redistribute social wealth. In her later work, Strange provided powerful critiques of the destabilising effects of financialization (Strange, 1998; Strange, 2015a). However, an important feature of Strange’s work remains an acknowledgement that an appropriately developed financial sector provides a significant pillar of structural power.

Meanwhile, along with the progress of globalisation, maintaining the stability of both domestic and international financial systems is one of the conditions of continuous economic growth. On the other hand, finance may be problematic as it can lead to higher degrees of inequality and fail to coordinate the global financial system as a whole. By analysing the dollar crisis in 1971, Strange points out that the four propositions of political economy – domestic politics, international politics, domestic economic management, and international economic management - are all intertwined and interacting, either directly or indirectly (Strange, 1972). Overall, the financial structure is an organic component of domestic and international economic management that eventually becomes influential to political decision making and political activities. Therefore, the study of financial structure is necessary and meaningful for an understanding of power.
The knowledge structure is the most ignored in the traditional studies of power. Moreover, power within the knowledge structure is intangible and extremely vague, as knowledge can be any kind of information and the way the information is conveyed or denied. Strange concludes three changes occur in the knowledge structure from the state’s perspective in IPE. They are – control and regulations over information; the use of language and form of communication; changes in basic beliefs, value judgements; and understanding the ways in which human society functions (Strange, 1987).

This structure can be conceptualised by defining the discoverer of knowledge, the receiver of it, sometimes the media of storing knowledge, and the means by which it is passed on. Power derived from this structure is rarely similar to those in other structures. It is comprised more of consent than coercion. Partially coinciding with the critical theories, the authority of the knowledge sphere comes from shared beliefs or values among individuals (Strange, 1996). Similarly, on the wider stage of global governance, mutually recognised consensus and value judgement grant international entities, such as states and international organisations, authority over certain issues.

Besides the four primary structures, Strange also mentions another four secondary structures, including transport, welfare, energy, and trade. The four primary structures come together to construct a pyramid-shape composition of power, which ultimately supports the authority of a legitimate state government, while the secondary structures somehow fall within the domain of the four major ones (Palan, 1999). Furthermore, the four primary dimensions of structural power are interlocking and interact with each other. Notably, Strange points out that the structural powers are dynamic instead of static. Through the progress of human society and international affairs, it is possible to forge changes within these structures.

Overall, then, through her writings, Susan Strange provides a conceptual framework for understanding the foundations of structural power. This framework provides a flexible and explicit template, that can be built on to assess the foundations of hegemonic power; however, Strange’s focus on measuring each specific structure and the issue of hegemony remains under-defined. The following section provides an overview of the manner in which this framework is built out from, through which Strange’s four main and four subordinate sources of structural power and transposed into two overarching themes around which the analysis of the rise of China is structured.
3.6. The Two-pillar Approach

On top of the four broad traditions identified within IPE literature on hegemony, part of the contribution made by Strange through the conceptualisation of structural power was to disaggregate the concept of power, and to do so in an empirically focused manner. This disaggregated approach allows for the apparent pattern of variegated development in China to be effectively probed. As presented in Chapter 2, the rise of China is a very complex phenomenon with the uneven development of different sectors. Empirically, Strange’s framework provides an approach with which to create a disaggregated analysis of the rise of China and allows an account to be constructed that identifies and explores the foundations of this variegated development.

On the back of this chapter, in applying the concept to this case, the two economic pillars of structural power are focused on to explore the contemporary politics surrounding the rise of China. These two pillars consist of the internal transformations in financial sector development and the production structure of China, as well as their external implications in terms of the wider international political economy – a total of four areas of interests, as a development of the original Structural Power Theory.

Table 3.1 Analytical Framework

<table>
<thead>
<tr>
<th>Foundations of Economic Power</th>
<th>Criteria of Evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial power (internal)</td>
<td>Depth of financial system; Productive enterprises’ access to credit; Internal financial stability;</td>
</tr>
<tr>
<td>Financial power (external)</td>
<td>Role within state-based regional and global financial organisations;</td>
</tr>
<tr>
<td>Productive power (internal)</td>
<td>Production volume; Productivity; Prevalence of inward FDI-supported production Prevalence of exportation-supported production</td>
</tr>
<tr>
<td>Productive power (external)</td>
<td>Trade volume, Outward FDI and infrastructural investment, Depth of institutionalisation of trade and investment relationship</td>
</tr>
</tbody>
</table>

Table 3.1 presents a brief overview of the factors explored in each of the four areas. The thesis prioritises the economic structures of China’s power following Strange’s argument that market
and economy play an increasing weighted role in politics as opposed to conventionally defined state power (Strange, 1996; Strange, 2015b), while acknowledging the importance of the other two structures.

The financial structure follows largely Strange’s suggestion of evaluating through the state’s ability to generate credit and its monetary power. The production structure examines the outcome of value-adding activities. To enrich Strange’s conceptualisation of finance and production, each empirical chapter includes an operationalisation section at the beginning of the chapter, using the predominant existing literature in each field to give guidance on how to evaluate that aspect of China’s economic power.

On top of that, this thesis adds to Strange’s theory an approach of ‘internal and external dimensions’, following insights from the relevant existing literature. Although Structural Power Theory lay special emphasis on the internal components of power (Strange, 2015b), Cohen (2001) points out explicitly that power exists in the internal and external dimensions of power. While the internal dimension of power “corresponds to the dictionary definition of power as a capacity for action,” the external dimension of power “corresponds to the dictionary definition of power as a capacity to control the behaviour of others” (Cohen 2001: 433). Evidence of power stem from the external and internal factors can be found throughout predominant IPE literature. Krasner (1978) specifically focuses on the production-foreign policy point of view, using the US hegemonic power as the instance and suggesting that production structural beyond the national border is equally vital to the big state’s pursuit of power. Ikenberry (2008; 2017) points out that external elements that international order and regime building are also components of hegemonic power. Keohane and Nye (2011), from a neoliberalism perspective, have added that the measuring of power cannot be separated from interdependence under the contemporary global structure, coinciding with Ikenberry’s comment on power-order/regime interaction.

By developing this disaggregating approach to studying power, the resulting analysis can engage with the multiple strands of literature reviewed above. While drawing primarily on Strange’s conceptualisation, the two pillars have been designed to integrate analytical focuses that feature commonly across the existing works reviewed above.
The structural power of finance and production are typically privileged by Strange in her own work, where she explores the declining role of the conventionally conceptualised state and the increasingly influential position of market and economy (Strange, 1991; 1996; 2015a; 2015b), and are areas that China appears to exhibit variation in development. As Strange points out, powers are dynamic. The process of refining the understanding of power is to continuously question existing theories and engage with the contemporary context. Three decades have passed since the theory of structural power was first suggested, and the context of international relations has changed during this period. The two-pillar approach designed for this thesis draws heavily on Strange’s theory of structural power while retaining additional insights from earlier work on hegemonic stability theory and critical literature. The following paragraphs will introduce the two pillars chosen to be studied in this thesis – finance and production, and the reason for choosing them.

Fundamentally, the assessment of financial power focuses on a system about credits – financial deepening and reforms that enabled the creation of credits while maintaining stability throughout the reform. The finance pillar, as Strange concludes, contains an entity’s ability to generate credit. Credit is a modern development but has no less significance for a state. Besides the argument built by Strange, many also believe that financial development has a positive effect on the levels of economic growth (e.g. McKinnon, 1973; Shaw, 1973; Drake, 1980; Levine, 1991; King and Levine, 1992; King and Levine 1993), consequently leading to the growth of power. As Schwartz and Seabrooke (2008) present, the financial sector is a source of power and as a key causal force for domestic and international economic outcomes.

With a particular focus on the housing finance system and comparative politics, Schwartz points out that ‘financialisation’ can either generate or cause great damage to a property market and social wealth, using the US as an example and analysing the relationship between crises and financial systems taking a macroeconomic perspective (Schwartz, 2009). Regulatory failure, loose monetary policy, and global imbalances can, therefore, cause a financial crisis and economic recession, for example, the recent Subprime Crisis in the US and the subsequent global crisis (Allen and Carletti, 2010). Tracking back to an earlier age, Skidelsky (1976) examines the fall of British hegemony, pointing that its hegemonic decline was directly the result of declining economic strength and lack of regulation. Keynes, as rephrased by Skidelsky, believes in taking the fiscal approach to solve financial struggle and to stimulate consumption. Failing to understand the post-war global situation and its inadequate financial policies finally
led to the end of Britain’s hegemony. In short, the financial structure, consisting of rules for regulating financial institutions such as banks, as well as financial instruments, is an influential dimension for a modern country aiming to achieve economic growth.

On the other hand, a country’s finance structure also has external implications. In Strange’s words, it has the ability to shape and influence the international monetary regime. Such an ability is undoubtedly determined by a country’s internal finance structure, particularly the ability to manage monetary stability. International institutions are a modern creation now playing an important role within the global financial system.

In *After Victory*, Ikenberry describes a post-war situation with the winners facing three choices—dominate, abandon or transform. He stated that states usually prefer the last option (Ikenberry, 2001). The so-called transforming decision, according to Ikenberry, refers to transferring power and building up regimes. Realists believe that such international regimes, in other words, norms, rules, and regulations, are a reflection on the interests of hegemonic power (Keohane, 2005). The Bretton Woods system and the International Monetary Fund (IMF) established under US hegemonic power are vivid illustrations of the significance of international institutions to power. If it is to support the argument of rising China, there should be evidence that China is either taking increasing responsibility for existing international financial institutions or building new institutions to reshape the balance of the current regime.

To a certain extent, the early literature on China’s financial structure explored China’s financial reformation following the founding of the People’s Republic. More recent work has also explored further changes to China’s capital market and monetary policy (see Bowles and White, 1992a and 1992b; Laurenceson and Chai, 2003; Mehran, 1996), while a relatively small number of studies have been done to correlate China’s financial reform with its growing power under the context of a hegemonic transition. Hence, Chapters 4 and 5 will conduct an analysis of China’s financial structure.

Chapter 4 evaluates China’s financial deepening. As it identifies, the concepts of financialisation and market were first introduced to China in the late 1970s. Banking reforms took place followed by the emergence of a series of financial instruments, such as stocks exchange and credit rating. All these new introductions freed up credits to be borrowed by individuals and private firms while maintaining the stability of the financial market throughout
these drastic changes. To date, China is still undergoing an increasingly diverse financial deepening. Policies and regulations play a significant role in the evolutionary transformation. Chapter 4 explores how relevant elements, since the late 1970s, cement the result of China’s financial system today and evaluates the economic power from this strand.

Chapter 5 focuses on the external achievement of China’s financial structure as the subsequent result of a series of domestic reforms. It aims, in other words, to evaluate China’s influential role in the international financial system through its engagement with international financial institutions. Having gone through decades of reform, China’s financial capacity is raised to a much higher level than prior to the reform. As a result of the internal development, China’s financial structure started to manifest its influence on the external sphere, namely the international level of monetary and finance regime. Besides participating actively in pre-existing US-led institutions, a few China-led regimes have sprung up promoting China’s capital-output following the OBOR initiative. Chapter 5 examines the extent to which China’s external influence could reach as the result of economic reform which started to materialise since the 2000s, as the chapter fines. Jointly, Chapter 4 and 5 provide a comprehensive understanding of China’s rising power from a financial perspective.

The second pillar focuses on the structure of production and also consists of two aspects – internal development and external implications. As production is fundamentally the process of generating wealth, it is a prerequisite for big states who are looking to exercise diplomacy, provide security, or even progress in scientific advancement. In other words, by adding value to and selling products and services, the rewards can be used to invest in further production and other structures including finance, security, and knowledge, thus comprehensively strengthening state power.

Historically, all hegemonic states have been leading countries in terms of production during their hegemonic eras. For example, the industrial revolution starting in the late 18th century changed Britain’s production in many ways, such as sector composition and labour distribution (Stokey, 2001). A drastic growth in production, reflected in GDP per capita and GDP growth being the highest among great powers, subsequently created the British hegemony of the early 19th century (Maddison, 2007:92). This was a lead taken over by the US in the early 20th century when European countries became tired out from continually fighting each other (Ibid.).
The correlation between production and hegemonic power is certain. Furthermore, as reviewed in the previous chapter, the existing literature acknowledges that foreign policy, security concerns, and other dimensions of state activities, can often be affected by economic benefits, for example, through trade partnerships. The externality of its production structure can determine a country’s position in the global regime and its relationship with others. Therefore, due to the significance of production in relation to state power, it is a fundamental structure that needs to be examined in any analysis of power.

As for the case of China, a great amount of literature has discussed the economic reformation on production structure, and it has also been reviewed in the previous chapter. The information from this literature is rather scattered. Besides the widely acknowledged soaring GDP number, many other elements should also be taken into account when evaluating production. In order to create a thorough comprehension of China’s production structure, Chapter 6 will analyse the current status of China’s domestic production by looking into several parameters selected based on the existing literature. Similar to what is examined in Chapter 4, for the content of Chapter 6, policy changes play a vital role in the development of this structure, with some influential factors dates back to the late 1970s. Furthermore, because this research is to study China’s rising power in the context of hegemonic transition, Chapter 6 will also present some results in comparison with the US. Using the US, the current hegemon, as a reference, the chapter will ultimately provide an understanding as to how progressive China’s production structure has actually been.

The external implications of production are mainly reflected through resource diplomacy, in other words, trade and cooperation, as suggested by Krasner (1978). In the case of China, constant high economic growth led to high demand for natural resources and saturation of the domestic market; thus, the country was urged to a seek solution to secure access to resources and to overcome over-capacity in order to continue the transferral of products into social wealth. A large amount of literature on OBOR as reviewed in Chapter 2 also put forward the significance of China's evolving trade relationships. This chapter provides material that is of relevance to this literature. Given the extended timeframe within my analysis, I do not explicitly frame the material presented in relation to OBOR. Nonetheless, empirical detail provided helps to demonstrate the institutional foundations from which the OBOR initiative emerged. This part of the analysis focuses on the case of changes in trade and cooperation-related diplomatic activities with resource-rich partners. Chapter 7 will study the issue of
China’s resource diplomacy to explore how China can extend its production structure abroad and how it intends to acquire stable resource access to maintain its high-speed production rate. This chapter mainly focuses on the 2000s and onward. During this period of time, an increasingly frequent engagement between China and resource-rich regions is observed – cooperation framework being established and transformation in the pattern of engagements occurs as this chapter finds.

Although Strange has categorised knowledge and security as two additional primary structures and undisputable these are an important set of issues, this research, in line with Strange and others, prioritises political-economic foundations.

The security structure has been a key focus of political researches. A good number of previous studies are discussing China’s intentions in terms of territorial expansion and security concerns. As mentioned in Chapter 2, China’s interaction with the US and APAC nations have been a dynamic process of seeking equilibrium between economic interests and security, even though Chinese governmental reports and official announcements have repeatedly emphasised the term ‘peaceful rise’, one that focuses on economic gains rather than coercion. It is necessary to acknowledge that security remains a valuable topic in studies about the rise of China, meanwhile, it is of lesser significance for this thesis.

According to the World Bank, China’s military expenditure (% of GDP) remained below 2.2% since the millennia, especially since 2010 it has been under 2%. This is less than half the amount the US is spending on military. In absolute number, China’s military expenditure is also much lower than the US. China’s general attitude towards military spending is that it is a demonstration of the ability of self-defence, to earn respect, rather than assertive or aggressive expansion of influence. The literature review also points out – many scholars suggest that military concern is no longer of urging importance due to the increasingly frequent economic cooperation. Both countries are equipped with nuclear warheads, and both countries are aware that a direct military conflict between big states is a zero-sum game. Assuming that states are all rational players in the global regime, certainly, a lesson of the cold war should be learned.

On the other hand, Campbell and Ratner (2018) also argued that neither the US military force nor regional balancing has significantly removed China from its pursuit of global power. The deterrence of military might has diminished in the case of China. As mentioned in Section 2.2,
a contest between China and the US in terms of security power is keeping a relatively stable equilibrium. The US strategy is to welcome China to ‘play a constructive, peaceful role in the Asia-Pacific region’ to avoid direct conflict with China (Stewart, 2009 as cited in Acharya, 2014:167). Part of China’s security interest is also aligned with that of the US when it comes to anti-terrorism (Callahan, 2005). Furthermore, although China is indeed placing more attention on developing its military strength to defy US influence in Asia, particularly in regard of Taiwan, South China Sea, and Japan, economic development is always a prerequisite of security strength – as President Xi noted in his speech, putting ‘becoming rich’ before ‘becoming strong’ (Campbell and Ratner, 2018:66-67). Therefore, the security structure is sitting outside the focus of this thesis.

For the knowledge structure, ‘knowledge’ itself is a vague concept; and there is limited literature on how to evaluate knowledge. Therefore, in reality, it is extremely difficult to define and examine power from knowledge perspective due to the lack of theoretical guidance.

Knowledge can be defined as technology, literature, or any intangible power. If knowledge is to be defined as technology, undeniably, China has been promoting its power from this aspect, funding domestic technology firms for scientific innovation. This can be reflected in the production structure – while initiative for promoting knowledge power has been on the government agenda, China’s position in the global supply chain remains relatively low as Chapter 6 found. If knowledge is to be defined as cultural influence, there is also evidence of China strengthening its power by establishing Confusious Institutes worldwide. From the aspect of international relations, the knowledge-power can refer to ideologies and values; it is similar to the case of mutual benefits to overcome ideological disagreements, especially for China, a country rising on the basis of pragmatism.

The conceptualisation of knowledge structure overlaps with the concept of soft power and faces the same problem as soft power is facing – what exactly is the term referring to. If to include knowledge in this thesis, this structure itself can constitute a significant length of conceptualisation and analysis due to the lack of a systematic approach to evaluate power from a knowledge perspective. Knowledge can eventually reflect into finance and production structure. For example, scientific breakthrough leads to production boost; changes in ideology introduce a new model of business that can improve efficiency. For the purpose of this study, knowledge and soft power are certainly relevant and significant factors to power but are not
necessarily the primary structures. While acknowledged to be one of the essential dimensions of China’s power, because this thesis prioritises the economic components of China’s power, knowledge structure is also set outside the scope of this thesis.

Besides, Strange in her original theory privileged economic factors in the contemporary issues of IPE by emphasising the effect of market and non-state players (Strange, 1994; Strange, 2015b). Although security and knowledge are intriguing areas to explore, they would probably lead to another piece of thorough research. In a realistic and pragmatic manner, this particular thesis considers the security and the knowledge issues secondary structures and instead focus on fundamental economic structures. It will not conduct direct studies on security and knowledge structures because of their relative complexity and insignificance in relation to the case of China’s economic rise.

3.7. Thesis Research Methodology

To carry out this research analysing how China’s power can be described as a ‘rising hegemonic power’, this thesis will contain several qualitative case studies of the four dimensions mentioned above.

In general, the use of case studies in social science research can identify the operation of casual mechanism in individual cases, and also allow researchers to select variables most related to the case (George and Bennett, 2005). The case of China’s rising power contains a wide range of factors, and just as many historical events; the case study method allows the researcher to choose which event, which facet of the event, and which variables to focus on. As a few scholars have pointed out, China is a unique case in IPE from many perspectives (Frieden and Lake, 2002:377-381; Kang, 2003). China’s power should thus be studied in a way that is suitable for its variegated development pattern. Keeping this in mind, this research will be adding a rich and historically informed case study that sits alongside existing literature.

Other advantages of using a case study include ‘developing historical explanations of particular cases, attaining high levels of construct validity, and using contingent generalizations to model complex relationships’ (Bennett, 2004:19). The advantages of giving an explanation and
identifying complex relationships fulfil the aims of this research which is to explore the disaggregated foundations and composition of China’s growing power.

Furthermore, the nature of development appears as continuous progress, not a static point on a historic timeline. To understand how China’s comprehensive power was promoted and how certain decisions changed the trajectory of China’s economic development, it is necessary to describe the situation and make casual inferences to the relationships between elements – especially when a case requires a strategy for accommodating different sets of conditions (Yin, 1981). Moreover, according to Yin (2009) and Schell (1992), a case study is most suitable for answering ‘how’ and ‘why’ questions regarding a contemporary event without the need to control behavioural events. Therefore, it is necessary to make use of case study methodology, including a set of detailed methods such as process tracing, as the key instruments for carrying out this research.

According to Yin (2003), the procedure for a case study contains the design of the case study, collecting data, analysing data, and presenting the result; in particular, the design of a case study should be carried out under certain theoretical frameworks prior to conducting the following steps. That is to avoid diluting the intuitive practice and thus the validity of the study. For this research, each analytical chapter can be deemed a single case study, containing, at the beginning of the chapter, an operationalisation section where the design and the analytical method of the case study are defined.

In terms of collecting data, literature on methodology in the social science emphasises the importance of aligning method with research questions and aims. For instance, ethnographic or participant observer approaches are considered appropriate for developing a rich understanding of the functioning of an organisation or social group (Hammersley and Atkinson, 2007). For another instance, Bennett and Elman (2007) and Wallace et al. (1999) suggest that when the focus is on understanding policy-making, policy implementation processes, or more broadly on understanding the role of particular individuals within processes of organisational or social change, interviews and archival sources are more valuable. Such method can be found used by Evangelista (1999) and Moravcsik (1998).

This thesis follows Persaud’s (2010) broader definition of primary data, using published sources by states and international institutions for a first-time interpretation. Although Ritchie
et al. (2014) and Fontana and Frey (2008) have pointed out, within literature in the field of social science in general, interviews are commonly used as a means of generating insight into particular social change, policy shifts, and institutional developments (e.g. Yang, Wall, and Smith, 2008; Oi, 1992). However, in literature focusing on issues of hegemony, institutional change, and the foundations of state power with much greater time span, it is common for rich accounts to be derived from secondary literature and primary documents and data (e.g. Kennedy, 1988; Naughton, 2007; Maddison, 2007). Strange’s work on structural power (2015b) follows this methodological approach. In this application of Strange's framework to the analysis of the rise of China, this thesis draws extensively on secondary sources and primary documents and data. By including a broad range of Chinese-language sources, this thesis sheds new light on the four areas of empirical focuses. This will be done based on primary sources, including governmental regulations, official reports, statistics, and announcement by state departments, as well as secondary literature on the relevant topics.

Furthermore, Schell (1992:6) points out that case studies should be ‘based upon the use of multiple sources of evidence (multiple triangulation)’ or ‘review of multiple case studies’ to enhance the validity of the data. The challenges of data collection from and about relatively closed political systems have been documented by Sadiq (2005) – quite often, an authoritarian state would suppress statistics that disagree with the desired political outcomes and realise modified numbers. This might be true for a study focusing on China, which is a subject with a relatively closed political system. The overall impression one may have over China’s official statistics publication is that it contains a concerning amount of falsification (Rawski, 2001). While there are dissenting voices, the balance of studies suggests that published official economic data in China suffers from problems of inaccuracy and can be the subject of manipulation. In line with such suggestion, these paragraphs, therefore, seek wherever possible to triangulate such data.

Some countries are found embellishing its economic data strategically – China being one of them who overstated GDP while understating trade surpluses (Michalski and Stoltz, 2013). Early research believed that China’s official statistics were biased and generated through enumeration (Travers, 1982). This is entirely plausible when data is generated based on a political purpose especially in an authoritarian regime where transparency is questionable before the liberalisation of market. Later-on study about China’s official economic statistics of the 90s found that, for various reasons, some of these numbers are certainly erroneous and
poorly organised, failing to capture the reality of growth (Holz, 2008). Wallace (2016) suggests that there is a discrepancy between China’s economic data such as GDP and GDP growth and electricity consumption – normally, the two should be positively corresponding. Furthermore, such phenomenon occurs more often during politically sensitive times and at a provincial level.

On the other hand, Chow (2006:396) believes that China’s official data is ‘by and large reliable and useful for drawing conclusions about the Chinese economy, but some statistics are not reliable’. Holz (2003) also suggests data falsification at a central governmental level is unlikely. In other recent literature, researches cannot find clear evidence that the numbers provided by China’s National Bureau of Statistics (NBS) are full of manipulations: deviation could be caused by a different definition or a different method of calculation (Cai et al., 2013; Holz, 2014). The central government has no intention or incentive to manipulate national data, whereas some local governments are motivated to exaggerate provincial data; but as long as NBS directly calculate local key indicators, interference by provincial officials can be minimised (Ma et al., 2014). Even if there is false reporting, the general trend of China’s GDP/GNP growth and sectoral value-added correspond to other economic parameters like price and expenditure (Holz, 2014). Other research supports the finding by stating that China’s growth is largely reflected by its official data while no evidence can be found proving that the published numbers are less reliable than usual (Fernald et al., 2013).

While Chinese-language government sources and data constitute a valuable material, this thesis where possible triangulated against further evidence from independent sources, including English-language scholarship, documents, and statistics extracted from international organisations and research institutions. The data and resources used in this thesis consist of 1) statistics published by international organisations including the World Bank, IMF, OECD, and the Observatory of Economic Complexity; 2) statistics published by China’s Bureau of Statistics, Ministry of Commerce, and other relevant Chinese state departments; 3) official texts and documents published by international financial institutions including the World Bank, IMF, NDB, and AIIB; 4) official foreign policies and announcement made by the Chinese government; 5) official domestic economic policies published by the Chinese government.

As George and Bennett (2005) also point out, a case study may lead to indeterminacy. To overcome this limitation, they suggest that a mixed method may be able to provide more explicit results, with the statistical method verifying undetermined inference. Hence, while
most of this research relies on the qualitative analysis of case study, it also includes the
quantitative method as a supplementary tool when necessary – for example, when discussing
productivity in Chapter 6 – in order to obtain a better understanding of this specific feature of
China’s economic development.

In addition to these explanations of the value of rich case study investigation as a source of
insight, the empirical content of the thesis is structured in a manner that mirrors the approach
that is evident within Strange’s own work. Strange advocated the use of the historically
contextualised study of patterns of systemic transformation, following a flexible and practical
approach. The aim of this study is to build on Strange’s approach to the generation of insight
into power, hegemony, and IPE, by systematically applying to the study of the rise of China in
the manner outlined above.

3.8. Summary

Earlier literature privileged military power as the dominant factor in hegemonic power. More
recent studies pay attention to the economic basis but remain divided by contested definitions
and measures. Nevertheless, Strange provides the case of China with a useful framework,
which this thesis operationalises through a two-pillar approach. With this disaggregate
approach, the internal and external dimensions of China’s production and finance structures
are systematically explored, allowing for a comprehensive evaluation to be presented regarding
the variegated hegemonic rise of China.

Although discussed intensively in the existing literature, analyses of empirical case studies of
power shifts can remain underdeveloped. Conventional IPE approaches often focus on a single
element as the driving force of hegemonic power. Different scholars present very distinct
suggestions due to the different entry points or aspects they work on. Hegemonic power can be
related to military strength, economic performance, the establishment of international regimes,
and dominant social classes. It also has many different manifestations based on these rationales,
but there remains no consensus on this topic. Through the reading, it is noted that, in fact, these
various factors have mutual effects on each other.
Furthermore, the existing IPE scholarship rarely explores the pheromone of a rising power; the analyses are mostly done on the basis of a static picture – an established hegemonic power, instead of a dynamic changing status. The state of the art in the field of hegemony studies is a live debate among contending scholars. To engage with this broad-based field, this study adopts a comprehensive and systematic framework for analysing of this issue.

As is outlined in the closing paragraphs below, the ambition of creating a systematic analytic framework is reflected in three central elements of the approach to studying hegemony adopted through this work.

Firstly, this research studies the rise of China following a clear conceptualisation of hegemony and structural power by existing literature and Susan Strange. By doing so, this research creates a theoretical rationale and defines the economic components of power that can be examined empirically.

Secondly, this research introduces the two-pillar approach in order to enable a systematic analytical framework for the issue. Instead of exploring hegemonic power by focusing on a narrow range of dynamics, this chapter presents a framework with the two chosen pillars, including insights on internal developments and external implications regarding international political economy, therefore conducting a more systematic study of China’s rising power in a disaggregating manner.

Thirdly, this thesis will extend the English-language literature on the contemporary politics of hegemonic transition by integrating a wide collection of resources in the Chinese language, providing new details from official reports, news sources, scholarship, and governmental notices that together allow more comprehensive insights to be developed. This collection of primary materials includes the official announcement, statistics, and reports by the Chinese government to illustrate the progress of China’s economic development. By looking at the fundamental elements of China’s growth via the two pillars of economic power, this research will conclude what China’s rising power ultimately means – what are the statues of China’s economic power in terms of international political economy, and what are the implications of this economic power to the changing global order?
4. Internal Development of the Finance Pillar: Banking and Investment Transformation

This chapter explores the trajectory and dynamics of China’s financial deepening as the internal aspect of the first pillar. The focus is on the rapid expansion of the financial market and the growing variety of financial products associated with the development of China’s banking system, financial assets, financial intermediaries, and instruments. It aims to find out to what extent the transformations of the financial sector provide a substantial foundation of China’s economic power and, potentially, to the overall promotion of China’s role in the world’s financial development.

Overall, it is confirmed through this chapter that a significant improvement has taken place; with the result passable yet also shallow and criticised. The modernised banking system’s provision of more free capital has become the essential means of financing all types of enterprises, while the emergence of the stock exchange and credit rating service has further boosted the comprehensive development of China’s financial market, although there is still room for regulation improvement. The modernised financial structure has promoted China’s ability to manage its monetary stability, including the special ‘dual-track’ approach to help withstand financial crises. The reform, then, subsequently consolidated China’s financial position among neighbouring countries and regions. Meanwhile, China’s currency, the RMB, is becoming increasingly internationalised, which is considered another significant achievement of China’s financial structure. Although it has been playing an important supplementary role in world finance, it is a very large distance from overtaking the dominant role of the US dollar.

After in the first section below presenting the rationale for the focus of analysis adopted in this study of the internal development of the financial system, the second section of this chapter briefly introduces the historic foundation of China’s financial sector post-1949. This was when the state, being the only entity in all economic operations, strictly controlled all property and capital. The third section presents a review of 1970s financial reform. The core of this reformation was market liberalisation, transforming the planned economy into a market-oriented one by separating out the role of financial institutions into administration and business
with a very clear line demarcating the two. The fourth section moves on to explore how China’s financial institutions managed national monetary stability, especially during the period of the wide-spread financial crisis. This is followed by a fifth section examining the progress of RMB internationalisation.

4.1. Operationalising the Study of the Finance pillar: Internal Development

The structure of finance, according to Strange (2015b:99-100), consists of two aspects, the aspect of generating credit and the aspect of monetary power. Together, these two aspects determine a state’s financial power. For example, historically during WWII, the US repositioned itself as the greatest creditor and was able to supply credit to other parts of the world. This strategy paved the way to a hegemonic peak. Additionally, it was the massive outflow of public funds and private capital from the US to the world economy that kept Bretton Woods, a monetary system, functioning in the early stages of the US hegemonic regime. Hence, applying that to analyse China’s rising power from the perspective of financial development, this chapter will look at both the abilities of credit generation and managing monetary issues.

The measurement of these two aspects of financial power is straightforward. For the first one, Strange suggests that ‘no advanced economy can function without a system for creating credit’, no matter if it is a capitalist economy, a socialist market economy, or a planned economy (Strange, 2015b:101). Generating credit is the liability of states and banks; and therefore, one’s financial power can be evaluated through the ability to generate credit – the amount of funding that can be provided to all kinds of fiscal and business entities to facilitate investment. Besides the volume of credit, a set of detailed financial policies should be taken into consideration as the foundational factor affecting the overall financial structure.

Other literature coincides with Strange’s argument on the financial structure being a key aspect reflecting economic power and supporting the argument that policy is a leading factor determining financial performance. It is suggested that the functionality of financial institutions, for example, banks, and a variety of financial instruments, such as stocks and securities, can ‘facilitate trade in goods and services and… funnel resources from savers to investors’ (King
and Levine, 1992:1). Early empirical studies pointed out that government policies towards financial activities and financial instruments determine the extent of financial deepening. Furthermore, McKinnon (1973) highlighted the importance of capital market liberalisation, for example, how much freedom is given to banks by the state, and the role of the central bank of determining the interest rate. King and Levine (1992) also suggest factors such as investment volume as indicators of financial deepening.

The case of China, complying with its special communist doctrine, has significantly close monitoring and exerts strong control over its banking system. The capacity of credit creation is borne solely by the state because all banks in China are state-owned, with heavily loaded bureaucracy in the pre-reform period. To understand how and to what extent China has launched itself from this rigid system to become today’s modernised financial structure, means looking at policy change, which is a significant area of interest in terms of the liberalisation of the market. This includes policies regulating the banking system, stock market, and credit rating system, which are considered major instruments in the Chinese finance structure.

As for the management of monetary issues, Strange notably suggests this being determined by states and markets, while also being dependent on how much freedom governmental regulation gives to other actors (Strange, 2015b). While Strange’s notion of monetary power remains vague, voluminous amounts of predominant IPE literature about hegemonic power have made a connection with currency power or monetary power, mainly using the significant transition between Britain and the US as an example. Both hegemons were, first and foremost, powerful in managing their own monetary system, and subsequently were able to extend this power to a significantly larger structure where they could manipulate and control the international monetary system. Both regimes once possessed their own exchange rate system, namely the Gold Standard under Pax Britannia and the US-led Dollar-centred Bretton Woods system.

Having its currency internationalised is often desired by great powers because it can greatly consolidate a state’s power from five aspects - reducing transactions costs while providing more international seigniorage, macroeconomic flexibility, political leverage, reputation (Cohen, 2012). In pursuit of great power, it would be a state’s interest the promote its currency status. Cohen (2014) also acknowledge the difficulty of measuring monetary power, but particularly under the context of hegemonic analysis or China’s rising power, Cohen believes one can simply look at ‘influence’ to determine a country’s monetary power (Cohen, 2014:24);
and China’s currency, being one of the most non-convertible currency, can be a great obstacle for the nation to pursue greater power. Holding a similar view, Victomov and Abramov (2019) suggest that monetary power autonomy, determined by liquidity, is a key component for emerging countries’ financial power, combining with macroeconomic policies, to encourage the use of credit. Enhanced liquidity of currency can strengthen a state’s ability to withstand financial crises and boost foreign trade and investment. Victomov and Abramov also point out that the study of banking reform is closely associated with changes in monetary policy and financial strength.

At the same time, internationalised currency imposes policy responsibility to that great power. Kindleberger (2013) argues that the role of hegemonic power is to provide certain public goods, such as an exchange system, in order to maintain the stability and functionality of its regime. During the late 19th and early 20th century when London was the world largest market for gold, money, and capital, other players willingly adopted the monetary system advocated by Britain in order to lower transaction costs, represent creditworthiness, and respond to the financial policy made by states (Schwartz, 1996). This vis-à-vis approach stimulated the increasing consolidation of British financial hegemony. Similarly, and to a greater extent, the Bretton Woods system facilitated US hegemony, with countries participating in this system for more convenience in trading goods and dealing of financial assets. Kindleberger believes that a hegemon would, therefore, have the ability and willingness to bear such responsibility. The transition between Britain and the US fully illustrates this argument. The instability during the transition period was essentially caused by the inability of Britain and unwillingness of the US to play the hegemonic role (Kindleberger, 2013).

Although it is difficult to measure ‘willingness’ to become a hegemon, from a straightforward point of view, to study hegemonic power and transition from a monetary perspective is simply examining whether an emerging power has the increasingly overwhelming ability to establish and maintain monetary stability. Furthermore, the ability of the leading international monetary regime should be established upon profound financial strength. If it is to bear the responsibility of maintaining global financial stability, a hegemonic power should be able to manage to balance its own payment problem so that the stability of international finance can be continued, particularly in the case of the US. That is to say, the US has been facing a chronic current account deficit due to the dollar’s role as a reserve currency (Triffin, 1960). The hegemonic decline of the US manifested when the pre-existing dollar-centred monetary system gradually
became inadequate to fulfil the needs of subordinate countries and has been attributed to catastrophic crises worldwide. Based on this rationale, a change of the hegemonic regime may take place if a rising power shows an ability to restore order and maintain currency equilibrium.

The internationalisation of RMB, the Chinese currency, is closely related to the issue of convertibility. Due to political concerns and safeguarding China’s financial stability, China has been reluctant to fully liberalise its capital account. With the consequences of financial globalisation, currency internationalisation requires effective policy (Gao and Yu, 2011). This means responsive and sensitive polices need to be in place as the foundational and structural power of China’s finance.

To simplify the issue, this chapter will focus on the degree of RMB internationalisation, the extent it has been used as reserve currency and in transnational clearing, as the indicator of one of the aspects of China’s financial power; whereas China participation and responsibility within the international financial regimes will be analysed in the next chapter on international institutions, in line with some further theoretical guidance.

To sum up, the analysis of China’s financial structure will construct an understanding of the internal development of this structure, and subsequently, examine the outcome of this development in relation to China’s ability to manage monetary stability. This chapter focuses on the former aspect by analysing China’s ability to generate credit and its financial strength from the monetary aspect. It will explore the institutional arrangement of China’s finance pillar by reviewing relevant policies and reform outcome in several key areas, including the banking system, stock exchange, and credit rating system; meanwhile, it will also present a brief discussion on currency stability and the status of RMB internationalisation as a direct outcome of financial reform.

4.2. The Early Foundations: Pre-reform

This section briefly reviews the pre- and post-1949 financial structure of China, thus providing an overview of the structural foundation of China’s financial sector. The first part introduces the pre-1949 Nanking structure. The second part presents the changes made since 1949 under
the ruling of the Communist Party of China (CPC), followed by the third part showing certain detailed monetary policies and China’s attitude towards foreign businesses at that time. The overall message paints a picture of far-reaching central control for China’s financial sector, one established early on and which has had a covert influence on the trajectory of China’s financial development.

The Chinese nation has a history of thousands of years, but China, as a modern economy, is conversely young and unstable. China’s history of modernisation can generally be divided into a few phases. Starting from 1912 till 1949, the Chinese mainland was under the governance of the KMT party after abolishing the monarchy; it was known as the Republic of China. Several civil and World Wars took place during that period of time, leaving the country in chaos. Problems were lurking within the Chinese regime throughout its years of development, mostly caused by mismanagement (Paauw, 1957). For example, continual wars drained the wealth of the nation and caused serious inflation. With the help from counterfeit money made by Japanese troops and the Silver Purchase Act implemented by the Americans, by 1945, the total issue of banknotes stood at 556.9 billion Yuan, which was more than 400 times the number of 1.4 billion that existed in 1937 (Fan, 2008:4). Gross production failed to catch up at the same rate.

Following 1949, when the People’s Republic of China was founded, the structure of the Chinese government changed completely, as did the financial system. As the Nanking structure had been accused of representing the ‘evil of bureaucracy’, it was completely abolished by the communist government following the establishing the People’s Republic of China. The post-1949 structure, however, was essentially a transition. The new ‘Big Four’ system was set up, although the roles were perplexing. To maintain a high level of central control, the people’s government issued a whole new form of currency, while foreign business was strictly supervised by the People’s Bank of China. The nation again experienced unrest.

The long-time focus of the country was on issues related to ‘class struggle’ under the rule of Mao. The Great Leap Forward and Cultural Revolution greatly pushed back the progress of social development in China, as well as having a huge impact on the political system, and on technological and cultural development. During the Mao era, China’s system was one of a highly centralised planned economy. As political factors can highly affect financial and
economic progress, it was not until a few years after the Cultural Revolution and a change in leadership that China finally started reforming its economic structure.

4.2.1. Post-1949 Banking Structure

After the ‘War of Liberation’, the remaining structure of bureaucratic capital that had been left by the predecessor was repugnant to a new government under CPC leadership. A series of actions were quickly taken as soon as the People’s Republic of China was founded. The ‘socialist transformation programme’ took place using a ‘Soviet style’. The People’s Bank of China, functioning as the central bank, was set up in late 1948 in preparation for the establishment of a new financial sector. It took over all bureaucratic capital banks at that time, placing a strong grip on capital control and investment (Zhang, Wang, and Wang, 2012).

The Common Programme, serving as an interim constitution, was adopted by the Chinese People's Political Consultative Conference on 29th September 1949. It announced that action would be taken to ‘assume control of the remaining bureaucratic capital’ in order to serve the communist ideology (PRC. The People’s PCC, 1949). By ‘assume control’, it meant more precisely confiscation. The Common Programme provided juristic support for the specific policies that came later, including, initially, closing down and liquidating the Central Bank of China, the Farmer’s Bank of China, and the Postal Remittance & Saving Bureau. Other minor commercial banks, such as Sin Hua and the Imperial Bank of China, which were once jointly owned by governmental officials and businessmen, were restructured into public-private partnerships. The role of the central bank was solely and completely taken over by the People’s Bank of China, previously established in 1948 and officially moved to Beijing in 1949.

Meanwhile, the Bank of China and the Bank of Communications (later renamed China Construction Bank) maintained most of their original function and business, although the board of directors was completely reselected and most of the shares were confiscated into public ownership. Along with these two banks, the Agriculture Bank (founded in 1951) and

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2 Later on, the Bank of Communications changed its name to the Constructions Bank of China, while a new Bank of Communications was founded in 1987.
3 China’s party leaders described the political and economic system as ‘people’s democratic autocracy’. This term indicates that all rights of the nation belong to the people. The
the Industrial and Commercial Bank of China (founded in 1984) came to constitute the ‘Big Four’ – the leading four state-owned commercial banks (Ho, 2012:293). These four banks have come to play a role as specialised banks in order to provide funding assistance to urban and rural constructions, transportations, business and merchandising, and industrialization. Meanwhile, the People’s Bank of China has come to work jointly with the Ministry of Finance on issues determining the direction of financial development (Okazaki, 2007:6).

4.2.2. Post-1949 Monetary Policy and Foreign Business

As stated previously, one of the biggest problems for the CPC to tackle was the high inflation level left by the nationalist party, KMT. This was mainly caused by a series of long-running wars and lack of financial experts during that period. In fact, there had even been more than one currency in circulation. Precious metals and foreign currencies flooded the market along with the Gold Yuan, whilst local banknotes also made themselves popular with citizens. It took a year for the CPC government to completely abolish the previous currency system. Besides legislatively recognised RMB as the only national currency, the CPC set up numerous exchange offices for citizens to get rid of the abolished currencies within a limited time, using a fixed local price for the Gold Yuan. For instance, the exchange rate of the Gold Yuan to RMB was 10:1 when the new government was founded in Beijing and this business lasted for 20 days; later, when Shanghai was liberated, the rate was set at 100,000:1 and the service was opened there for merely a week (Yao, 2007:423). The short period and rapid devaluation of the Gold Yuan urged people to abandon the previous currency system. Meanwhile, laws and regulations were set up against the dealing of precious metals, especially speculative activities in silver and gold.

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government represents and is responsible to the people. Thus, public ownership is namely state ownership in China.
4 Some scholarship considers the new Bank of Communications, re-established in 1987, as the fifth biggest state-owned commercial bank, which thus constitutes the ‘Big Five’, see e.g. (Dobson and Kashyap, 2006) and (Zhang and Ye, 2011).
5 The Gold Yuan had been in use from 1948. Before it appeared, the Chinese Fiat was the official currency, from 1935 to 1948, see (Yao, 2007).
6 From 1949, local banknotes gradually came to be retrieved, and at rates issued by different local banks. For example, banknotes in Southern Hebei at 1:100 to RMB; Northwest Farmers Banks at 1:2000; 1:3 in central China, etc., see (Yao, 2007).
Since the national currency market was centralized, the next action taken by the People’s Government was to strictly control foreign exchange and the ownership of foreign currencies. Individuals were completely forbidden to carry either national or foreign currency when crossing the border without being granted permission from the central bank (PRC. Government Administration Council, 1951).7 Citizens were also encouraged to give up ownership of foreign money in exchange for RMB.

At the same time, foreign banks could no longer enjoy privileges within China. Those privileges included issuing currency and an FX franchise, which had been granted by the Nanking government. The People’s Bank of China then became the only institution responsible for determining the exchange rate of RMB against other currencies (Zhang, 1999). Besides this, it authorised the Bank of China as the operating and regulatory agency, as well as assigning several specific and reputable foreign banks as designated franchisers. The exchange rate was set according to a comparison method based on domestic and foreign commodity prices.

For example, in 1952, the Yuan-dollar exchange rate increased from 800:1 to 42,000:1 because of domestic inflation in China and a crisis in the West (Yang, 2002:72). The exchange rate was, however, heavily based on governmental decision-making instead of market relations. In fact, this way of handling the exchange rate with strong central control somehow protected China from the heavy impact of some of the worldwide financial crises, which will be discussed later in this chapter.

The foundation of China’s contemporary financial sector retains similarities with these early foundations, for example, with four major commercial banks and the joint leadership by the Ministry of Finance and the People’s Bank of China. Other measurements were also taken into account along with China’s rapid economic recovery post-1949. This structure was efficient in controlling the whole situation after a series of wars and allowed the CPC to secure its ruling. Such a financial structure also enabled China to quickly recover and unify the financial market.

These very detailed policies were very much influenced by communist and socialist ideologies, as well as the Soviet Union. However, they were also part of an inflexible structure – so highly

7 The 1951 policy was replaced by Control Procedures of the PRC on Carrying the State Currency into or out of the Country on 1 March 1993. The latter allows movement of currencies under controlled method.
centralised that almost every economic activity would have to go through either the People’s Congress or the People’s Bank. Due to the political structure in China at the time, policies were made largely according to the personal will of the party leaders. In Chinese history, there have been several major mistakes in economic and political development such as the Great Leap Forward and the Cultural Revolution. Financial development was mainly serving political purposes and was off the course; therefore, a reformation was urged, with Deng Xiaoping pointing out that ‘finance is the core of a modern economy’ (Deng, 1993). Soon afterwards, in 1978, financial reformation eventually took place, taking China’s economy to a new level.

4.3. Post-1978 Internal Development and Reform

Finance is one of the most important anchors for the national economy in a modern society. McKinnon (1973) points out the significance of a liberalised financial system to healthy economic growth. As mentioned multiple times previously, it is nowadays widely acknowledged that financial development has a positive effect on the levels of economic growth through the facilitation of production and trade.

This section is divided into four parts. The first two parts introduce the changing role of the People’s Bank of China (PBOC), commercial banks, and the banking system in general, with evidence of related laws and regulations. The changes eventually led to a more liberalised market and freer capital flow, which greatly promoted the country’s financial and economic performance. The argument then moves on to explore related aspects of symbolic financial instruments, including the emergence of credit rating standards, and the stock exchange. Both the rapid changes and the slow progress to date signify that despite the fruitful outcome of such reformation, China’s financial sector remains lacking in sufficient scientific regulation and might face fatal institutional and policy problems in the future. Therefore, there is still considerable room for improvement within China’s financial structure.

4.3.1. Role of the People’s Bank and Monetary Regulation

Starting in 1978, China was involved in a number of reformations, especially in the economic and financial sectors. Before that, the nation was for a long period of time utilising a planned
economic system. Banks were strictly centralised and controlled by the CPC government, while foreign exchange was supervised closely and only permitted via the People’s Bank. Such a financial system was described as ‘shallow’ (Naughton, 2007) until the decision to carry out financial reform in 1978. The commercialisation of banks started in the mid-1980s when the modern concept of banking emerged in China. The People’s Bank of China, as the central bank, gradually released specific banking business and a certain level of autonomy to newly established commercial banks (Okazaki, 2007). Bonds could be purchased privately. New intermediaries were gradually allowed and regulations for open market started to be set up (Xu, 1996).

One of the essentials of this reformation lay in identifying and clarifying the roles of a central bank and commercial banks. Complete separation of the Ministry of Finance and the People’s Bank in early 1978 marked the beginning of this financial reformation. It started as a slow process but gradually accelerated.

In September 1983, the Decision on Functions of the People’s Bank of China taken by the state council symbolised the establishment of a regulatory role for the PBOC in terms of macroeconomic control. It no longer carried out saving function and credit business for neither individuals nor enterprises. Instead, there was a stipulation that the PBOC would transfer all its daily commercial business to the Industrial and Commercial Bank, and the PBOC would only carry out functions including:

“Research and drafting of principles, policies, laws and regulations, the basic system, and their implementation of financial work; regulating currency issuance and currency market; unified management of RMB deposit and lending rates and the exchange rate...” (PRC. State Council, 1983)

Beginning after this announcement was made, and over the next two years, the PBOC’s household saving business dropped away dramatically (Xu, 1996). Eventually, the People’s Bank was transformed into a non-commercial administrative-only institution.

In 1986, Deng Xiaoping stated the importance of reforming the banking system as ‘banks must fulfil their role and function as banks’ (Deng, 1993). During the next year, the People’s Bank proposed four targets to achieve and a series of detailed policies. Yet, China’s financial sector
was liberalised to a very limited extent and still restrained under the planned economy. Banks were highly reliant upon and bound to the government while the market economy mechanism was still under construction.

It was not until the end of 1993 when the government announced the *Decision of the State Council on Reformation of the Financial System*. This announcement clarified the four ultimate targets of financial reformation in China, which were namely: 1) establishing a strong and stable regulatory banking system based on the rules of a central bank; 2) implementing the separation between policy finance and commercial finance; 3) establishing an open, regulated, competitive financial market under the instruction of related laws; and 4) reforming the foreign exchange management system by coordinating foreign exchange policy and monetary policy (PRC. State Council, 1993a). Those targets correspond with the principles given by the World Bank – that financial systems should be able to make economic transactions easier, more efficient, and low-risk (World Bank, 1989).

In 1995, the enforcement of *The Law of the People’s Republic of China on the People’s Bank of China* conferred official and legal protection to the PBOC’s nature as the central bank of modern China. Apart from regulating the whole financial sector in China, the PBOC also bore the obligation of maintaining currency stability and determining interest rates (Pei, 1998). As, since 1985, individuals had been permitted to hold and make deposits using foreign currencies, transactions involving foreign exchange began increasing every year. Following the trend of liberalising the exchange market, the PBOC firstly improved the relevant laws and regulations; secondly, it used its macro-control power to set up appropriate exchange rates and maintain currency stability.

The *Announcement on Further Reform of Foreign Exchange Management Systems* by the PBOC in 1993 clarified that the long-term target of China’s exchange management system was to make the RMB a ‘freely convertible currency’ (PRC. State Council, 1993b). The prevailing circumstances were those of social transformation – from a planned economy to market economy (Qian, 1995). Thus, the Announcement put forward a three-phase plan: current account conditionally convertible, current account freely convertible, and finally capital

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8 This announcement was marked expired in 2009.
account freely convertible. A nationwide unified foreign exchange market was then established with the PBOC’s centralized management of foreign exchange reserves.

In 1996, the *Regulations on Exchange Control of the Peoples Republic of China* set up a legal framework on the foreign exchange of RMB current accounts. Meanwhile, the capital account was still under strict control (Zhang, 2006). Foreign exchange income could be saved in a special foreign currency account at designated banks but was not allowed to be converted into RMB without permission (PRC. State Council, 1996). The export of overseas investment and foreign investment capitals also required permission from the State Administration of Foreign Exchange.

As for the exchange rate, China adopted a unified exchange rates system, which means the domestic financial market exchange rate is consistent with the exchange rates of the international financial market. However, it was not completely consistent as, to a great extent, it was reliant on management by the government and the PBOC. For instance, the graph below shows a dramatic depreciation of the RMB in 1994, which was attributed to an aggressive exportation strategy (Huang, 2010).

Figure 4.1 RMB to USD exchange rate, 1981-2014

![Figure 4.1 RMB to USD exchange rate, 1981-2014](image)

Source: (PRC. National Bureau of Statistics, nd)

9 This law has been revised in 2008. The new version allows certain types of currency conversion, for example for registered regular trade activities.
The devaluation of the RMB resulted in a much lower price for China’s export commodities when compared to local products of Western developed countries. This gave China’s manufacturing industry and economic growth a great advantage. It also impacted on normal people’s everyday lives as domestic pricing became unstable. Inflation began to increase sharply, from 6.3% in 1992 to 14.6% in 1993 and 24.2% in 1994, according to the World Bank.\textsuperscript{10} Thus, this system was criticized as a “mandatory FX settlement system” (Chen, 2003; Huang, 2004). Clearly, while a certain level of freedom was introduced into businesses involving foreign exchange, the system overall remains under strict control as the central bank retains a strong grip on convertibility in order to coordinate with China’s economic strategy and maintain monetary stability. This aspect will be discussed in further detail in the fourth and fifth sections.

4.3.2. Liberalised Commercial Banks

The second remarkable achievement in the process of financial reform is the liberalisation of commercial banks. This is a development of the second track – the emergence of market as coordinator of economy (Qian, 2000). Before China’s reformation, as mentioned previously, banks functioned as an economic lever following political orders. Sinclair described this as a worldwide phenomenon whereby ‘commercial banks used to be the institutions that corporations, municipalities, and national governments sought out in order to borrow money’ (Sinclair, 2005:3). It was the same situation in China, with strong socialist privilege favouring state-owned enterprises. The banking system, isolated from the external world, caused ‘stagnant productivity, extensive inefficiency and waste, and low morale’ (Jao, 1991). In order to change the situation, progressive action was taken. In the paragraphs below, these actions are reviewed.

Before 1979, credit management was mainly based on a ‘supply system’ – relying merely on governmental decisions (Leng, 2009). At the early stage of reformation, changes mainly targeted reactivation, reopening, and recreation. ‘Bank branches were encouraged to explore new ways of attracting savings and were given more discretion in the allocation of credit’

\footnote{See World Development Indicators, Inflation, consumer prices (annual %) (World Bank, nd).}
In 1984, the PBOC activated the interbank market mechanism, allowing more flexible credit allocation between commercial banks. Structural reform occurred at the same time. Major commercial banks converted from a state-owned to a shareholding framework. Thus, without the strong backing of the government, these banks were compelled to seek out new mechanisms for operating and showing responsibility to their stakeholders.

The Law of the People’s Republic of China on Commercial Banks was published in 1995 and has been constantly revised up until today, providing legal the basis and instructions through which commercial banks can operate; especially for the Big Four, the leading state-owned commercial banks, whose role changed from the ‘cashiers of government’ into independent enterprises (Fu and Heffernan, 2009). Gradually, starting with a few major cities, certain authority was granted to local government and PBOC branches in order to make flexible use of funds and credit.

The relationship between the PBOC and other commercial banks changed in general, as commercial banks became relatively independent from the PBOC. Commercial banks gained a right to self-management, instead of receiving funds from the PBOC and taking orders from the state councils (PRC. People's Congress Standing Committee, 1995). This transformation encouraged commercial banks to initiatively attract and distribute capitals, which eventually led to the separation of policy and commercial finance. The concept of a ‘dual-track’ emerged, as both the administration and the market came to play equally matched roles in economic activities. Therefore, an era of ‘market socialism’ started in China.

‘At the end of 2003, the four major commercial banks had a capital growth rate of 2.11%, but improved to a 13.17% accumulation rate by the end of 2007. Bad loans dropped from 16.84% to 2.81% in the same period’ (Hou, 2011:423). China’s central banking system was therefore reshaped following four basic principles, including unified planning by the People’s Bank; account division among specialised banks; fund and loan availability control and constraints; and interbank lending as cash-flow back up (CSRC, 1993:285, as cited in Lu and Yu, 2000:198). Yet, some have argued that banks were given more autonomy while remaining weak in imposing discipline on enterprises (Bowles and White, 1993). Mehran and Quintyn (1996) believe that the first ten years of reformation were wasted on institutional development instead of real market development. After all, the reformation was largely restricted under communist ideology. In comparison to the relatively more developed Western financial institutions,
China’s banking system still contains features of immaturity and rigidity, while the level of operational autonomy is limited (Tam, 1986).

Overall, the independence and liberalisation of commercial banks, including both the Big Four and other smaller commercial banks of different types of ownership founded later on, greatly altered the way for businesses to finance their capitals. While some critique suggested that further reform and liberalisation are required, the liberalisation of commercial banks under China’s ‘dual-track’ system has led to the liberalisation of capitals, constituting one of the most significant components of China’s enhanced financial power.

4.3.3. Stock Market Development

Shareholding represents a significant mechanism for generating productive capital, and for storing and accumulating value by investors. While securities trading was stopped in 1952, the practice re-emerged in the post-1978 reform period. A number of SOEs started to raise funds by offering shares to the public. This action is most accurately characterised as emergence of corporate bond issuance than the emergence of stock exchange per se, due to the very limited scale of both market scale and participants. Nonetheless, this development represents a significant aspect in the deepening of the Chinese financial system and China’s strengthened ability of generating credit, which constitutes an emergent node of economic power.

Six years after the financial reform officially initiated, in 1984, Feilo Acoustics Co Ltd became the first authorised company to openly issue shares on the stock market, when both the Shenzhen and Shanghai Stock Exchange started operation (Tang, 1999). Since then, freedom for exchanging and trading was given to the public, and the government began to work on improving its regulatory role in the stock market. In 1992, the China Securities Regulatory Commission (CSRC) was also founded as an institute of the State Council, while the *Interim Provisions on the Management of the Issuing and Trading of Stocks* was published in the following year as the first regulation in relation to the stock exchange. The *Interim Provisions* set standards for procedures for stock issuances, exchanges, and most importantly, information disclosure, as well as investigation and punishment. For example, a:
“listed company shall provide the following documents to the Commission, stock exchanges to: (A) submit an interim report within 60 days after the end of the first six months of each fiscal year; (B) submit an annual audited report by a certified accountant within 120 days after the end of each fiscal year.” (PRC. State Council, 1993c: Art 57)

Figure 4.2 Total stock market capitalisation, 1997-2017 (billion yuan)

![Graph showing total stock market capitalisation, 1997-2017 (billion yuan)](image)

Source: (PRC. National Bureau of Statistics, nd)

However, when implemented on 27 March 1995, it inevitably had some loopholes and defects, and scandals involving irregularity by several companies were exposed. Again in 1997, the Qiong Minyuan Case involving securities fraud was investigated as the biggest fraud case in China’s securities market history. Consequently, revision to relevant laws and regulatory practices were urged (Sami and Zhou, 2008).

A study conducted by He and Pardy (1993) shows that based on data between 1978 and 1990, financial depth positively correlated with stock market development and market capitalisation as a proportion of GDP. The study also concludes that such a correlation can explain the reason why continuous foreign investment attracted markets with a more advanced infrastructure.

Despite the obstacles encountered throughout the development process, China’s stock market has now been operating for 25 years and obtained some remarkable achievements. The market expanded dramatically, from 104.8 billion Yuan total market value in 1992 to the 37.25 trillion in 2014 which created a 355-time increase. At the beginning of 2015, the total share capital of
listed companies on the Shanghai Stock Exchange was 27.09 million Yuan, while total market capitalisation reached 24.40 trillion Yuan, with a gross float market capital of 22.05 trillion Yuan. Until June 2018, the Shanghai Stock Exchange had a total of 1425 listed companies and 1469 stocks (Shanghai Stock Exchange, 2018). This is not to mention the amount of capital flowing in both Shanghai and Shenzhen Stock Exchanges together.

Table 4.1 Annual transaction overview of A, B shares in Shanghai Stock Exchange

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Market capitalisation (Billion Yuan)</th>
<th>Float market capitalisation (Billion Yuan)</th>
<th>Number of Transactions (million)</th>
<th>Total Turnover (Billion Yuan)</th>
<th>Average Earnings Ratio (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>2401.78</td>
<td>51124.28</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2016</td>
<td>28460.76</td>
<td>2383.18</td>
<td>50170.04</td>
<td>15.94</td>
<td></td>
</tr>
<tr>
<td>2015</td>
<td>29519.42</td>
<td>5134.08</td>
<td>133099.21</td>
<td>17.63</td>
<td></td>
</tr>
<tr>
<td>2014</td>
<td>22049.58</td>
<td>1590.87</td>
<td>37716.21</td>
<td>15.99</td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td>13652.63</td>
<td>1153.37</td>
<td>23026.60</td>
<td>10.99</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>13429.44</td>
<td>925.55</td>
<td>16454.50</td>
<td>12.3</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>12285.13</td>
<td>1273.28</td>
<td>23756.04</td>
<td>13.4</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>14233.74</td>
<td>1661.49</td>
<td>30431.20</td>
<td>21.61</td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td>11480.50</td>
<td>2142.61</td>
<td>34651.19</td>
<td>28.73</td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td>3230.59</td>
<td>1278.84</td>
<td>18042.99</td>
<td>14.85</td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>6453.22</td>
<td>1617.33</td>
<td>30543.42</td>
<td>59.24</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>1642.83</td>
<td>447.26</td>
<td>5781.66</td>
<td>33.3</td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>675.46</td>
<td>210.14</td>
<td>1924.02</td>
<td>16.33</td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>735.08</td>
<td>260.16</td>
<td>2647.06</td>
<td>24.23</td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>820.11</td>
<td>206.61</td>
<td>2082.41</td>
<td>36.54</td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>746.73</td>
<td>175.57</td>
<td>1695.90</td>
<td>34.43</td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>838.21</td>
<td>209.75</td>
<td>2270.93</td>
<td>37.71</td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>848.13</td>
<td>304.91</td>
<td>3137.38</td>
<td>58.22</td>
<td></td>
</tr>
<tr>
<td>1999</td>
<td>424.97</td>
<td>179.71</td>
<td>1696.57</td>
<td>37.09</td>
<td></td>
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<tr>
<td>…</td>
<td>…</td>
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</tr>
</tbody>
</table>

Source: (Shanghai Stock Exchange, 2018)

The Chinese Stock Market also attracted a number of foreign stocks and foreign investors. However, the openness of the market is still very limited, with the degree of market liberalisation unable to catch up with leading Western countries. One major problem is the

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11 Catalogue A is stocks issued in CNY within China and trade among Chinese investors; B is stock issued in USD and HKD within China but subjects to foreign investors; H stands for stocks of Chinese enterprises issued in HKD and listed in Hong Kong stock market.
function of the stock market in relation to SOEs. The government still maintains a high degree of control over the market via the operation of SOEs. Backed by the state and able to bypass regulatory bodies, SOEs have been exploiting stock exchange as an easy financing instrument. It was advised, however, that this operation be avoided as a long-term strategy (Lin, 1999).

In the early 2000s, a few state-owned giants appeared on the stock market. Those included monopolists such as China Sinopec and the Baosteel Group. As mentioned previously, the reform of commercial banks and the setting up of a credit rating standard made it more difficult for enterprises to obtain funds and investments from banks. That was mainly because of the rigid bureaucratic system within SOEs, as they were very used to being privileged and supported by the government. Therefore, SOEs chose to join stock markets as a way out. As soon as the more reputable SOEs had attracted enough individual investors, the price of each share went on a roller-coaster ride. There is evidence showing that China’s stock market is, in fact, the tool used by the government to make up SOEs bad debt or to provide temporary and superficial solutions to inflation (Chen, 2006).

Additionally, as Figure 4.2 and Table 4.1 above show, during 2007-2008, the opening up of the stock market with the lack of an effective regulator led to serious instability. The stock exchange in China went on to become overheated, that is, from 2005 to 2007. The reasons for this are various. Combined with the data on GDP growth rate, which increased sharply from 10.08% to 14.19% during 2004-2007 (World Bank, nd), the overheated stock market was due to the apparent prospect of the market and a rapid increase of spendable income of Chinese public.

The apparent high return thus enhanced a stock market bubble phenomenon. In response, during 2007, the Ministry of Finance and the State Administration of Taxation jointly announced an adjustment on the stamp duty for stock exchange transactions, an increase from 1‰ to 3‰ (PRC. Ministry of Finance, 2007). The new policy caused an immediate effect the next day – prices of 853 stocks dropping by the daily limit of 10%. China’s stock market thus received a heavy blow and the tension was not eased until the next year. This adjustment eventually held back the unhealthy growth of the stock bubble, although it also seemed to be an improvised tool made and used by the government, and for which China’s stock market paid a high price.
The lack of scientific and effective regulation is also confirmed by the data of 2015-2016 (Table 4.1 and Figure 4.2). Following an overheated market, early 2016, the CSRC introduced Circuit breaker to the Chinese stock market. Triggered twice in four days, the new mechanism was quickly abolished by CSRC, but leaving a 7.41 trillion Yuan loss of market capitalisation according to the BBC (Pramuk, 2016; BBC, 2016). Scholars, therefore, urged the government and financial experts to reconsider the condition of China’s capital market and manage ‘scientifically’ (see Chen, Zhang, and Wang 2009; Jiang et al., 2010).

In general, the accomplishment of building securities and a stock regime is remarkable in China. In comparison to advanced countries, it took much less time for China to achieve the same scale of market. Still, the size and transactions keep growing, and the gross value of stocks has multiplied dramatically. On the other hand, some have argued that the outcome of capital reform was disappointing because it is a problem by default to introduce the capital market into a socialist economy (Bowles and White, 1992b). The lack of thoughtful regulation and lagging policy indicate the still very immature Chinese stock market. It is a big step forward for the development of China’s capital market and for the strengthening of China’s financial power. However, because of the low starting point and inexperience, the outcome of this development remains shallow. The instability of the market and swinging regulatory decision are the major obstacle of China to pursue profound economic power through the instrument of the stock exchange.

4.3.4. Crediting Rating

As economic systems become increasingly complex, there is a need for credit allocation to move beyond personalised relationships between investors and investees (Sinclair, 2014). While the performance of credit rating agencies has been subjected to much scrutiny before and after the global financial crisis, such mechanisms constitute an important component of contemporary financial systems (Sinclair, 2010; White, 2010). In the paragraphs below, the relatively recent emergence of credit rating agencies in China is reviewed.

In the 1980s, a crediting rating agency emerged in China, first as a department formed by the PBOC. However, it took a decade before this department became independent and other independent agencies started to emerge (Yang, 2002). Due to the openness and independence
of the banking system and the increasing volume of investment, the emergence of a credit rating system came to be of great significance for investors in the Chinese financial market looking to reduce risks and losses.

In 1997, the PBOC identified nine rating agencies who had acquired qualification for engaging in corporate bond rating. After nearly twenty years of development and market testing, only four of them remain. The development of China’s credit rating system is simple and largely reliant on borrowing experience from the West. In December 2002, *Measurements on Eligibility of Employees in Securities Industry* issued by the CSRC required credit rating agents to hold certain qualifications and practice certificates. It was not until 2007 when the CSRC put forward *Interim Measures Stock Market Credit Rating Business*, which laid down more detailed rules regarding licensing, business rules, supervision and management, and legal responsibility for credit rating agencies. However, this document is fundamentally immature and limited, only regulating the credit rating for listed companies and stocks (PRC. CSRC, 2007).

In October 2016, the PBOC published a set of drafted interim regulations regarding the whole credit rating industry. Instead of putting it into immediate effect, the PBOC invited public opinion on the new regulations. The biggest contribution of this draft text was the clarification of basic principles and responsibilities, from aspects of management, use of personnel and procedure of operations to information disclosure and supervision (PRC. PBOC, 2016a). The industry is supervised by several government departments including the PBOC, CSRC, and National Development and Reform Commission while maintaining a high level of independence. It is also strictly forbidden for any agency to make any kind of promise regarding results in order to solicit clients. The draft text can be seen to provide a basic guideline on credit rating activities and, in principle, the ability to greatly reduce the chance of unqualified entities entering the financial market.

However, at the same time, the CSRC rules are vague in term of the actual practice of credit rating. There is no detailed specification on the different varieties of bonds and credits. Multiple supervision and different regulatory authorities having different standards for approving the qualification of a credit rating agency thus resulted in a lack of unification and effectiveness for the regulation of rating agencies. In reality, two of the six agencies qualified by the CSRC failed to obtain qualifications for a corporate bond rating; another two were not recognised by
China Insurance Regulatory Commission; three of them were assessed as unqualified to carry out short-term and medium-term bonds’ ratings (Zhang, 2013b:79).

Because the credit rating industry is still young and immature, data accumulation and database construction are still lagging behind due to limited development time. In particular, the lack of data on defaults makes it difficult to evaluate corresponding indicators such as probability and loss given default (LGD). In addition, China’s domestic macroeconomic and financial environment changes rapidly owing to fast-paced economic development and growth, thus, there can be deviations between timeliness rating results and the actual situation.

Besides, a rating analysis can be a qualitative process. In the case where there is no specific legal provision enforced yet, various agents may give out various results on the same subject (Zhao, 2011). On the other hand, such defects have driven potential clients towards more reputable and trustworthy agencies abroad, for example Moody’s and Fitch Ratings in the US. This has led to a vicious cycle of stagnancy in China’s credit rating business. Scott Kennedy (2008) believes that China’s credit rating companies find it difficult to gain reputation and affect the decision-making powers of those entities that issue or invest. Moreover, Kennedy observes that though privatised, many credit rating agencies, as well as other financial institutions, are greatly dependent on a government mandate, rather than supported by the market.

Overall, as a newly developed instrument, credit rating system can be a significant component to stabilise China’s financial structure and to boost liberalisation of capitals once the system is properly designed and regulated. While Chinese credit rating agencies tend to make their own rules under a loose governmental regulatory, their role is somehow weakened by the strong grip of central control. It is too soon to make the verdict that the Chinese credit rating system has already constituted an influential share of China’s financial power at this moment.

4.3.5. Summary: Post-1978 Financial Development as a Source of Economic Power

Besides the drastic reform in the banking section and liberalisation of capitals, Chinese government also gradually introduced other financial products, instutions, and measurements to further diversify China’s financial structure. Provencian and local state-owned banks
emerged as supplements to the Big Four to better serve people’s every-day life. Apart from stock exchange, other financial products, such as insurance, trusts, and growth funds, were made available for public to purchase with the corresponding laws in place to regulate these newly emerged industries. Development in this area recently started to expand to overseas markets. Chinese commercial banks, since the 2000s, are seeking opportunities of expansion through setting up subsidiaries and merger and acquisition, and by 2011 these state-owned commercial banks are in control of 270 billion USD worth of assets overseas (Zhang, 2013a). Although the internationalisation of Chinese domestic financial institutions going abroad is still at an early stage, this industry is developing quickly with new institutions mushroomed in recent years and relevant studies published since the late 2000s (e.g. Zhu, 2005; Wu, 2006; Hu, 2009).

Chinese scholars are also looking at the internationalisation of China’s stocks market. Tian (2001) compared stock markets of various countries and concluded that the process of internationalising Chinese stock markets should follow ‘baby steps’ – slowly and gradually, because the impact of voluminous foreign capitals will greatly increase the risk and instability of the Chinese market. Similar researches followed, continuing to guide the process (e.g. Kang and Zhang, 2001; Yang and Huang, 2003; Wang, 2017), whereas other research has pointed out that the structural defects in China’s securities system and weakness from the legal perspective are the main restrain of the internationalisation (Li, 2017).

By examining major developments in China’s financial structure, the general pattern of reform and transformation can be discerned, and reflection provided on the extent to which changes constitute significant foundations of economic power. The CPC leadership has determined at the constitutional level that China’s economy and property ownership is under stricter central control compared with Western regimes. On the one hand, financial reform, by reallocating responsibility and resources among different banks, indeed has generated and liberalised a large amount of capital. On the other, the modernisation of China’s financial structure remains problematic, especially in terms of the regulation of financial activities. The gap in policymaking can consequently lead to great losses within the financial market – for example,

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12 For example, Chinese Insurance Law was published in 1995 followed by the national Trust Law in 2001.
the stock market crashes that occurred in the late 2000s and 2016. Further reform is necessary to allow financial deepening to overcome this obstacle.

Overall, the 1978 financial reform has fundamentally reshaped China’s financial structure from several dimensions, including reform of the banking system and the introduction of modern financial instruments. The banking reform is the predominant factor that enhanced China’s financial power, as this action has clearly separated the roles of different institutions and freed capitals from the previous rigid planned economy. China’s economic power has reached a new height compared to its old self pre-1978. Meanwhile, the development of financial instruments, including the stock market and credit rating system, is relatively recent. Because of the lack of scientific management and the fundamental ideological restriction, the increase of China’s economic power through this dimension is incremental. In general, while the reform has achieved great outcome providing meaningful foundation of China’s financial power, this outcome does not sufficiently indicate an economic power enough to become world hegemony.

4.4. The 1990s: Crisis, Transition, and Monetary Stability

Besides the liberalisation of the financial market, the ability to manage monetary stability is also considered a key function of a financial structure. This section examines China’s response to financial crises as the indicator of its ability to maintain monetary stability. Since the Third Plenary Session in 1978, the opening up of the financial market had also become a reform goal. Large scale communications and cooperation brought China a breakthrough in terms of international financial relations. While the market has become liberalised and open for more actors, including foreign institutions, to access, the impact from beyond the border has also increased.

This section proceeds by first examining China’s reaction to the Asian Financial Crisis, and then moves on to discuss the transition process when Hong Kong was incorporated as a major milestone in China’s financial structure. Both cases suggest that the gradual transition into a socialist ‘dual-track’ financial system, has enabled China to withstand the impact of sudden change and avoid the vulnerability of excessive liberalisation; therefore, China possesses good capacity to manage its domestic monetary stability.
By the end of 1997, China had set up 687 financial institutions abroad, including 654 business institutions and 33 representative offices, operating across 24 countries and regions (Yao, 2007:541). Foreign institutions started to enter China’s market progressively as well. Those institutions not only included banks, but also insurance agency and trust agency. At the beginning of 1999, Beijing cancelled the regional restriction on foreign financial institutions, allowing these entities to operate in all major cities in China. In February of the same year, the total number of foreign financial institutions reached 191, with a total of $36 billion assets (Wu, 2008:488).

China’s market has huge capacity and potential due to the large population and its own demands for development. It is certainly an attraction for all kinds of cooperation. Throughout the process of the market opening, the Chinese government continued to play its role as regulator, and from a micro-economic perspective, keeping the degree of intervention to a minimum. Echoing the view of macro-control, China insists on using the ‘market socialism’ principle as guidance.

The East Asian financial crisis erupted in 1997, starting in Thailand, before spreading through East Asian, and affecting cross-continents. The causes are many. Apart from the immature financial market within the majority of developing countries, the economic bubble and bad debt contributed a lot to the occurrence of such an incident (Radelet and Sachs, 1998). There are similarities among those who suffered the most in this crisis, from those who had their national currency pegged to the dollar, to the unregulated market and those experiencing less advanced risk management.

By contrast, as the previous section pointed out, the Chinese government adopted a step-by-step approach in liberalising the exchange of RMB with other currencies. Its capital account was not fully opened to free converting. The relatively low level of market liberalisation and relatively highly concentrated macro-control prevented the country from experiencing a devastating blow to its financial system. This was despite the huge pressure to prevent the RMB from depreciating.

Internally, it had taken an effort to expand domestic demand and make policy to stimulate economic growth, as on 23 October 1997, the PBOC issued Notice of Lowering Deposit and
Lending Rates of Financial Institutions and Offshore Banking Administrative Measures. By the end of 1997, the CPC Central Committee and the State Council made an official notice regarding financial deepening and risk control. The notice pointed out the importance of risk management, stressed the need for strong macro-control, and expressed resolute opposition against speculation and other illegal financial activities (PRC. State Council, 1997). This attitude was able to maintain the operation of China’s domestic economy at a healthy and stable level, easing tensions around Asia, and promoting economic recovery.

In addition, to ease the crisis, the Chinese government adopted a series of positive and proactive policies. Externally, it provided, through bilateral channels, a total of more than $4 billion in aid to Thailand and other countries in the framework of the IMF arrangements. It also sent out free emergency medicine plus import and export credit to Indonesia and others (PRC. Ministry of Foreign Affairs, nd).

Taking the crisis as an opportunity, the Chinese government, represented by Jiang Zemin during the APEC Economic Leaders Meeting of 1998, proposed the need to strengthen international cooperation, reform and improve the international financial system, and respect others’ choices in overcoming financial crises (PRC. Ministry of Foreign Affairs, 1998). In other diplomatic meetings, China’s leaders pointed out and advocated for making the following a priority: strengthening regulation and supervision on short-term capital flows and encouraging communications between finance ministers and expert groups (Ba, 2003).

Economists concluded that the financial crisis may have caused big damage for China’s economy and national wealth, but even greater was the political gain as the impression of China’s ability to stand fast against the crisis was created (Noble and Ravenhill, 2000). Despite heavy losses to national reserves and economic development, the ‘China mode’ won its reputation during the series of financial crises occurring worldwide. It was also at that point that the debate about the Washington Consensus and ‘Beijing Consensus’ began, as many believed that China’s use of macro-control would be superior to the highly liberal economic policy used in a US-oriented financial framework.

Another major impact on China’s financial system in the 1990s was the handover of Hong Kong. Before 1999, Hong Kong was under the administration of the UK. The 1970s was an
era of a rapid emergence for the financial industry in Hong Kong due to an improving relationship between China and the UK. The reformation in Mainland China provided huge business opportunities and strong backing for Hong Kong’s economic development.

Hong Kong itself as an open harbour with access to the Chinese market attracted numerous financial institutions. The British Hong Kong government adopted high-level liberal financial policies, including the abolition of exchange controls, the importing and exporting of gold, and restraint on foreign banks. Though under the governance of the British Hong Kong government, the main target and dependent object of Hong Kong finance was China. The CPC did not recognise the Treaty of Nanking, the Convention of Peking, or the Second Convention of Peking, but insisted on the handover of Hong Kong to Chinese authority instead. As to the economic structure, privileges were given to Hong Kong to keep the status quo. Hong Kong Basic Law13 Chapter V Section 1 clarified that Hong Kong enjoys a high degree of autonomy in its financial sector:

“The Hong Kong Special Administrative Region shall have independent finances.  
(Art. 106)

... The Government of the Hong Kong Special Administrative Region shall provide an appropriate economic and legal environment for the maintenance of the status of Hong Kong as an international financial centre. (Art. 109)” (PRC. People’s Congress, 1990)

As the Articles indicate, such policy was significant in maintaining the stability of Hong Kong’s economy, as well as its position as a pioneer with its open harbour and intermediary role in China’s external finance. It also guaranteed its role as a free port.

Furthermore, the mainland and Hong Kong became each other’s biggest investor, with the latter providing strong financial and technical support to the former. Correspondingly, the PBOC promised to bear the liability of stabilising the Hong Kong dollar according to the bilateral agreement on repurchasing US Treasury Bonds signed by both in 1996 (Chen, 1996). This was a successful move, for as the previous section showed, China’s solid national reserve

13 This law came into enforced on 1st July 1997
was able to reduce an Asian Financial Crisis impacting Hong Kong and preserve the stable value of the Hong Kong Dollar. Mutual benefit has been considerable throughout the development of Hong Kong.

For China, incorporating Hong Kong into its financial structure was a huge step forward in terms of market reform. Meanwhile, the strategy of maintaining autonomy in Hong Kong and close macro-control in Mainland China proved to be effective, especially after the Asian Financial Crisis when Hong Kong was exposed to severe financial instability. In other words, if Hong Kong was subject to strict control as it was in the mainland, it would lose the advantage of being a free port and regional financial centre; on the other hand, while in need of integration, if the mainland market was fully liberalised, China would not be able to stabilise its domestic monetary system due to lack of regulation and the impact of global crises, not to mention being the regional stabiliser.

Overall, the period of the late 1990s illustrates China’s enhanced financial power through the eruption of the international financial crisis and the handover of Hong Kong. While China had liberalised its financial market to a certain extent, a concentrated macro-control remains as the core of the Chinese financial system. The dual-track approach enabled China to withstand impact of international incident and maintain largely internal stability.

4.5. RMB Internationalisation

Due to the progress of globalisation, there is always a natural need for one currency to be the single common international denomination for all countries. If the world did not choose the US dollar, it would have chosen a currency from another country. As concluded by Helleiner and Kirshner (2009), the reserve currency usually has to bear several obligations, including the ability to exchange, store, and value, while, more importantly, act as an anchor for the world’s monetary system. These functions and roles can be reflected in several aspects of economic and political activities. Central banks of each country are not only economic entities but also governmental bodies. Monetary policy and currency, therefore, imply the status of markets, the instrument of certain authority, and the grand strategy of the whole nation.
As the market indicates, the reserve currency certainly has enough attraction towards players in international exchange. The sources of such attraction rely largely on the pre-existing market share of the currency, as well as in liquidity and a transactional network. Market share is a direct basis of currency hegemony. Until 2014, the US dollar maintained a share of around 60% in the foreign exchange market, with about 25% by Euro, whereas the RMB took up less than 3% overall (IMF, 2016). Though occupying the majority position in terms of foreign exchange reserves, the US dollar still suffers negative predictions that it would endure as the world-leading reserve currency eventually.

An influential amount of existing literature has shown expectations for China’s RMB to dominate the market over time (e.g. Bowles and Wang, 2008; Cohen, 2012; Eichengreen, 2005). It is not necessary to elaborate on the point that dollar hegemony is challenged currently by the Euro, instead of the RMB. In terms of long-term analysis and prediction, the current statistics on market share are superficial, thus containing a natural defect. Over a longer period, there is the obvious downfall of the dollar compared to half a century ago.

The Triffin dilemma has already been suggested as a major reason for this, for the unipolarity of the dollar was undoubtedly a failure (Triffin, 1960). The decreased occupation of the dollar was in fact due to an adjustment to the dollar hegemonic system itself, in order to maintain the dollar’s major sphere of influence. Though expecting increasing popularity, the RMB is actually falling far behind the US dollar while the latter is still the most favourable currency (Figure 4.3). From the perspective of market share and market dominance, there is a possibility for the RMB to outdo the dollar, however, it would be a significant and long process. Because of the lengthy and unpredictable upcoming timeline, in addition to both China and the US being active and dynamic actors on the world stage, the pattern of international finance would also be more dynamic than ever.

Liquidity and convertibility are the other major aspects considered in terms of reserve currency. Liquidity stands for the scale of flow of a certain currency, especially the usage of the currency outside of the original country. Chen and Tian (2013), from China National School of Administration, state that the function of an international currency should not merely be about storage, but more importantly be reflected in the valuation, settlement, investment, and financing of businesses. Such functions should include the ability to open letters of credit,
guarantees, and honour checks regarding international financing. More specifically, to carry out financial derivative business corresponding to interest rates, exchange rates, stocks, and bonds. Thus, the status and influence of a currency can continuously improve and expand.

It would be insignificant for an international currency to be kept in stock without any use. Chen points out that the direct output of capital in RMB should allow and support foreign institutions and individuals opening RMB accounts within their countries, so that the RMB could enjoy the national treatment of making deposits, finance, and various securities investment. Moreover, the liquidity of market investments must have sufficient security, timeliness and effectiveness (Chen, 2010).

Figure 4.3 Market share of trade financing by currency, 2012 and 2013

Source: (Deutsche Bank and PBOC, 2014)

Thus, besides being held by countries as a reserve, liquidity is an additional parameter for reflecting on the acceptance of one currency by others. In the most simplified way, the wider use of this currency, the more liquidity it contains. Adequate liquidity usually creates enough trust in the currency, therefore making it more likely to be held and used, because it can help to minimise vulnerability to external shocks.
As Figure 4.3 and 4.4 indicate, liquidity of RMB is increasing, gradually taking over the second-place position, and keeping to a general trend of growth. The transactional network indicates the convenience of converting it. Namely, there is a need for a certain network to support transactional activities. With the support of a friendly network, convertibility can be greatly enhanced. An opened financial market and the stock markets in Shenzhen and Shanghai, as well as Hong Kong, have provided such a platform for transactions to be taken place in China.

Figure 4.4 China cross-border trade RMB settlement by month (Jan 2012 – Jan 2014)

![Bar chart showing RMB settlement by month from Jan 2012 to Jan 2014.](image)

Source: (Deutsche Bank and PBOC, 2014)

In 2016, the RMB was determined to be a freely usable currency and will be included in the new SDR basket. This can be a great step forward for the internationalization of the RMB. It is supported by the massive size of the financial market inside China as well as the more frequent use of RMB outside its border. The market is free for entry and exit. This works the same for currency. Economic entities are free to choose the currencies they wish to use during a transaction.
However, from a governmental perspective, the major currency is determined by what tools and instruments are used at a political level. The extra grip of central control means China is unwilling to float its RMB exchange rate due to trade advantage and fear of absolutely ‘free’ currency market (McKinnon, 2013:162-169). Besides this institutional restriction, the international currency not only reflects the level of usage in trading and other financial activities but also the degree of recognition at a governance level. Thus, the dominance degree of national currency in cross-border transactions can also indicate political dominance, namely hegemonic power, that this obtains. China’s currency undoubtedly has its regional successes and is challenging the US dollar, but the disparity between them is so huge that it cannot be cleared up within a short period of time. A much more complicated question asks whether there will be a point of equilibrium between the currencies.

Overall, it is certain that a long period of time is required before the RMB becomes truly international. The internationalisation of RMB implicates China’s much-improved ability to manage monetary stability while promoting the liquidity of its currency in general. It also means that China’s financial power has been remarkably enhanced in relation to the currency-related financial power defined by Kindleberger and Strange. However, from the aspects of market share, convertibility, and liquidity, China’s currency-driven economic power maintains a relatively weak foundation.

4.6. Chapter Summary

To conclude, the internal reform of the financial sector has seen a deep transformation in the nature of banking and credit allocation in China. China has absorbed practices from the West and combined these with its own national institutional structures. The aim of the reformation was market liberalisation, which to a great extent has underpinned a period of rapid economic growth over recent decades.

The separation between administrative and financial roles of institutions provided a clearer division of obligations and liability for governmental offices, central banks, and other commercial banks. The People’s Bank of China, which is liable to make macro development policies, handled the overall trend of development independently, using a dual-track
framework. It also adopted a series of monetary policies to correspond with the ‘market socialist’ approach. Besides institutional change, the market economy was established as well.

A gradual but slow and trimming reform was introduced to commercial banks and other financial institutions. The liberalisation of capital flow, cash flow, and the concept of credit became accepted. The result of this turned out to be fine, with the reformation allowing for higher efficiency when performing economic activities. The central bank focuses precisely on adjusting the national interest rate and exchange rate, while commercial banks were freed from being linked to state-owned enterprises. Firms of all kinds are able to borrow credits from the commercial banks if meeting certain requirements. The introduction of stock exchanges further allows businesses to utilise available funds from the public. Although still in development, the credit rating system has come into shape to safeguard the interests of investors. Players in the financial market have thus achieved a state of healthy competition compared to the past.

At the same time, the openness of China’s financial market exposed it to the impact of the international regime. Nevertheless, China’s reform strategy was fit for its time, and the Asian Financial Crisis provided a chance for China to show off its abundant national reserve and the advantages of powerful central control. It caused a discussion on whether the Beijing Consensus is superior to the Washington Consensus, as well as improved the relationship between China and others, especially Hong Kong SAR and some developing neighbours.

As the progress of development speeded up, expanding economic growth in China was seen to stimulate external cooperation and vice versa. The People’s Bank is now also working on promoting the international status of the RMB, which recently joined the SDR basket. The RMB has thus become the sixth most used currency in the world, and its status will improve in the future, backed up by continuous economic growth.

Nonetheless, China’s financial structure is, at the same time, problematic. The transformation from highly concentrated central command to a free market is a lengthy process. The reformation and opening up of China’s financial sector is still less than half a century old, and it faces similar problems to the old Nanking government, with a lack of experience and experts.
First of all, much policy-making aims superficially to solve the surface phenomena, ignoring the actual problem. This kind of ‘robbing Peter to pay Paul’ solution intensifies internal instability and inequality. Major policies have been made that focus on institutional and structural change, with little detailed guidance on the operation of various financial institutions. The space left blank leaves the government with an opportunity to explain and modify regulations based on the state’s need.

Secondly, the degree of market freedom remains shallow. As stated before, reform is a long process, and a free market mechanism cannot be built in one day. To have a mature and complete financial regime, there needs to be a sound regulatory and legal system, as well as effective implementation. It will take more time for China to establish both of these. Before that, China’s finance structure would remain operating under the high level of governmental control and the majority of financial institutions would be guided directly by the state.

Arguably, China’s style of financial reform and governance has its advantages, stimulating discussion on whether the ‘China model’ is better than the American liberalised economic style. Nevertheless, purely focusing on financial liberalisation and financial deepening is not useful, instead, further reform and improvement will be needed over the forthcoming decades so that China can level its power with leading Western countries. The task for China is more difficult than it was for the West, because while continuing the process of liberalisation, vulnerability and stability must also be taken into account.

Overall, China’s financial power has been notably strengthened due to the rapidly expanding internal financial market and stable monetary management since the 1978 financial reform. Banking reform introduced credits into China’s socialist market economy. State-owned enterprises and private firms can further seek capitals via the stocks exchanges with the emerging credit rating system reducing risks. On the other hand, A strong government control over financial instruments aims to safeguard stability against the dropback of opened-up market. However, as mentioned in the paragraphs above, the reform is superficial and restricted by ‘ideological doctrine’ – a paradox for the Chinese government at the moment. Thus, the foundation of China’s economic power in relation to the internal aspect of the finance structure is insufficient to be defined as a source of hegemonic power.
5. External Development of the Finance Pillar: Engagement with International Institutions

This chapter examines the pattern of China’s engagement with international financial institutions and how effectively China is inserting its influence into the international financial regime. Two manifestations of China’s engagement are explored, with its evolving role in the IMF and World Bank being considered alongside recent attempts to create new organisations in the spheres of financial stability and development finance, respectively.

The general observation is that China is relatively passive within existing international institutions, but proactive in creating parallel institutions that nonetheless are supportive of the existing order. China is becoming more proactive than it has previously in terms of participating in predominant global financial institutions, with its overall status being promoted alongside its improving economic performance. Although China shows increasingly intense engagement with existing US-led institutions, its increased power within those institutions is incremental and limited in comparison to the deeply rooted dominance of the US. Meanwhile, China, with its emerging and developing allies, is perusing a regional influence by setting up new institutions side by side with those that predominate (Kupchan, 2012). Such a move poses a significantly enhanced Chinese economic power to the US in relation to the leading role in coordinating the international financial system, although it also compliments the system that exists.

This chapter first presents the rationale for the focus of analysis adopted in this study of the external influence in institutions of international financial governance. Then it analyses each case in the following order – first, China’s engagement with the IMF and the World Bank as the existing international institutions under US hegemony, followed by the case of the BRICS Contingent Reserve Arrangement (CRA) and Chiang Mai Initiates Multilateralization (CMIM) as emerging institutions for the purpose of financial stability, and finally, the New Development Bank (NDB) and Asian Infrastructure Development Bank (AIIB) as emerging equivalents of the World Bank. The overall conclusion delivered through this chapter is that China’s economic power manifested from this external aspect of finance structure is insufficient to move towards a hegemonic status.
5.1. Operationalising the study of the Finance Pillar: Engagement with International Institutions

The topic of hegemony and international institutions has received substantial attention over the years. Seminal scholarship suggests that establishing international institutions can be a key mechanism through which a rising power serves to lock-in its position of relative advantage (Ikenberry, 2001). There is a broadly shared interpretation that the post-1945 architecture of international institutions was, to a notable extent, founded on the basis of US power, and aimed to facilitate the promotion of US preferences and interests through the international system.

This chapter explores the changing relationship between China and a selection of existing and more recent international institutions involved in monetary and investment regimes.

A number of the existing literature have explored the relationship between hegemony and international institutions. This section provides a synthesised overview of the contemporary understanding of this relationship, including theoretical writings on this topic and some empirical studies, before presenting the organisation of this chapter.

The existing literature has suggested that international institutions interact with states in a contemporary IPE structure (e.g. Keohane, 1998; Milner, 1997). A substantial body of work explores the ways in which hegemonic power uses and structures international organisations, and a more modest body of work explores the relationship between changing the distribution of power and the performance of international organisations. If a hegemonic regime or balance of power is to change, it will manifest such change through the operation of its international institutions. Overall, it is confirmed that power can manifest through states’ performance within international institutions and can be examined through aspects of the formal governance structure, informal mechanism of influence, and institutions’ balance of power.

International institutions are widely acknowledged as possessing two key features – being intergovernmental and having determined rules. Being intergovernmental determines that the mechanism of international institutions is state-based, where states are the actors in relevant activities. This feature distinguishes international institutions from other non-governmental
organisations and civil societies, which do not directly reflect state interests. Meanwhile, with legally binding rules and regulations, international institutions represent relatively formalised spaces within the international political economy (Duffield, 2007). Since WWII, international institutions, as specialised agents, have been effectively undertaking the task of transnational problem solving (Zamora, 1980).

Existing studies suggest that international institutions can function as a form of hegemonic power in contemporary international politics. While Kindleberger (2013) clearly points out the role of a hegemon in establishing order through international institutions, as demonstrated by the case of the US, Keohane (2005) consider the establishment of institutions an instrument for the hegemon to extend its reign when entering the phase of hegemonic decline.

Regimes and institutions appeal to the hegemon’s agenda to pursue optimal interests. The establishment of international institutions reduces transaction costs by building up economic cooperation (Keohane, 2005; Betts, 2017); meanwhile, from the aspect of policymaking, international institutions can also reduce the cost when one intervenes into another’s domestic law. This is particularly true since the global environment has changed so dramatically since the great wars. Interdependence between states has gradually become stronger and peaceful development has become a key theme worldwide. Power is interpreted not only through the material aspects, but also has become structural, institutional, and intangible. Conventional international relations literatures have also largely agreed that in history the establishment of certain international institutions, through the process of the formation and the legally binding operating rules, symbolise the emergence of hegemonic regimes, as well as its weakening and collapse when some institutions fail to maintain the global order as designed (Ikenberry, 1999; Krisch, 2005; Kindleberger, 2013).

It is widely held that international institutions are a major instrument in the construction of global order and are typically used to support the interests of the great power (e.g. Keohane, 1988; Keohane, 1998; Bohle, 2006; Hurrell, 2001; Bieler and Morton, 2004). In the contemporary structure, the hegemon would prefer to achieve the goals governing international regimes through institutions, extending its influence over subordinate players and consolidating its interests worldwide. The Gramscian approach has particularly highlighted that the role of materials – market and capital, as the social forces of the dominant capitalistic class – are taking increasing control of political decisions, and as a result, economic and
finance-related international institutions have been largely aligned to promote free trade and free flow of capital as their core agendas (Gill and Law, 1989; Cox, 1981).

In the current global environment, this means US hegemony, as international institutions ‘are deeply influenced by US power, [and] US power also rests in large part upon the ability to influence international organizations’ (Stone, 2011:3). From the financial aspect, the existence of international institutions, namely the IMF, provides conditions and resources that need coordinating among countries with various domestic laws, especially in the vital circumstances of crisis.

In short, the reason for a hegemonic power to create multilateral institutions can be concluded as being so ‘that institutional agreements can lock other [weaker] states into a relatively congenial and stable order’ (Ikenberry, 2003). This allows the hegemon to insert its core values and interests as principles; such a congenial and stable order can thus provide the conditions for both strong and weak states to pursue their maximum and mutual benefits in the long term.

To sum up, current IPE theories deem international institutions as instruments, especially at the moment, or following the birth, of a hegemon, for achieving global governance based on the hegemon’s self-interest. International institutions have a direct link to hegemonic power and can often indicate the status of that power.

Much literature on hegemony and international institutions looks at the role played by the current preponderant power in international institutions (Keohane, 2005; Young, 1986). In this regard, typically contemporary literature focuses on the US and contemporary architecture. This literature highlights the importance of formal governance structures, informal mechanisms of influence, and balance of power (e.g. Stone, 2011; Woods, 2003; Keohane and Nye, 1974). The main body of this chapter uses the concepts of formal and informal mechanisms of governance to explore the role played by China within existing and emergent structures of global governance. In the paragraphs below, existing literature that explores formal and informal mechanisms of governance are reviewed.

One major strand of empirical studies focuses on the formal and informal governance of institutions. It is suggested that the US engages with international financial institutions, namely the IMF and the World Bank, via a formal power structure and informal mechanisms of
influence (Woods, 2003). These two kinds of structures justify the leading state’s power embodied in the institutions.

Other literature also supports the suggestion, presenting that US structural power and its influence on the IMF are reflected in forms of formal and informal governance. More precisely, formal governance usually refers to formal rules containing standard operating procedures, including ‘voting rules, property rights, and a status quo distribution of costs and benefits’ (Stone, 2011:13); whilst informal governance is inexplicit and varies according to different contexts, allowing powerful states to extend their own interests as long as they are not explicitly forbidden. Stone also points out that the building of an institution is about the balancing of interests via formal and informal governance. While weaker members safeguard their interests through consensual formal rules, powerful states enjoy more benefits via informal governance, besides the mutual interests set by formal rules (Stone, 2011).

The formal structure of international institutions manifests largely in the formal consensual rules that facilitate interaction. The formal design of the institution and its written standard procedure is acknowledged as the source of an institution’s legitimacy and reason for its participation (Hawkins et al., 2006; Koremenos, Lipson, and Snidal, 2001). The most important element of this formal structure is the voting mechanism which grants members the authority and power to make decisions. A state’s formal power within an institution includes ‘voting rights, veto power, membership on committees, or other control rights that are legally assigned to members’ (Stone, 2013:125). It is an explicit concept. The formal rules of an international institution can specifically point out the agenda, core interest of the institution, and operational method, regardless of coinciding with the leading state’s interest or not; and among these mechanisms, voting shares can be mathematically measured to present the general picture of power distribution among member states (Martin and Simmons, 1998).

Meanwhile, informal governance is the other structure used by international institutions in parallel to the formal rules. It concerns one’s structural power which is ‘outside options of the leading state and the externalities that its participation generates for other members’ (Strange, 1988, as cited in Stone, 2011:33). Informal governance can be any practices that are outside but not forbidden by formal forms of governance and written rules of the standard procedure. States with stronger structural power are more capable of exercising their power outside the rules. Informal forms of governance within international institutions are more likely to be
powerful players’ instruments and designed to maximise interest, because small states are often underrepresented and decisions of a global institution, for example, the IMF are often made in the Executive Boardroom with little transparency (Clegg, 2012; van Houtven, 2002). Despite being inexplicit, informal practices feature manipulation through transparency and information asymmetry (Stone, 2011; Stone, 2013; Christiansen and Neuhold, 2012).

Other empirical studies focus on the ‘balance of power’ in international relations, following Keohane and Nye’s initial suggestion. Institutions are found to not always represent the sole interests of the most powerful states, because if not offering enough to the weaker actors, the design would be unable to attract enough participation and hence its effectiveness would diminish. As a result, big states may, for example, sacrifice dominant voting shares to maintain the legitimacy of the situation and compensate by exerting power in marginal areas. The balance sought is to firstly maintain the accountability and credibility of the institutions themselves; then to maintain the stability of an international system by showing consideration to both the great power and the subordinate players, often in the form of shaping agendas (Keohane and Nye, 1974; Niou, Ordeshook, and Rose, 2007).

Some reflection on the relationship between hegemonic transition and international institutions are offered in the existing literature. Specifically, it is suggested by Stone that when an institution becomes out of control of the hegemon, the great power may choose to marginalise or abandon them, meaning they no longer reflect the leading state’s core interests as they did when they were initially built (Stone, 2011). Such examples include the partial failure of Bretton Woods, the US bypassing the UNSC on the Iraq War decision, and the WTO after the Doha round (Glennon, 2003a; Glennon, 2003b; Mercurio, 2007). However, it does not necessarily mean that the hegemon or the institution has failed completely; instead, it is in the process of seeking a new equilibrium and rebalancing power.

To explore China’s shifting relationship with international institutions in the broader context of hegemonic transition, this chapter focuses on two dimensions: firstly, examining China’s behaviour within pre-existing institutions that have previously been dominated and controlled by the US; and secondly, studying China’s participation in some newly established institutions that have overlapping functions like those US-led institutions and are arguably challenging the role of the latter in current global governance. As Heep (2014) points out, a country in the position of a creditor can often allow it to exercise direct press on other states.
Because the focus of this thesis is the transition of power, the context of this study should stress a new rising power entering a realm where a predominate power already exists and is in charge. Therefore, inside the long-standing US-led Bretton Woods institutions, a clear power contest can be captured between China and the US. China’s interest in these institutions is worth discussing as China’s international status promotes simultaneously with its economic growth. On the other hand, the world has been seeing a growing number of institutions founded in recent years. Some newly-established institutions, where the US does not participate, can be considered as agencies of emerging markets and developing countries (EMDs) in the same field as the Bretton Woods institutions, with China actively engaging with, and pushing for, a new global equilibrium.

In other words, to picture the external effect of China’s engagement with international financial institutions as evidence of its hegemonic rise, the most likely approach is to evaluate the extent of China having influence from within US-led institutions; and considering the significance of other similar but non-US institutions within the overall regime. The second point is to identify to what extent the international institution in question can instrumentally affect the global order as a manifestation of the hegemonic (or leading state’s) power. The first point looks at how state powers are distributed within an institution – in other words, to what extent can the leading state exercise its power to control the institution, because despite being created or led by a certain great power, an institution might not always turn out to serve its tentative purpose.

Most specifically, the corresponding cases applying this approach include the IMF and the World Bank, which date back to Bretton Woods and can be considered representatives of US hegemony (Kindleberger, 2013); and their China-led or China-participating equivalents – namely, the BRIC Contingent Reserve Agreement and the Chiang Mai Initiative Multilateral, corresponding to the role of the IMF, the NDB and the AIIB, and serving a similar purpose to the World Bank.

The CRA and CMIM are regional and multilateral contingent swap arrangements. Their purpose is to minimise the impact of the financial crisis as well as maintain financial stability, which falls in the same category as the IMF. Although they do not have a specific governance body or appear to have an organisation, they fulfil the criteria for institutions defined previously, that is, being state-based, intergovernmental, and having formal rules of operation.
The NDB, also known as the BRICS Development Bank, and the AIIB, invest in infrastructural projects in BRICS countries and Asian-Pacific developing countries. They possess a similar agenda to the World Bank. These two institutions, China-proposed and China-led, are believed to embody China’s interests in several different respects. Scholars believe that the design of these China-led institutions can reduce the international financial system’s dollar dependency and the impact of American-oriented financial crises (Abdenur, 2014). Furthermore, these institutions can also promote Chinese currency and outflow investment (Ren, 2016) and relieve China’s overcapacity of production structure (Cheong, 2016). This will potentially lead to increasing rapport with developing countries as well as spread counter-American ideology. These impacts hint at a potential hegemonic conflict between China and the US, and therefore, these institutions are chosen to be the cases this chapter will examine.

To sum up, although various strands of the existing literature have studied different forms of international institutions, looking at various aspects in various contexts, there is a broad consensus that international institutions always represent and reflect hegemonic power within an international regime. In prominent literature, a suggestion is made that, to an extent, hegemonic power is demonstrated through the control of international institutions. For example, according to Kindleberger (2013), US hegemony was formalised through the establishment of institutions. Keohane (2005) argues, in the context of declining hegemonic power, that institutions are the mechanisms for maintaining a hegemonic regime and for continuing to fulfil the interests of the hegemon. International institutions can consolidate hegemonic regime even when the relevant power is in decline. Existing literature has also analysed hegemonic power through formal and informal mechanisms, stating that a new balance of power and new institutions may emerge at the point of hegemonic shift (Stone, 2011). In light of these rationales, this chapter explores China’s engagement with international institutions, focusing on formal and informal aspects of power, and on these particular existing and new arenas below.

5.2. China and the Existing Order: The IMF

As a centrepiece of the Bretton Woods monetary system and the symbol of US hegemonic establishment, the IMF is a long-standing financial institution tasked with maintaining global financial stability. This section examines China’s formal and informal engagement with this
foundation of the Bretton Woods order. After presenting a brief overview of the history of China’s engagement with the IMF, dynamics surrounding governing bloc with aligned interests, quota allocation, and staff activity are reviewed. Overall, it is suggested that China’s power within the IMF, although improved, has grown incrementally compared to the US dominant formal and informal control over the IMF. Therefore, China’s economic power has not yet formed enough influence in this case.

Alongside the internal development of the financial market, China seeks more intense external activity to further boost its economic and political capacity. Since re-joining the IMF in 1980, China’s status has been promoted dramatically due to its rapidly growing economy. As institutions are believed to reflect interests of great powers, China’s engagement with the international financial institutions – the IMF in this case – can be interpreted as the external aspect of China’s growing financial power.

China’s changing role within the IMF consists of two themes. First, as China has become the second-largest world economy, joining the G20 elites, it has developed a deep interest in seeing the IMF effectively support a stable global economy (Bryant, 2008:14). Second, China has become a significant representative of the EMD, considering promoting the wellbeing of the poor as an important endeavour. It is this unusual and unique position that is driving China’s activity within these institutions.

Since the 2000s, China’s position gradually shifted from sole borrower to lender, and accordingly, its financial interests aligned more with the US and other developed countries. In the area of transnational investment and global financial stability, there is some alignment between the preferences of China and those of other leading OECD countries (Wang, 2005; Christensen, 2015), because, just like every other country in this world, China has no immunity against worldwide financial crises. When a crisis starts elsewhere, it quickly undermines the wellbeing of massive amounts of Chinese labour, through the import and export link, for example (Chan, 2010). In other cases, crises spread through the business cycle where Chinese foreign direct investments and financial products can also lose great profits (Fidrmuc and Korhonen, 2010).

Therefore, according to the more general picture, regarding the role of global financial institutions that take care of global financial stability and monetary issues, there is no conflict
or power wrestling between China and the West. Becoming a major IMF lender means that China has much more responsibility around global stability when compared to previously when it was a sole borrower, and it would be more likely to make a cautious decision if the risks were assessed as too big. While embracing the Western-oriented global institutions to cope with financial vulnerability, China intends to reform the IMF in the long term – a clear change in its compared to its initial attitude of mimicking the Western system (Ferdinand and Wang, 2013). It will begin to demand a bigger share of the decision-making power and a relatively more equal position alongside the developed countries in the governing body.

In the IMF, a member’s status and voting power are determined by the quota or capital stocks to which it subscribes. Since quotas are calculated based on economic performance, including GDP, openness, variability, and reserves, they are regularly reviewed and adjusted. Moreover, the Executive Board of IMF had been under criticism for a long time for its lack of representativeness and calls for quota reform have been made by both academics and politicians (Stiglitz, 2003; Woods, 2000). Especially since quota reform in 2010, China’s actual quota and quota shares have both seen a significant increase, whereas the other five major members have all received decreased quota shares (see Table 5.1).

Table 5.1 IMF Historic Quotas and Quota shares of Major Member States

<table>
<thead>
<tr>
<th></th>
<th>2006-2008</th>
<th>2012</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quota</td>
<td>Share (%)</td>
<td>Quota</td>
<td>Share (%)</td>
</tr>
<tr>
<td>China</td>
<td>8,090</td>
<td>3.994</td>
<td>30,483</td>
</tr>
<tr>
<td>US</td>
<td>37,149</td>
<td>17.660</td>
<td>82,994</td>
</tr>
<tr>
<td>Japan</td>
<td>13,313</td>
<td>6.552</td>
<td>30,821</td>
</tr>
<tr>
<td>Germany</td>
<td>13,008</td>
<td>6.107</td>
<td>26,634</td>
</tr>
<tr>
<td>France</td>
<td>10,739</td>
<td>4.502</td>
<td>20,155</td>
</tr>
<tr>
<td>UK</td>
<td>10,739</td>
<td>4.502</td>
<td>20,155</td>
</tr>
</tbody>
</table>


Currently, in the structure of IMF, the quota for China is 30.4829 billion SDRs, the equivalent of $43.014 billion, 6.41% of the total. This quota entitles China to a 6.09% voting power among all members, making it the third most powerful state within the IMF’s formal governing structure. It is also slowly closing the gap between China and the top two, the US and Japan.
However, the 2010 quota reform was not as deep-rooted as many have suggested. The BRIC countries together received an increase of 3.46% voting shares with China being the winner; however, the OECD bloc saw a very slight decrease, with the rest of the world, mainly small states with poor economic performance, dropping by about 3% in voting power. As no change occurred to US voting power, it remains the most powerful governor of the IMF and can potentially veto the IMF’s major decisions which require a majority of 85%. In comparison, together, the BRIC countries currently possess 13.71% voting power. As such, the extend of China’s formal power within the IMF should not be over-stated.

Indeed, it has been suggested that the gains in formal power made by China run far below the level warranted by the country’s economic growth and increased importance to the global economy over recent decades. Among the other BRIC and developing countries, China is considered the most underrepresented member of the IMF – although having 18.59% of the world’s economy in terms of PPP, voting power of 6.16% ought to bring about continuous adjustments in the foreseeable future (Weisbrot and Johnston, 2016). The voting power of BRIC countries, even after reforms have taken place, still does not match their share of world GDPs (Nelson and Weiss, 2015). With China’s GDP growing at a much faster pace and the country becoming more active internationally due to marketization reform and opening-up, it is very likely that China’s quota share among top IMF members will continue to increase; correspondingly, its voting power will gradually grow as well.

Beyond this measure of formal influence, a series of dynamics surrounding informal influence can be explored to shed further light on the relationship between China and this important existing foundation of global financial governance. Meanwhile, Chinese representatives of the IMF are also endeavouring to promote its status. In terms of the geographic location of the IMF headquarters, networking, easy access to informational resources, and hence the activities and activeness of staff, the US has the unparalleled advantage. It is key for many scholars like Stone to illustrate US power using the informal structure of international organisations. Because the US enjoys this deeply rooted institutional advantage, China, here referring to Chinese staff and management within institutions, have few options for acquiring further power. In principle, these options come down to getting their voices heard more frequently and more clearly.
On the management level, the Chinese ED and governor have been challenging the formal power of the previous leading states through the informal channel by advocating reforms and making alliances with other EMDs. In 2007, during the 15th IMFC meeting, the Chinese deputy governor made a statement suggesting quota and voice reform as a mid-term strategy for the IMF, specifically stressing the role of EMDs (IMF, 2007); shortly afterwards, at the IMF and World Bank 2010 annual meeting of governors, the Chinese IMF governor also made a statement reemphasising and calling for quota reform (IMF, 2010). At the 28th IMFC meeting, the Chinese deputy governor affirmed the result of reform and pointed out that EMDs could potentially challenge the legitimacy of the IMF if the institution did not adapt to the current global structure (IMF, 2013).

Instead of making direct proposals and calling for the vote, the strategy of ‘raising others’ awareness’ through speeches and statements appears to be working for China in the long-term. The effort made by Chinese governors to push forward formal reform turned the disadvantage of China’s lack of informal power into an advantage with its increasing formal power.

Some existing literature defines one form of power as a country going for an alternative arrangement and bypassing institutions’ formal rules, such as the US negotiating within the G7, which was powerful enough to force a decision (Stone, 2013). The G20 has now replaced G7 as a mechanism for club-based control over the IMF, and emerging economies, the ‘neo-developmental states’, are finally getting their voices heard more frequently (Stone, 2011; Gallagher, 2015). The legitimacy and stewardship of international institutions would be insufficient if China was not included in the major leader camp, this is simply because the increasing interdependency of the global economy and China’s growing strength enable China to, ‘through monetary policy, trade’, while, ‘… to a growing extent, its foreign and security policy wreck the international system’ (Penttilä, 2009:4).

China as a member of the new leadership group offers an effective counterbalance to US dominance. The expansion of leadership from G7 to G20 makes it harder for the US to negotiate, especially when the latter intend to exercise informal power by making arrangements and bypassing the formal voting system. China’s opinion should be taken into serious consideration, even if the US wishes to reach an agreement through negotiation with other leading states. In other words, China is gaining relatively more power within the IMF governing due to its economic performance, especially following the 2008 crisis.
Furthermore, while joining the elite camp, China still poses itself as being strongly allied with other under-developed countries and EMDs. Nowadays, China’s informal power can materialise through bilateral arrangements, often with developing countries, that bypass institutional rules or decisions – in other words, that invalidate the role of the IMF. For instance, many African countries are willing to provide access to resources in exchange for loans and investment from China. The most significant case of this kind in practice is China’s $2 billion loan to Angola via channels outside the IMF (Alden, 2005). This is because, on the one hand, IMF loans often come with conditions, sometimes rather harsh ones (Goldstein et al., 2003), while, on the other, China has the resources and ability to provide funding to counterbalance Western dominance (Humphrey and Messner, 2006).

More of this kind of examples can be found in China’s engagement with developing countries outside the IMF and other US-led institutions. Bilaterally, China invests actively in Africa and South America for infrastructural development projects provide much more options than conventional institutions do (Zweig and Bi, 2005; Ray and Gallagher, 2015). Furthermore, China-led institutions – the AIIB and the NDB – are also taking up an increasing portion of funds and loans provided to developing countries (Sekine, 2015; NDB, 2016). These two strands of engagements are further explored in the later section of this chapter (Section 5.5 for China-led institutions) and Chapter 7 (for bilateral cooperations). Despite China’s incremental power within the IMF, its power via new institutions and bilateral cooperations demonstrates its rising influence in the global financial regime and continues to marginalise conventional Western institutions.

To sum up, there is clear evidence that China has been actively engaged with the IMF. China’s quota contribution and voting power have significantly increased to 6.41%, almost double that of previous decades, while Chinese staff have been calling for fairer decision-making mechanisms. It can be interpreted that as its economic strength increases, China has shown a greater interest in improving its position within the IMF’s governance body. In some individual cases of giving out funds and loans, it was able to counterbalance the IMF due to its own financial resources. However, there is no suggestion that China would proactively seek to overtake the IMF regime as it is a beneficiary of the existing structure, including financially; also, it is not capable of doing so as the US retains the power of veto over any significant structural change.
In short, China’s power within the IMF is growing incrementally but remains relatively marginal. While significant improvements have been achieved when compared to China’s position in previous decades, overall, China’s power to influence the IMF is still relatively low compared to the power of the US.

5.3. China and the Existing Order: World Bank

In the other leading global financial institution, the World Bank, China has also gained significant power growth in several aspects. This section proceeds by exploring China’s formal voting power within the Bank, the implications of its coexisting status as major borrower and lender status, and its cooperative support for particular projects within the World Bank. Overall, the suggestion is that although having achieved incremental power gain within the organisation, China’s power and influence over the World Bank remains limited due to its domestic poverty issues, including regional imbalance and overpopulation. China’s economic power in relation to its engagement with the World Bank is limited and insufficient to become hegemonic ready.

Following the ‘Voice Reforms’ of the World Bank, referring to the IBRD and IFC, that took place in 2010 (Vasta, 2010), China joined the ranks of the largest shareholders, with the IBRD and IFC opting for an increase in capital shares. Subsequently, China’s voting power within the IBRD climbed from 2.77% to today’s 4.53%, making it the third-largest decision-maker, ahead of Germany, France, and the UK (Wroughton, 2010). China is also among the top countries with both their own executive director and exclusive constituencies. The detailed share subscription and voting power of China within each of the organisations under the World Bank Group can be identified in Table 5.2.

<table>
<thead>
<tr>
<th></th>
<th>IBRD</th>
<th>IFC</th>
<th>IDA</th>
<th>MIGA</th>
<th>ADB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subscription</td>
<td>4.77</td>
<td>2.41</td>
<td>n/a</td>
<td>3.12</td>
<td>6.444</td>
</tr>
<tr>
<td>Voting power</td>
<td>4.53</td>
<td>2.30</td>
<td>2.19</td>
<td>2.64</td>
<td>5.454</td>
</tr>
</tbody>
</table>

According to the Article of Agreement, in most cases, voting within the World Bank requires a simple majority and sometimes a special majority of two-thirds, three-quarters or other. The extreme case of voting in both the IBRD and IFC, for example, amending an article of agreement, is when a super majority 85% vote is required. Based on the current voting power distribution within the IBRD and IFC, only the US, the largest shareholder possessing 16.28% and 20.99% voting shares in each organisation respectively, has the power of veto to block a major decision alone. Therefore, in the current structure of the World Bank, the US still retains the most power, whereas China’s formal power has increased but remains insufficient. Due to possessing the power of veto over the World Bank, the US can overturn decisions regarding significant organisational changes that would potentially shake its dominance, for example, a significant increase in China’s stock subscription and voting shares.

On the other hand, similar to the reaction to IMF quota reform, scholars have also commented intensively on the World Bank’s voice reforms. The focus of these debates is undoubtedly the sufficient representation of developing and transition countries (Clark, 2017; Strand and Retzl, 2016). In order to maintain the World Bank’s legitimacy, it would be necessary to consider the changing global order, the increasing weight of EMDs (Wade, 2011), and calls for further reform from within the institution (Lu, 2009); also, to reallocate members’ voting powers, allowing substantially more voices from the relatively lower tiers.

Surely the road to extensive voice reforms would lead to obstacles, such as from the US and those with vested interests; nonetheless, as many middle-income developing countries are emerging at a much faster pace than the advanced world, the general trend is heading towards a fairer ground for all. China, as the leading emerging economy with the biggest share of wealth and the largest population, is likely able to see an increasing voting power within the existing global financial institutions in the foreseeable future.

Moreover, it is also worth mentioning that since launching a series of organisational reforms and increasing contributions, China has its own executive director’s office to solely represent the country among a total of 24 EDs on the IMF Executive Board. This is the same as its position among the 25 EDs within the World Bank – making a significant improvement for China. In this case, having an individual EDs office can strengthen a country’s representation because the director is able to focus on the sole interest of the represented country. Especially when voting on decisions, the ED representing one country is less concerned and does not need
to divide votes into different proportions for the interest of different stakeholders (Momani, 2013).

Despite its promoted voting power, China’s demonstrated capacity to exert influence within the World Bank organisations remains modest. It is widely acknowledged that control over the World Bank’s budget represents an important source of state power over the World Bank (Clegg, 2010; Clegg, 2014; Simmons and Martin, 2002). It is through this mechanism that member states are able to support either broad-based reform to operational practice in the Bank, or to support the emergence of more specific new types of project and priority. China’s capacity to exercise such control can be seen to be relatively limited, given the constrained volume of finance supplied by China to the World Bank.

Based on data recorded by the World Bank, China’s position is both a borrower of the IBRD and a ‘lender’ in terms of capital subscription and contributions to IDA replenishment. China graduated from the IDA in the Fiscal Year 1999. As a lender, it makes regular contributions, for example, 427.94 million SDR for the most recent 18th IDA replenishment, as well as 199.05 and 107.02 million SDR for the previous two; but the number of its contributions are far behind many Western contributors, such as the US and the UK, who manage to contribute just shy of 3 billion SDR for each replenishment (World Bank, 2017).

As a borrower and classified as an upper-middle-income country, China remains as a major borrower of the World Bank, with cumulative borrowing of $50.5 billion for 343 projects from the IBRD at the end of November 2017. Figure 5.1 and 5.2 show that China has been receiving loans for multiple projects from the IBRD each year, and the amounts of each project vary between $100-400 million in recent years. There has been no significant decrease in the number of projects approved each year, meaning that China maintains an active borrower of the World Bank. By the end of 2017, China still has 98 on-going IBRD projects worth $10.07 billion and 111 on-going IFC projects (Global Reach, 2017). In comparison, according to World Bank records, other lending members, the US, Japan, France, Germany, and the UK, have been sole lenders since the 90s, following Japan’s full repayment of its IBRD loan in July 1990.
Although China has been dramatically promoting its comprehensive economic and political strength, a complex set of factors, such as population, regional imbalance, and productivity, is holding back its per capital income level; thus, ranking it as an upper-middle income country. China’s chief tasks and interests are different from those of the other leading states, regarding the World Bank’s purpose of tackling poverty. Due to its current status as a borrower, China may face the situation whereby lenders hold their human rights or other political issues hostage – for example, in 2000, when a project in Qinghai province was cancelled because of concerns over Tibet (Wade, 2009). In order to receive investment, China must meet the requirements attached to the World Bank loans for borrowers without having much say in determining those conditions, this is in addition to circumstances where other leading states are able to easily outvote China (Woods, 2000). In this case, China has rather limited control over World Bank decisions even though it has become the one of the top six members with an exclusive ED office.
Nonetheless, China does indirectly influence the World Bank through its foreign direct investment. Chinese banks were found to have provided loans of ‘at least $110 billion to developing countries between mid-2008 and mid-2010’ and the World Bank plans to intensify its cooperation with Chinese banks by venturing joint projects (Bretton Woods Project, 2011). With emerging multilateral development banks springing up over the world, the World Bank’s lending dropped sharply (Wang, 2017). Some even argue that large sum of capitals from China and China-led institutions have rendered the World Bank irrelevant (Clemens and Kremer, 2016). Although sometimes labelling itself as a developing country, China is asserting itself as the ‘wave of the future’ and representative of the emerging markets, asking for a fairer playing ground within the World Bank (Wade, 2011).

Previous studies also found that with China’s assistance, borrowing countries or investment recipients also face fewer conditions when acquiring World Bank funding. It is believed that ‘they receive 15% fewer conditions for every percentage-point increase in Chinese aid’ – with investment and funding from China to developing countries able to reduce the size and conditionality of a World Bank loan (Hernandez, 2017:544). This finding demonstrates that China has the ability to dilute or even ‘replace’ the World Bank’s operational reach.

In short, China’s power within the World Bank is also growing incrementally but remains relatively marginal. Although compared to China’s role in the World Bank decades ago it has been a great achievement, China’s power to influence the World Bank is low because of the unsolved poverty. China’s borrower position diminishes its state power and influence within the World Bank. Overall, China’s economic power through engagement with the World Bank is limited that cannot form global hegemonic influence.

5.4. China and the Emerging Order: CRA and CMIM

The previous sections suggested, broadly in line with expectations from the existing literature, that China’s influence on the World Bank and IMF remains limited. Below, attention is turned toward new institutions created by China that parallel the functions of the IMF. After introducing the CRA and CMIM, this section reviews China’s voting power and major activities within these aforementioned institutions, followed by a comparison with the IMF. Overall, the suggestion is that as the leading figure in the CRA and CMIM, China demonstrates
great capacity and willingness to become a regional leader. However, it is important to note that these new institutions are important complements to the existing Bretton Woods institutions, not replacements.

As a major rising power, it is possible that China may wish to circumvent its status as a subordinate member of existing institutions and regimes by seeking out alternative arrangements and arenas that allow for enhanced capacity to promote its interests. The Chiang Mai Initiative represents one potential manifestation of this dynamic.

For the purpose of maintaining financial stability, especially since the 1997 Asian Financial Crisis, a regional reserve scheme has been carried out among Southeast Asian countries, including China, Japan, and South Korea, namely the Chiang Mai Initiative (CMI). Initially built as a regional currency swapping mechanism, it later upgraded into the Chiang Mai Initiatives Multilateral (CMIM) in 2010 and was institutionalised by setting up reserve pools as well as implementing operational rules.

The CMIM’s function body includes a Resolution Facility and a Prevention Facility in addition to its governance body, which is, as indicated, responsible for supervision and resolution. In recent years, the ASEAN+3 Macroeconomic Research Office (AMRO), as an independent international organisation, was also established to provide policy guidance and supervision for the CMIM. The CMIM peacetime checklist and operational guideline have run tests ‘under various scenarios since 2013’ (CMIM, 2016a), preparing to respond actively and effectively to potential major financial crises.

The reserve pool of the CMIM currently totals $240 billion, approximately 1/3 of IMF quotas, amongst which the ‘plus 3’ countries (China, Japan, South Korea) contribute 80% of the total reserve. More specifically, China (including Hong Kong) and Japan, are the leading contributors, each taking up 32% of the total reserve contribution. The voting power of the members is determined by their financial contribution plus a basic vote. As a result, while others possessing a much less significant number of votes, China and Japan, each holds 28.41% of the total voting power, making them the most decisive figures within the organisation (CMIM, 2016b). However, due to the special autonomy given to the monetary authority of Hong Kong, the voting power of Mainland China is in fact 25.43% which may be a potential obstacle for China in acquiring further influence. Yet, this is a very minor setback, as most
significant decisions require 2/3 majority – meaning that not a single country has the power of veto, a great distinction when compared to the IMF.

In general, it can be concluded that the ‘plus 3’ countries obtain most power from the CMIM, with China and Japan obtaining most power among the ‘plus 3’ group. For example, the governance body includes two co-chairs to coordinate any activities triggered by swap requests, and these co-chairs consist of one of the 10 ASEAN countries and one from the ‘plus 3’.

Besides voting power and control over the chair, China’s influence over the CMIM contains many informal aspects. There are arguments that the CMI was initially dominated by Japan, with China advocating for the formalisation of rules and the transformation of CMIM. From that perspective, the CMIM is mainly the fruit of China’s endeavours. Scholars have also concluded that the power source of China comes from its regional trade volume, the amount of its foreign reserve having surpassed Japan since 2006, as well as the tremendous amount of US debt it holds (Tso and Yeh, 2013). Since Beijing has been totally ready to spend its large reserve on foreign diplomacy, regional cooperation with neighbouring countries, as in the CMIM, is a good place to start (Jiang, 2010; Kuik, 2005).

The CMIM, then, represents a quantitatively significant new addition to the regional monetary regime in East Asia, and a structure in which China enjoys considerable mechanisms of influence. However, it is important to note that the CMIM maintains significant operational links with the IMF. As such, the CMIM is fundamentally supportive of the IMF, albeit in a manner that may introduce a degree of inter-institutional competition. The IMF alone is increasingly unable to provide sufficient stabilising finance to countries in need, as shown in examples of Asian Financial Crisis, Greece, and Egypt, whereas joint funding is now the common practice (Boughton, 2004; Lütz and Kranke, 2014). CMIM represents a mechanism for potential concerted lending with the IMF across ASEAN countries (Khor, 2017).

There is a general trend whereby the CMIM is growing in strength and importance as it enlarges its reserve pool and increases ‘the drawable proportion out of the IMF approval to 30%’ (Tso and Yeh, 2013:114). In practice, this means that borrowers can draw up to 30 per cent of their swaps prior to agreeing to an IMF rescue programme, meaning that the 30% drawable fund is the de-link portion.
Scholars believe the establishment of the CMIM represents a step towards the institutionalisation of an Asian Monetary Fund that will provide the region with independence from the IMF. It is suggested that China’s participation in this arrangement is aligned with its interest of RMB internationalisation and a move away from US dollar dependency to RMB reliance (Grimes, 2011; Tso and Yeh 2013).

Overall, as to the future of the CMIM and China’s role, it is suggested that the stable economic growth of China and Japan are key foundations to Asian financial stability; however, the increasing financial and political instability in Europe, as well as America’s changing attitude towards globalisation under President Trump, are potential risks. No significant crisis has occurred under the CMIM framework. The CMIM has not yet been drawn upon since its founding. Therefore, the CMIM resolution mechanism and its reliability are yet to be tested in real practical situations; nevertheless, the experience of incidents happening worldwide have equipped the CMIM with valuable lessons for its daily operation and crisis prevention (AMRO, 2017).

Another strand of China’s external engagement with new structures of international monetary governance lies with the BRICS Contingent Reserve Account. Financial cooperation among the BRICS countries saw the establishment of the CRA, which fulfils a similar purpose to the IMF. It was designed to ease the short-term balance of payment pressure for BRICS members and maintain financial stability by providing emergence loans with members’ committed reserves.

The CRA is based on commitment rather than subscriptions of stocks, meaning that other member states are required to provide only when a fund is requested by a member in need. China has committed $41 billion according to Article 2 of CRA treaty, which is 41% of the initial total $100 billion committed resources, and just 1.3% of China’s total holdings of the foreign reserve (Brazil. Ministry of Foreign Affairs, 2014). Article 3e also indicates that the voting power of each member is calculated based on the proportion of their contribution plus

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5% shared equally among all members. Under this formula, China’s voting power within the CRA is 39.95\%15.

The CRA, as a relatively smaller and more flexible mechanism with just a handful of members, has a governance organisation consisting of one governing council and a standing committee. Both these governing bodies are expected to make decisions by consensus; except when the standing committee is dealing with a ‘request’ or with ‘renewal or request of support through the liquidity or precautionary instruments’ where a weighted vote by the providing members is required (Brazil. Ministry of Foreign Affairs, 2014: Art. 3cii & 3ciii).

As a very recent development, the CRA can provide limited information on its operation. There is no dedicated research institution linked to supervise it, neither can abundant academic research be found relating to this arrangement. It is not fully materialised as no reserve pool has formed like for the CMIM, instead, there has merely been a commitment. Because it is relatively small, flexible and informal, there is still huge uncertainty regarding the nature and the future of the CRA. Nevertheless, it can be inferred that the CRA can potentially become an organic component of the global financial system just as the CMIM, especially against the backdrop of the IMF’s insufficient functionality. Also, China’s significance and influence are substantial due to its economic size and reserve size in comparison to the other four members.

To sum up, as outlined Strange, one of the core characteristics of a financial power relates to the ability to manage monetary stability. In addition, Kindleberger has also emphasised hegemony to be the willingness and to provide stabilising finance during a time of crisis. While both the CMIM and BRIC Contingent Reserve Account remain untested during times of crisis, through their creation we see that China is willing and able to take the lead in institutionalising international financial stabilisation mechanisms. In both cases, China has played a prominent role in creating structures, is the largest supplier of capital, and wields preponderant control. As such, while their durability and effectiveness are yet to be proven, the CMIM and CRA can be seen to represent significant movements in the shift towards hegemonic status on the part of China. However, it will take a certain amount of time before China moves forward to global leadership from the role of a regional hegemon.

\[5\%/5+41\%\times(100-5) = 39.95\%\]
5.5. China and the Emerging Order: the NDB and the AIIB

In recent years, as regional equivalents of the World Bank, the emergence of the NDB and AIIB has caught the attention of both politicians and academics. This section will examine China’s engagement with these newly established infrastructural investment banks from the aspects of their organisational structures and operational activities. The analysis will focus on the NDB and then the AIIB. The overall insight is that China has proactively supported the establishment of these infrastructure investment institutions, with its substantial material resources playing an important role in furnishing the organisations. However, the NDB and AIIB do not cover some of the World Bank’s core function of tackling poverty, and therefore are unlikely to overtake the latter.

In the face of a double-standard and sometimes ineffective Bretton Woods institutions, the BRICS countries have been discussing launching ‘a $100 billion Contingent Reserve Pool or arrangements for strengthening global financial safety’ (Singh, 2013:394). The result of such discussion was the NDB, officially founded in 2015 by the five BRICS, a year after the Agreement on the New Development Bank was signed in July 2014 (NDB, 2014). According to the Agreement, the general agenda of the NDB is to provide capital to its member states for sustainable developmental projects, such as fundamental infrastructure and clean energy supply.

The establishment of the NDB included a total of US$100 billion authorised capital, of which US$50 billion accounted for subscribed capital, equally distributed among the founding members. The voting power of each NDB member is calculated based on the shares held by the member, with one share worth US$100,000 at par. At the moment, membership of the NDB remains limited to the five founding members. As one of these, China subscribed capital of US$10 billion, holding 100,000 shares as 20% of the total voting power, the same as the other BRICS members. Meanwhile, the NDB has another US$50 billion in unsubscribed capital. This means that potentially, if any eligible state is willing to join the organisation or if any existing member extends its subscription, it will lead to changes in the distribution of voting power within the limits of the institution’s regulations.
Although NDB membership is open to any country recognised by the UN and no specific amount of capital stock subscription is presented, the Agreement has laid down certain conditions for when a subscription becomes invalid – if 1) founding members hold less than 55% of voting shares; 2) non-borrowing members hold more than 20%; and 3) a non-founding member holds more than 7% (NDB, 2014: Art. 8c).

Therefore, over the time, as new members join the NDB, China along with other BRICS founding members would possess a minimum of 11% of the total voting power each and still maintain their leading position; or as an opposite extreme scenario, China could possess 56% of the total voting shares if it subscribed to all the unallocated capital stock, although this is unlikely. Under any circumstance, China can certainly maintain a dominant position in the NDB, either alone or together with its BRICS allies, as the controlling bloc of the bank; currently, as a founding member, it enjoys a 20% share of the voting power, which is equal to the other four members.

The organisation of the NDB includes the Board of Governors, the Board of Directors, and Management. Besides the Board of Governor possessing the ultimate powers in decision making, according to the Articles of Agreement, the Board of Directors is in charge of most of the decision-making. Directors solely consist of personnel from the founding member countries, as each of the five BRICS countries appoints one director and one alternate, except otherwise elected by the Board of Governors, in terms of additional directors. Judging from the current arrangement of the NDB, with founding members each subscribing to an absolute equal share of capital, and based on the Bank’s rotation approach to arranging other management staff, it can be assumed that each director is currently entitled to an equal share of 1/5 in a voting circumstance.

Furthermore, the management consists of a president and four vice-presidents who are responsible for managing the daily functioning and operation of the NDB. They should come from the five founding members on a rotation basis and are appointed by the Board of Governors to certain task areas. Currently, the Chinese representative, Xian Zhu, has the role of vice president and COO of the NDB, while vice presents from other member states hold the roles of CRO, CAO, and CFO. The roles of the presidency are also on rotation as stated in the NDB agreement in order to show absolute equality and mutual respect.
Among the BRICS countries, China has the biggest economy in terms of size, especially since the 2010s, when China’s GDP exceeded that of the other four countries put together. This was partially due to its domestic financial reformation as mentioned in the previous chapter. Resource and capital are allocated more freely and accordingly to the market demand, and the introduction of various kinds of financial assets has diversified China’s financial market. This may lead to further capacity and ability for China’s financial structure and consequently enhance its external influence, especially among its BRICS cohort.

The NDB has been officially operating for more than a year. The 2016 annual report presents the current organisation and personnel, current achievement, and major decisions made by the NDB. In this report, the frequency of words is shown as follows:

Table 5.3 Word frequency of the NDB 2016 annual report

<table>
<thead>
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<th>times</th>
<th>word</th>
<th>times</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>46</td>
<td>Russia(n)</td>
<td>19</td>
</tr>
<tr>
<td>Chinese</td>
<td>7</td>
<td>Africa(n)</td>
<td>9</td>
</tr>
<tr>
<td>India(n)</td>
<td>29</td>
<td>Brazil(ian)</td>
<td>7</td>
</tr>
<tr>
<td>RMB</td>
<td>13</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: (NDB, 2016)

Words directly addressing China appear the most, much more so than for other member states. China’s involvement, as presented in the annual report, includes perspective of geographic location (in terms of headquarter), involvement of relevant persons, borrowing and lending activities, and projects. For example, the NDB bond was issued only to China’s inter-bank market and two out of the five approved projects are in China. China’s credit rating agents participating in the NDB operation is also included in the report, which leads to a much more frequent appearance of China. It can be assumed from these numbers that China’s engagement with the NDB is much more intensive than for other members.

Furthermore, while the Chinese currency is specially mentioned in the report, the remaining currencies were not as privileged. The report states key parameters for loans, specifying a few types of loans provided. Among the six different loan types, there is one called ‘Sovereign Project Loan in RMB’ whilst all the others are in USD. Correspondingly, by the end of 2016, the NDB had received $2.2 billion of paid-in capital and approved 7 projects worthy of $1.561
billion; among the 7 approved projects, two of the loans were made to China in its local currency, the RMB (NDB, 2016).

In short, this is the first case where an international institution, has used something besides the US dollar as a major operational currency. Moreover, this is an exceptional case that only applied to NDB loans to China, as no exception in terms of loan currency has been made to other BRICS members.

Further to these lending activities, the NDB has also been borrowing from China’s commercial banks on top of the capital stocks collected from member states. The first NDB green bond was issued in China’s onshore market denomination of RMB as part of its financing instrument and was considered very ‘successful’ according to the recent NDB five-year strategy (NDB, 2017:7). The green bond had a size of 3 billion Yuan, the equivalent of $449 million. Two Chinese credit rating agencies were also granted the chance to assess the NDB and both gave an AAA rating to the institution upon issuance of this first green bond. This can be interpreted as a sustainable infrastructural project in China allowing for the acquisition of funding in local currency through the NDB with a sovereign guarantee, while the funds eventually coming from a Chinese commercial bank.

The use of local currency and the process where funds go through different hands greatly reduce various aspects of risk, for example, exchange rate and timeframe. Although there are press releases on plans to issue similar bonds in other member states, none have yet materialised (Galbraith and Holmes, 2017). The NDB currently still operates mainly based on the US dollar, aside from the RMB business.

In short, current numbers indicate that a large proportion of NDB activities and operations take place in China, based on Chinese resources and communication channels. Because China has the capacity, resources and information, it shows a much more intense sort of engagement with the NDB than the rest of its BRICS cohort.

In comparison, some arguments on the US control of institutions suggest that its effective control is due to the great number of members, insufficient representation of small states, and coalition among big states due to aligned interests, that the US is allowed to bypass formal rules (Stone, 2011). While the World Bank has 189 members, the NDB contains merely five,
with highly consistent mutual interests; it has also been operating for less than two years. The decision-making mechanism of the NDB is much more flexible compared to the World Bank, and each member can be sufficiently represented.

The director meetings take a relatively simple form, and although a formal vote can be requested by directors and should be recorded, there is no record of any vote taking place in the minutes of the quarterly Board of Director meetings (NDB, nd). Most likely, decisions by the board are made through consensus.

The new approach stated in the NDB strategy indicates that the NDB choose to adopt ‘a more streamlined project review and implementation oversight without unnecessary bureaucracy’ and that approval of projects is based on risk assessment (NDB, 2017:4). This means delegating investment decisions to the credit and investment committee, which comprises of the president and all vice presidents, each representing a member state while having the directors and governors focus on high-level policymaking. As presidency is set to be on rotation and all members are represented in the credit and investment committee, therefore, having one member trying to imperceptibly dominate or manipulate the NDB against the will of other members is an unlikely achievement. Nonetheless, through the aspects of market capacity, resources and locations, and information, it can be confirmed that China possesses a rather high level of informal influence on the NDB.

Another China-led institution with developmental and infrastructural purpose is the AIIB, and here, China has drawn the attention of a wider range of participants. The AIIB is also of developmental purpose as it aims to invest in infrastructural projects in developing countries, mainly Asia. At the moment, there are 38 regional members from Asia and Oceania, and Eastern European, and 20 non-regional members. With new members signing up over time, the AIIB is constantly expanding in terms of scale and there are consequent changes to the composition and distribution of power.

As laid out in the AIIB’s Articles of Agreement, the voting power of each member state is determined by a combination of basic votes which make up 12% of the total votes equally distributed among all members, share votes, and 600 founding member votes (AIIB, 2015: Art. 28); the initial authorised capital stock of US$100 billion is divided into one million shares at a par value of 100,000 each share (AIIB, 2015: Art. 4).
By the end of 2017, statistics show that China’s subscription of capital is US$29,780.4 million, 31.0215% of the total subscription; with the power of 300,518 votes, it thus accounts for 26.6491% of the total (AIIB, 2018). Compared to late 2016, this represents about a 2% decrease in both China’s subscribed capital shares and voting shares (AIIB, 2016). With approximately US$4 billion of capital still awaiting subscription, assuming all prospective founding members will have ratified the AIIB Agreement and China maintains the size of its current subscription, then ultimately China’s voting power should be approximately 25.58%. Nonetheless, with the second-largest voter occupying less than 8% of voting shares individually at the moment, and all current members facing a decrease in voting powers when new members join, China will maintain its dominant position in the AIIB voting system.

Furthermore, as its agreement has stated, any major decision, such as the distribution of income and the issuance of capital shares or new membership, should be approved with an ‘affirmative vote of two-thirds of the total number of Governors, representing not less than three-fourths of the total voting power of the members’ (AIIB, 2015: Art. 28). This means that as China currently holds 26.6491% of the total voting power and potentially a minimum of 25.58%, it has, in theory, the power of veto to disallow any major decisions from the AIIB; that said, China has declared that it would never use this veto power.

Besides the voting system which may shape the decisions made by the Board of Governors who represent the supreme power within the institution, the AIIB formal governance also contains a Board of Directors and a presidency. Directors are elected by governors and can cast votes based on the voting share of the governors who elected them. The current structure of the Board of Directors and the approximate voting share by each director are shown in Table 5.4, with the Chinese director shown to possess the largest share of the voting power overall, and other delegates holding shares ranging from 5% to 14%.

<table>
<thead>
<tr>
<th>Director No.</th>
<th>Constituency</th>
<th>Voting power</th>
<th>Total</th>
<th>Director</th>
<th>Constituency</th>
<th>Voting power</th>
<th>Total</th>
</tr>
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<td>5.6585</td>
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<td>Denmark</td>
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<td>Hungary</td>
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<td>Iceland</td>
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</tr>
<tr>
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<td>Country</td>
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<td>Share 2</td>
<td></td>
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<td>2 Azerbaijan</td>
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<td>5.3037</td>
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<td>4.6025</td>
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<tr>
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<td></td>
<td>0.9144</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Israel</td>
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<td>0.9554</td>
<td>5.4226</td>
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<td>0.8644</td>
<td>1.1206</td>
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<tr>
<td>Australia</td>
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<td>5.7122</td>
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<td></td>
<td>0.6915</td>
<td></td>
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<tr>
<td>Singapore</td>
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<td>0.4979</td>
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<tr>
<td>Vietnam</td>
<td>25</td>
<td></td>
<td>0.8761</td>
<td></td>
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</tr>
</tbody>
</table>

Source: (AIIB, 2017)

The structure of the AIIB is apparently similar to the World Bank except on a smaller scale. There is, however, a fundamental organisational difference between the two. As presented previously in section 3, among the six biggest shareholders of the World Bank, five are advanced countries that have not requested any investment for decades. Some scholars have argued that the weakened accountability of the World Bank and IMF is exactly due to such
organisations, where the rich and powerful determine the future of the weak and poor (Foot, MacFarlane, and Mastanduno, 2003; Stone, 2004).

Within the structure of the AIIB, non-borrowing members occupy less than a quarter of the total share. China is the biggest investor and, at the same time, also a borrowing country. This is the opposite of a picture of the World Bank. In other words, for developing countries, the nature of the AIIB is more one of self-help than an institution under hegemonic control; whereas, for non-borrowing members, the major attraction is the huge market of Asian developing countries in need of infrastructural development and pragmatic profit-making opportunities (Chen and Dai, 2015; Sekine, 2015).

Nonetheless, even though China has promised not to use its veto power or to manipulate the institution in any form (He, 2016), with such a short operating history it is impossible to arbitrate in what future direction the AIIB is headed. For this particular aspect, it is fair to argue that in comparison to the World Bank, the AIIB’s leader is much more benevolent; however, a more convincing conclusion will require close observation over time.

Some have speculated that the AIIB poses a great threat to the US-led World Bank as many European countries have willingly participated in this China-led institution (e.g. Heilmann et al., 2014; Wihtol, 2015; Chung et al., 2016). Despite some overlapping responsibilities and functions, there are some fundamental distinctions in the nature of both the AIIB and the World Bank.

Regarding the organisation of both institutions, the AIIB has clearly not set up a department for research and technical support, while, a large part of the work done by the World Bank includes providing technical suggestions and conditions to the fund receivers. The AIIB focuses heavily on investment risk and return rather than the ethical issue of tackling poverty in the long term.

It can also be confirmed that the World Bank is cooperating with the AIIB because so many joint investments are carried out. Among 24 approved AIIB projects, those displayed in Table 5.5. are co-financed with the World Bank. Many other AIIB projects are co-financed with the Asian Development Bank and other regional institutions. Indeed, it is rare for large AIIB projects to be financed solely by this entity.
Table 5.5 List of AIIB-WB joint projects (November 2017)

<table>
<thead>
<tr>
<th>Project</th>
<th>AIIB ($ million)</th>
<th>WB ($ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Philippines: Metro Manila Flood Management Project</td>
<td>207</td>
<td>207</td>
</tr>
<tr>
<td>Egypt Round II Solar PV Feed-in Tariffs Program</td>
<td>Amount unspecified</td>
<td></td>
</tr>
<tr>
<td>Tajikistan: Nurek Hydropower Rehabilitation Project</td>
<td>60</td>
<td>225.7</td>
</tr>
<tr>
<td>India: Andhra Pradesh 24x7 – Power for All</td>
<td>160</td>
<td>240</td>
</tr>
<tr>
<td>Indonesia: Dam Operational Improvement and Safety Project</td>
<td>125</td>
<td>125</td>
</tr>
<tr>
<td>Indonesia: Regional Infrastructure Development Fund Project</td>
<td>100</td>
<td>103</td>
</tr>
<tr>
<td>Azerbaijan: Trans Anatolian Natural Gas Pipeline Project</td>
<td>600</td>
<td>800</td>
</tr>
<tr>
<td>Pakistan: Tarbela 5 Hydropower Extension Project</td>
<td>300</td>
<td>390</td>
</tr>
<tr>
<td>Indonesia: National Slum Upgrading Project</td>
<td>216.5</td>
<td>216.5</td>
</tr>
</tbody>
</table>

Source: (AIIB, nd)

The financing details of the joint projects above also show that in many of these projects, the AIIB is playing a supporting role instead of taking the lead. If we compare the financial position of the two, the World Bank is more resourceful due to its larger membership and high level of participation from highly advanced countries like the US and Japan. Currently, the establishment of the AIIB shows little threat to the World Bank regarding its purpose, financial strength, and sphere of influence.

To sum up, within the structure of the AIIB and the NDB, China is the leading state holding the biggest number of stocks and voting powers. With China proactively taking the lead to establish these institutions, it presents an adequate amount of economic strength and a willingness to play the role of a regional hegemon, according to Kindleberger’s justification of hegemony. China’s non-coercive approach in organising and managing these institutions generates mutual benefits and attraction, drawing subordinate countries along and demonstrating hegemonic power under the liberal rationale. On the other hand, these newly established institutions do not pose a significant challenge to the existing order. This is mainly due to the fact that the new institutions are merely regional, only partially overlap with the World Bank’s function, and have a smaller fund size than the World Bank – the two see more cooperation than competition.
5.6. Chapter Summary

This chapter examines the pattern of China’s participation in international financial institutions, in terms of the external aspect of China’s financial structure, to understand to what extent China has demonstrated economic power within the international financial systems.

The existing literature has extensively discussed the relation between hegemonic power and international institutions. By illustrating this with the case of US hegemony, Kindleberger (2013) and Keohane (2005) both demonstrate the importance of institution to hegemons. While the establishment of an institution signifies hegemonic power, institutions are also an instrument for maintaining and stabilising an existing hegemonic regime, even in the context of hegemonic decline. Recent empirical studies show the formal and informal channels by which hegemonic power can exert power within institutions, arguing that the US remains the dominant power behind the apparent hegemonic decline (Stone, 2011). It is agreed that institutions heavily reflect the interests of the leading state.

Meanwhile, emerging economies, as their powers grow, often seek a new equilibrium or alternative if they are no longer satisfied with their share of power and interest. Therefore, this chapter aims to explore through two case strands – one, China’s pursuit of power in existing US-led institutions, and, two, China’s effort to participate in major US-excluded institutions.

In recent years, China has been more actively engaging with long-standing Bretton Woods institutions, namely the IMF and the World Bank, and seeking more of a voice and institutional reform so that these institutions can better meet China’s pragmatic interest (Ferdinand and Wang, 2013). Both these institutions have gone through a series of reforms to adjust members’ financial contribution and voting power distribution, with China being granted a much bigger proportion of quotas and voting shares.

However, China has remained a relatively passive member of the IMF; while the country has a clear interest in the maintenance of global and regional financial and economic stability, there is little evidence of attempts to use its influence to pursue specific goals through the institution. In relation to the World Bank, China has in recent years gained voting power and increased its contributions to the Bank’s budget. However, again, the overall characterisation is of a rising
power accommodating to an existing institutional structure. Overall, China’s influence has stayed relatively insignificant in comparison to the US’s existing dominance in these institutions.

The CMIM and AIIB both represent institutional structures in whose development and evolution China has played a central role. These developments suggest that China is moving towards taking up a hegemonic role, by virtue of its willingness and ability to contribute to making an injection of finance into the international economy, both for development and stabilisation-related purposes. However, given the established links between the CMIM and the IMF and the AIIB and the World Bank, it seems like this rising role is taking place in a relationship that is accommodative of existing structures. Therefore, in structures both existing and new, the rise of China appears to be taking place in alignment with, rather than in tension against, the existing global order.

Overall, while internal development of financial system fundamentally promoted China’s economic power, China’s engagement with international financial institutions demonstrates the external implication of this rising power. With the enhanced economic power, China is able to become a much more active player in the existing Bretton Woods institutions and a dominant role in newly founded regional institutions. Meanwhile, because of the incremental change of China’s influence and participation in existing institutions, China’s financial power remains limited within a global scope.
6. Internal Development of the Production: Market Reform and Sectoral Development

Along with its financial reformation, China has seen a qualitative leap in production since the late 1980s. As touched upon in Chapter 4, the enhanced freedom of capital and organisation of banking and investment provided foundations for these transformations. Through this chapter, attention is turned to the sources of strength and weakness relating to industrial structure reform, productivity, and increased reliance on external inputs and external markets to assess the extent to which these transformations constitute a source of economic power.

This chapter first provides an analytical framework for studying the issue of production in relation to hegemonic rise. Drawing on existing studies, this chapter defines the concept of production and outline major indicators for evaluating the strength of a country’s production structure. By looking through existing literature and empirical case studies on previous hegemonic powers, three aspects can be pinpointed as the focus of this chapter. These, namely, are production volume, productivity, and external dependence. Following this framework, the rest of the chapter proceeds to an analysis of each of these three aspects.

Overall, the suggestion is that although China is experiencing unprecedented economic growth in relation to its production volume, its production structure continues to be weakened by low productivity and heavy external reliance. This indicates that China’s rise toward hegemonic status suffers from significant constraint in relation to the production structure of economic power.

6.1. Operationalising the Study of the Production Pillar: Internal Development

When proposing the theory of structural power, Strange defines a production structure as ‘the sum of all the arrangements determining what is produced, by whom and for whom, by what method and on what terms’ (Strange, 2015b:70). In other shorter terms, production is about generating wealth and adding value. From an intuitive perspective of Strange’s production
structure, a fine production structure performance usually indicates a good level of overall strength.

Strange’s definition, however, remains very broad. The question of what the direct indicators of productive power actually are in relation to a hegemonic transition remains ambiguous. Before carrying out an analysis on China’s production structure, it is therefore vital to identify what indicators and factors should be assessed in order to evaluate the extent of hegemonic transition. Existing literature have attributed China’s production boom to factors such as the opening-up of the market, SOE reform, and the emergence of private and township collective businesses. However, unfortunately, potential indicators for measuring the strength of the production structure remain under-specified. By reviewing the existing literature, this section identifies three elements to indicate production structure – production volume, productivity, and external dependence. The paragraphs below outline the sources from which these focuses of analysis have been drawn.

Existing literature on empirical hegemony study has indicated that production volume is the major consideration when evaluating a country’s production structure. An interesting historical case to illustrate the significance of production volume involves the comparison between China and most Western countries. The different production structures of the East and the West, as reflected in industrial relations, social and economic dimensions, business activities, and so on, have consequently led to a distinction of economic and political power between those countries since the 16th century (Strange, 2015b).

Previous hegemony studies note that taking Britain as an example, between 1651 and 1815, Britain triumphed in ten major wars against the Netherlands and France, eventually dominating Europe and other parts of the world. One of the reasons for Britain becoming a hegemon was that by the end of the 18th century, Britain had already occupied a significant share of the world’s manufactured output and was exceptionally well endowed in agricultural term (O’Brien and Pigman, 1992). Later, Asia’s pursuit of capitalism and a market economy, as well as US hegemony can also be identified as vivid illustrations of the positive correlation between production structure and power.

When analysing what was termed ‘the myth’ of US hegemonic decline, Strange chooses the method of examining ‘the proportion of total world production of goods and services produced:
a) in the United States, and b) by enterprises ultimately headquartered in the United States and responsible to the government in Washington’ (Strange, 1987:566-567). By breaking down the statistics, Strange notes that the changes in market share of different US sectors, including the manufacture of both basic and high-tech products, the services sector, oil business, and so on, indicate that the US production structure is still dominant.

The reasons behind this growth in productive capacity were, for Strange, the large mass internal market of the US, laws and policies encouraging exploitation of the market and control over foreign subsidiaries. By emphasising the importance of the production structure to analysing power, Strange also points out that an increasing number of firms, including small to medium-sized companies, no matter if private or publicly-owned, are participating in the global market. Particularly regarding this context of internationalisation, a country’s production structure can be affected by transnational corporations (TNC). This includes figures reporting on TNC’s contribution to domestic wealth generation and the evaluation of how effective a state’s policy-making is in terms of regulating TNC (Strange, 2015b).

To sum up, in order to assess hegemonic power from the perspective of production volume, it is to consider the volume of output and market share, among all countries in the world, from a quantitative standpoint. Therefore, the first section will explore the reform of China’s production structure and the consequent production volumes of each sector, including the total amount of production and its relative share around the world. This section focuses on the growth of China throughout time as well as looking at the comparison and gaps between China and the US.

Besides production volume, an additional indicator that is turned to in existing literature relates to productivity. While there are significant challenges in precisely measuring productivity, broadly this refers to how efficiently factor inputs are translated into outputs. After all, along with the discovery of new lands and the forming of modern international society, countries come in all sizes with distinct levels of population and development. Merely judging a country by its total volume of goods and services being produced would be an incomplete measure of power. Therefore, the second factor inferred through reading existing literature is productivity.

Most of the existing literature briefly touches on the relationship between productivity and hegemony. Implicitly, productivity is lodged as an important explanatory factor in hegemonic
transition. Analysis comparing the British and US hegemonies hints a forthcoming transition as Lake (2002) found that by the end of the 19th century, the United States had reached a relatively higher level of labour productivity than Britain, as well as expressing some other production indicators. This higher level of productivity was, therefore, paving the way for the later transition of the US, when it overtook Britain to become the world hegemon.

Similarly, Maier, by studying the policy and political agenda of the US, notes that straightforward and clear stress on economic productivity in the US has actually existed across time, and up to the modern-day. For the US, ‘productivity’ was raised to the level of ‘principle of political settlement in its own right’ (Maier, 1977:609). In this way, the US was able to resolve its previous economic issues and reorganise its economic power. It could later produce hegemony as well as maintain it. This principle was considered so successful that the US also extended it to its subordinates following WWII, especially those devastated by war.

Building upon Maier’s work, Rupert further explains the phenomenon of US hegemony and ‘the politics of productivity’ by engaging IPE theories, particularly critical theory. Making productivity a political principle, in fact, reflects the ideology of liberal capitalism which is the foundation of US hegemony. By building a historic bloc of capitalism, in other words, neoliberal hegemony, the US was ‘simultaneously creating the social infrastructure of mass production and consumption’ as high productivity allowed it to ‘sustain the profitability of mass-production industry, and maintain social stability’ (Rupert, 1990:437-438).

Some other literature has also confirmed this opinion and stated that, in its infancy, US hegemony was grounded in productivity so that it could consequently acquire economic strength and later provide a large amount of dollar output for the eventual hegemonic transition (Cox, 1992; Cafruny and Ryner, 2007).

Furthermore, the method of using productivity to evaluate the changing dynamic of power can be found in previous studies as well. In a paper examining the relative decline of US hegemony, Corden makes an analysis based on US labour productivity and productivity growth, alongside with other indicators such as gross domestic products (GDP) and dollar value. As GDP and labour productivity of the US continued to grow, its rate of productivity growth began to slow down, although it had stayed positive since 1973 – this corresponds to the hegemonic decline.
in question and coincides with the collapse of the Bretton Woods system in the early 1970s (Corden, 1990).

Contrary to production volume, productivity moves focus away from the total amount of goods but looks at more detailed factors instead. It is connected to variables such as demographic features, energy consumption, and technological advancement.

For instance, population growth has been adding pressure to states’ production structure and the latter may come up with different solutions to stimulate output. Productivity is reflected in the types of production system, such as a feudal or capitalist system, and industrial structure, which is the composition of different economic sectors (Strange, 2015b). Another study on the rise of British Empire agrees that a shift from the Middle Ages feudal system to a pre-modern style of production was foundational for British hegemony, as resources were allocated and exploited differently (O’Brien, 2006). Admittedly, this is a very general rationale from the perspective of ideology and institutional structure.

For another example, productivity can be influenced by scientific and technological development. A straightforward example is the Industrial Revolution which took place during the second half of the 18th century and the early 19th century. The massive improvement in production methods and means, due to technological advancements, greatly boosted production volume and labour productivity, consequently resulting in the Pax Britannica (Lake, 2002; Glynn and Booth, 1996; Wrigley, 1988). Many economists generally believe that technological innovation has had an effect on economic growth and productivity gains (Kraemer and Dedrick, 1999).  

More recent studies on the ‘Productivity Paradox’ also note that technological innovation may negatively impact productivity as it could bring about the inability of technocratic instruments, a lack of regulation, and other instances of social regression. Some have argued, that ‘this has resulted in the undermining of one of the main conceptual fortresses constructed by the think tanks of neoliberal globalization, leading to a questioning of U.S. hegemony’ (Sunshine and Breña, 2007:44). Regardless of whether a negative or positive correlation has been found, there

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16 Also see VanGelderen (1913), Schumpeter (1939), Abramovitz (1956), Kendrick (1956) and Solow (1957), Arthur (1994), and Romer (1990), as all cited in (Kraemer and Dedrick, 1999).
is little dispute over the idea that productivity, affected by science and technology, can be a factor determining hegemonic power.

Despite the complexity of productivity, this indicator can be analysed both quantitatively and qualitatively. This chapter aims to examine the productivity of China and the US, focusing on the following aspects in order to evaluate the possibility of hegemonic transition. First, the composition of different sectors in the production structure will be explored, which is responding to Strange’s justification of productivity. Second, a quantitative analysis of labour productivity will be presented. According to OECD, among all kinds of productivity, labour productivity is ‘particularly important in the economic and statistical analysis of a country’ (Freeman, 2008:5). Several of the IPE literature noted above also privilege labour productivity as a measure of economic power. Third, an examination is presented on the relation between technology and its effect on China’s productivity in a qualitative manner. Through these three aspects, a comprehensive evaluation of hegemonic transition from the perspective of China’s productivity condition will be constructed.

Beyond the volume of production and productivity, external dependence features as the third factor of relevance to hegemonic rise and fall. External dependence here refers to reliance on foreign capital and foreign market – one’s position in the global supply chain. According to David Lake, during the 16th to 18th centuries, the international economy was ‘dominated by mercantilism’ (Lake, 2002:128). As previously introduced, with great technological advancements and the Industrial Revolution, Britain had become the model of modern countries when it reached its hegemonic peak around 1870. The significant improvement in production boosted the growth of national wealth and was soon urging its overseas expansion. Many previous British colonies, as well as other countries in the far East, had been playing a role in Britain’s overseas market as well as being Britain’s raw material supplier.

At some point, this involved forcing foreign markets to open up in order to sustain British manufacturing and merchandising. Meanwhile, in Europe, Britain was promoting its Corn Law, inducing neighbouring countries to participate in its free trade regime; indeed, regardless of the actual functionality of the regime, it would ideally enhance exportation and value-added to Britain’s production structure.
The hegemonic ascendancies involved opening up the international economy in both British and American cases. However, as compared to US hegemony, British hegemony was built upon its trade regime and exportation, as well as its domestic economic strength. In other words, Britain’s production structure needed greater external reliance to maintain its hegemony, which also means that British hegemony had a higher risk of being affected by other players in the international arena (Lake, 2002). In fact, as soon as wars broke out and the international economy generally collapsed, British hegemony also declined dramatically.

Similarly, Gamble also comments on British hegemony by comparing the two historical hegemonies, stating that an obvious distinction between Britain and the US is that the former relies much more heavily on trade than does the latter. For example, Britain ‘needed a visible trade deficit rather than a visible trade surplus in order to stimulate economic development in other parts of the world economy which boosted demand for British banking, shipping, and insurance service’ (Gamble, 2002:130). British hegemony was often considered benevolent in comparison to the US, due to the way it stimulated development elsewhere. However, this also means that the British economy was under greater risk of being surpassed by those economies it stimulated. It would not be an absolute decline in that case, but relative – which is sufficient enough to trigger a hegemonic transition.

Correspondingly, Mommsen (2002) notes that by the end of the era of British hegemony, Britain was at the brink of being surpassed by the US and Germany, not only in traditional coal and steel manufacturing, but also in some newly emerging industries, such as chemical and electrical industries. This can be proven from another viewpoint, that is, when mismanaged, excessive external dependence can lead to a relative decline in production and, hence, hegemonic power.

In other literature focusing on different periods of hegemony, Flynn considers that Spanish hegemony was largely built upon ‘extracting much of the excess mining profit’ (Flynn, 1982:140). Hamilton argues that this form of external engagement proved to be unsustainable, noting that ‘the most famous external cause of decline […] is that Spanish society had become addicted to the influx of American treasure; the peninsula could not survive the withdrawal associated with drastically reduced imports of precious metals in the 1620s and 1630s’ (Hamilton, 1937, as cited in Flynn, 1982:139).
Though Flynn’s article focuses on the fiscal aspect of Spanish hegemonic decline because silver was a currency at that time as well as a commodity, it is, nevertheless, the heavy reliance on external actors - in terms of importing materials - that made the empire vulnerable in the face of radical changes to the international situation. An excessive level of reliance on colonies and external players gave the Spanish Empire less say in controlling its own production structure.

However, it is not to say that external reliance has an absolutely negative impact on hegemonic power. In fact, by comparing Spanish and British hegemony as well as other European countries during the early stages of capitalism, many historians conclude that flourishing economic performance started alongside warfare in a particular period, with mercantilist economy and war mutually benefitting each other (Jurado-Sánchez and Jerez-Méndez, 2012). Similarly, for US hegemony, although war was no longer a means of recruiting subordinates, being the leading figure in exportation due to mass production equipped the US with hegemonic advantages (Norrolf, 2010).

The relationship between hegemonic rise and external dependence is explored in the case of the US by Krasner in his early work. For example, Krasner foregrounds the importance of gaining access to stable supplies of raw materials as a matter of US foreign policy in the post-1945 period. Indeed, such economic interest in countries within its near neighbourhood and beyond was identified as an important driver of foreign intervention (Krasner, 1978). More recently, literature has highlighted the manner in which US oil dependence through recent decades served as a source of structural vulnerability (e.g. Greene, Jones, and Leiby, 1998; Gnansounou; 2008; Greene, 2005).

Therefore, how external dependence affects a hegemonic or rising power is dependent on the contextual specificities of the individual case. External dependence, as presented above, includes dependence on overseas resources and overseas market. This chapter focuses on the overseas market and capital resources, and raw material resource will be analysed separately in the next section.

To sum up, this section seeks to qualitatively assess the benefits and vulnerability that China’s production structure is facing, and to identify what factors could possibly undermine or hinder
the continuing development of China’s production, thus resulting in an inability to push forward the potential hegemonic transition in question.

Overall, these three aspects, production volume, productive, and external dependence can be identified as the key indicators of China’s production structure when evaluating the possibility of hegemonic transition. Production volume is about assessing a country’s actual amount of output and its share in the world market, which is largely influenced by the country’s production-related policies. Productivity takes into consideration the sectoral structure, labour productivity statistics, and the use of technology in production methods. External dependence looks into whether China’s production structure submits to an excessive export-oriented style and assesses the vulnerability of its production due to external factors. By combining the analysis of these three aspects, this chapter aims to provide a thorough and comprehensive evaluation of the US-China hegemonic transition from the perspective of production structure as the second pillar of this study.

6.2. Post-1978 Economic Liberalisation and Production Volume

This section provides an overview and evaluation of China’s production volume. It consists of three major parts, analysing each of the three production sectors of China: agriculture, industry, and service. The analyses contain a historical overview of the development and reformation of China’s production structure and a statistical description of each sector. This section introduces the institutional foundation of China’s production pillar.

Overall, the suggestion is that since economic reform, the production volume of all three sectors have seen tremendous development, but at different speeds. The soaring amount of GDP and rapid GDP growth are based on an overemphasised industry sector. While taking second place as the country with the highest production volume, China’s production structure can be optimised and made more competitive by gradually shifting its focus to the tertiary sector. At the moment, it is the country with the second-largest GDP, which is the main reason for considering China a rising hegemonic power.

17 According to the Fisher-Clark tripartite classification of sectors, the three production sectors are about agriculture (primary), industry (secondary), and services (tertiary) respectively (Fisher, 1939).
The story of China’s prosperity can be divided into a few phases with historical demarcation points of 1978 and 1992, as major events occurred during those times. Statistics on China’s GDP growth rate provided by the World Bank echo this story of development. The political turmoil due to the Great Leap Forward between 1958-1960 and the Cultural Revolution of 1966-1976 greatly impacted productivity, and the reliability of data from this period could be questionable. Nonetheless, what is certain is that the 3rd Plenum occurred by the end of 1978 and a series of further reformations, particularly the one in 1992, have led the new people’s republic into stable, positive and fast-paced economic growth (Figure 6.1).

Figure 6.1 Annual GDP Growth Rate, China 1961-2015

![Annual GDP Growth Rate, China 1961-2015](image)

Source: (World Bank, nd)

The late 1970s is set as the starting point for this study, because it was the time when sectoral composition, industrial relations, and production methods were reformed after the 3rd Plenary Session of the 11th Central Committee of the Communist Party of China (the 3rd Plenum) (Tisdell, 2009).
6.2.1. Agricultural and Household Responsibility System

Before 1987, all the land was owned by the People’s Commune, production tools were distributed equally between farmers by the Commune, and no reward or punishment was given based on one’s contribution. Hence, people were likely to do the minimum and, in local terms, ‘eat from the same big pot’. This collective land ownership and agricultural system under the rigid Maoist system greatly undermined farmers’ enthusiasm and productivity.

Secretly carried out by 18 families from Xiaogang Village in the beginning, the Household Responsibility System was eventually acknowledged and encouraged by the central government, then extensively promoted nationwide. In the *Minutes of the National Rural Work Conference* published on 1st January 1982, a few points were made to acknowledge these changes to the essentials of China’s agricultural production:

‘... more than 90% of the rural areas have established a responsibility system for agricultural production ... The current responsibility system, including [different types of] contracting to individuals, households, or groups, are all legitimate method for production responsibility allocation of China’s socialist collective economy.’ *(CPC, 1982)*

Through this document, the CPC recognised that the time of class struggle and ideological conflict should be put to an end, and instead to conclude, perfect, and stabilise. The frequently appearing word ‘contracting’ recognised that this HRS could be considered a kind of insourcing contract between state and farmer, giving greater autonomy to farmers in terms of the whole process of production. More importantly, the second section of the Minutes provided guidance on the trading of agricultural and side-line products:

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18 In the original text, three words – ‘包工’, ‘包产’, and ‘包干’ – could all be translated into ‘contracting’. The difference is in the detailed methods of distributing responsibilities and ownerships of the products.
‘Increasing farmers’ income not only relies on raising purchasing prices or reducing the basic purchasing amount, but also the development of commodity production, to achieve product abundance and high profit.’ (CPC, 1982)

By allowing a commodity economy for agricultural products, farmer-land and farmer-state relationships were modernised. Farmers were given a certain level of freedom to allocate resources and distribute products produced on the land that they were responsible for. This reform successfully gave farmers the incentive to work and promote the production volume of agricultural products, and this responsibility system is still in use today.

Figure 6.2 Agricultural value added (current US$), China 1966-2014

Source: (World Bank, nd)

Further reforms were carried out after the millennium based on the existing results of the responsibility system reformation. From 1982, a series of ‘No.1 Documents’ regarding agriculture were successively published. In the heart of these documents were three issues: farmers, rural areas, and the agricultural sector. More specifically, a series of policies were conveyed, including those to ‘modernise China’s agricultural sector by adjusting its structure’.

19 ‘Basic purchasing amount’ means price fixed by the government for a ‘basic amount’ of products purchased from farmers and a flexible price for products beyond that amount.
20 ‘No.1 Documents’ is the nickname given to an annual announcement on agricultural policy by the CPC Central Committee and the State Council. These documents reflect the CPC’s main line of action on agricultural reform.
to ‘construct the rural areas by improving infrastructure’, and to ‘increase social welfare and state subsidies to farmers via macro control’. Overall, the effect of these policies can be seen reflected in the agricultural value-added (Figure 6.2).

The agricultural value-added in China has shown rapid growth since the initial reformation, which could be considered as one of the most important achievements of the production structure. China’s production volume of several major agricultural goods has since caught up with the US (USDA, 2018). In particular, China has faster production growth in livestock, crops, and, specifically, food production, than the US. According to the World Bank’s production index, while the US has occasionally experienced negative growth in crop and livestock production, China has kept steady growth at all times.

Up until 2013, China had a 33% increase in crop production compared to 2004-2006 and a 26% increase in livestock production. The equivalent data for its counterparts in the US were merely 8% and 7% (World Bank, nd). By 2015, China’s total grain production had taken up 20.68% of the world’s total whereas the US-occupied approximately 17.48%. Despite the US having a slight advantage in oilseed production, China is seeing steady growth and increasing its advantage over the US in overall agricultural production.

6.2.2. Industry and Market Economy

The secondary sector, namely industry, was a focus for the early stages of economic reformation, particularly in terms of manufacturing. Growth was significant, as were the changes made regarding the structure and its relevant policies. In an overview, the most significant push to the industry and manufacturing sector occurred around the mid-1980s, when the market economy was formally introduced to China’s industrial realm (Jefferson and Singh, 1999). Information containing ideological guidance was published by the central government under the leadership of Deng Xiaoping during the period when economic development replaced the class struggle as the focus of Chinese society.

Major changes started to take place during the mid-90s, starting with de-centralising and privatising state-owned enterprises (SOEs). In 1996, China’s central government initiated the

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plan of selling more than 300,000 SOEs. Before this plan was launched, these companies were described follows

'[they] employ 100 million workers, receive 90% of bank loans, and account for 40% of industrial output. Many are plagued by over-capacity, running at an estimated average 60% utilization, with perhaps 1/3 too many workers. Half of them lost money in 1996' (The Economist, 1997, as cited in Pyke, Robb, and Farley, 2000:579).

The plan of privatising SOEs, however, was not thorough. Only 10-15% of the previously state-owned companies reformed completely into private firms, with many more partially transformed and staying in the safe ‘grey zone’ where they were collectively owned or of mixed ownership. China’s economy still relies heavily on state spending, with lifeline industries, such as steel manufacturing, oil refining, and electricity generation, all part of a state monopoly (Yueh, 2007; Pyke, Robb, and Farley, 2000).

Nonetheless, the formation of China’s industry sector does not need to be totally negated. On the one hand, with a small number of firms privatised or owned collectively by township, light industries, such as the manufacture of daily necessities, were revitalised (Jefferson and Rawski, 1994; Murakami, Liu, and Otsuka, 1996). According to China’s Bureau of Statistics, the number of private firms has seen exponential growth in recent decades (PRC. National Bureau of Statistics, 2018; Lu, 2018).

On the other hand, ideological changes and transformations also took place within a large number of remaining SOEs. The 3rd Plenary Session 1993 adopted the Decisions on Issues of Constructing Socialist Market Economy System. Similar to the reformed agricultural sector, great autonomy was given to companies in terms of management, despite a lingering emphasis on state ownership. The second section of the Decision particularly pointed out the importance of establishing a ‘modern enterprise system’, one targeting a vast majority of SOEs, especially in the heavy industries.

The highly generalised conclusion of the Decision was that SOEs should ‘define ownership, clarify rights and responsivity, separate government and enterprise, and adopt scientific management’, among which the key was a separation between government and firms. Since
the state had withdrawn most of its support to, SOEs financially and strategically, the latter had to introduce new methods and strategies of production and management in order to promote its competitiveness and ability to survive.

The core message of the Decision continues to affect China’s strategy of production even today. Refining a socialist market economy became one must-have discussion during each meeting of the CPC. For example, in 2003, at the 16th meeting of the CPC Central Committee, mainline of actions, such as ‘consolidating public ownership’ and ‘guiding private business’, were advocated to ‘perfect the socialist market economy’ (CPC, 2003).

This transformation of manufacturing companies has led to quite a number of redundancies and bankruptcies. Nevertheless, by liberalising the industry sector, with human and capital resources better allocated, China’s industry sector has seen massive growth. To date, China has reached the top position in terms of industrial production and become the largest manufacturer among all countries in the world. China’s total value added for the industry sector surpassed the US in 2011 and the EU as a whole in 2012 when it became the world’s top manufacturer (see Figure 6.3). This has also become the major reason for China’s economic rise with a great contribution to the country’s GDP every year.

Figure 6.3 Industry, value added (current US$) by countries, 1966-2014

![Graph showing industry value added by countries](source: World Bank, nd)
Furthermore, the expanding domestic industry sector also reached beyond the border to further boost the national production. Since the 1980s, China has been trying to transform state-owned giants into globally competitive multinational enterprises; to date, however, some scholars believe the level of Chinese ownership integrating into the global supply chain is still rather low (Nolan, 2012). The challenge for Chinese business acquiring Western companies is also rather big due to factors such as local protectionism, political sensitivity, ownership structure of the target company, experience of overseas acquisition, and nearly half of the attempts have ended up in vain (Zhang and Ebbers, 2010; Zhang and Zhou, 2010). Therefore, progress of China’s production growth from this source is rather insignificant, more of an inspiration than adding to China’s national production growth.

6.2.3. Services and Further Development

On 16th June 1992, the CPC Central Committee and the State Council made the Decision on Accelerating the Development of the Tertiary Sector, marking the deepening of China’s production structure reformation. The target was to ‘spend ten years or more, gradually establish a services market system, a comprehensive rural-urban social service system, and a social welfare system that are suitable for China’s unique national conditions’ (CPC, 1992). This decision also pointed out that the growth rate of the tertiary sector should be higher than for agriculture and industry, while reaching the average level of developing countries in terms of the tertiary industry’s proportion of added value and employed labour force.

A speech by President Jiang Zeming on the 14th CPC Central Committee, four months after the previous decision, stated that

‘The expansion of the tertiary sector can not only stimulate market development, but also stimulate the market. It can [...] enhance economic efficiency and productivity [...] while providing more employment, which is beneficial to the transformation of economic structure, business management mechanisms, and governmental institutions.’ (Jiang, 1992)

The speech repeatedly stressed the target of accelerating the development of service industries and increasing their proportion within the national economy. By comparing China’s sectoral composition with what are considered major developed countries and regions, particularly in
the comparison between China and the US, it is clear that China’s primary and secondary sectors are still taking up more than half of the country’s overall value-added, whereas, for the US, the tertiary sector occupies more than three-quarters of its total value added (Figure 6.4). What this indicates is that the sectoral composition shift within China’s production structure is far from enough, despite China’s tertiary sector expanding dramatically based on the numbers.

Historically, China’s service sector was immature and often significantly underestimated due to historical reason and some special characteristics of the sector, as it was purposely suppressed during the Mao Era (Yue and Zhang, 2002; Tsui, 1996). It means that this sector necessitates further development with uncertainty lying ahead. Reform of the service sector comes naturally with difficulty because of China’s unique political form. Although small service businesses sprung up, large-scale service sector reform is hard to operationalise under state monopoly over certain segments, the so-called lifeline industries (Perkins, 1994; Pearson, 2007).

Figure 6.4 Comparison between China and the US on the composition of GDP by sectors

Nonetheless, according to the most recent statistics, value added by the services sector is taking 54.1% of China’s GDP, as result started to materialise since the government’s initiative to promote the share of services in the economy during the 12th Five-Year Plan (PRC. National Bureau of Statistics, 2017). Further to that, director of the Services Statistics Division of China’s National Bureau of Statistics, Xu Jianyi, gave two factors supporting the argument that services are leading China’s economic growth: 1) investment into the services sector has grown rapidly with an increase of 11.7%, 7.3% more than that into the industry sector; and 2) power consumption by the service sector is growing rapidly as well, taking 13.4% of the total
electricity consumption, with a growth of 9.2% (Xu, 2016). With the experience of liberalisation in the previous two sectors, while this reformation of China’s service sector may be experimental, it is still looking optimistic.

6.2.4 Summary

This section aims to provide a consistent description of China’s production volume. It also explores the institutional change of China’s production structure in order to identify the momentum for China entering a high-speed growth era – asking what has changed regarding ownership, responsibility, production method, and so on. By shedding light on this historical development, it is possible to explain China’s miraculous recovery from world wars and internal ideological struggles, especially post-Cultural Revolution, when all that had been left undone was to be re-done.

The trajectory of China’s production sector is a peculiar one. The transformation from a planned economy to a market-oriented economy has enabled China’s gross domestic production (GDP) to maintain a high growth rate at an average of 9.7% with 14% as a peak reported by the World Bank. Additionally, one major principle promoted during China’s 3rd Plenum was the market economy. In the heart of the reformed economy was a series of changes on sectoral composition, industrial relationships, and market-openness policies, which consequently led to a boost in production. Further to that, the introduction of the household responsibility system (HRS) in rural areas and the decentralisation of state-owned enterprises in urban areas were also focuses of this late 1970s/early 1980s reform. As a result, the industrial structures of many industries experienced a huge transformation, with domestic production and social wealth quickly multiplying (Figure 6.5, Table 6.1, Table 6.2).

Table 6.1 Growth of GDP, by Sector, at Constant Prices, China 1890–2003

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Farming, Fishery &amp; Forestry</td>
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<td>2.2</td>
<td>4.5</td>
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<td>10.1</td>
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</tr>
<tr>
<td>Construction</td>
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<td>8.5</td>
<td>7.8</td>
<td>9.8</td>
</tr>
<tr>
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<td>8.3</td>
<td>6.0</td>
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<tr>
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<td>3.3</td>
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</tr>
<tr>
<td>Other Services</td>
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<td>4.9</td>
<td>4.2</td>
<td>5.6</td>
</tr>
<tr>
<td>GDP</td>
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<td>6.1</td>
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</tr>
<tr>
<td>Per Capita GDP</td>
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<td>2.3</td>
<td>6.6</td>
</tr>
<tr>
<td>GDP Per Person Employed</td>
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<td>3.8</td>
<td>1.8</td>
<td>5.8</td>
</tr>
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</table>

Source: (Maddison, 2007:60)
Table 6.2 Structure of Chinese GDP, 1890–2003

<table>
<thead>
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<th>2003</th>
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<tbody>
<tr>
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</tr>
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<td>1.7</td>
<td>3.4</td>
<td>5.3</td>
</tr>
<tr>
<td>Transport &amp; Communications</td>
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<td>2.4</td>
<td>3.6</td>
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</tr>
<tr>
<td>Commerce &amp; Restaurants</td>
<td>8.2</td>
<td>6.7</td>
<td>5.1</td>
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</tr>
<tr>
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<td>11.9</td>
</tr>
<tr>
<td>GDP</td>
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<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: (Maddison, 2007:60)

Figure 6.5 Value added (% of GDP) by sectors, China, 1965-2015

Source: (World Bank, nd)

At the beginning of the 90s, China had already surpassed the USSR and Japan in GDP (Maddison, 2007: 60-62). According to the World Bank, China’s GDP took up approximately 14.8% of the world’s total in 2015, placing the country second in the world rankings, following the US (24.4%), and it continues to grow at a faster pace each year. From this perspective, undoubtedly, that China has reached a high capacity of production volume. It is now able to level, even surpass, the US regarding the production of several commodities, especially in agricultural and traditional industries. Although its tertiary sector is still lagging behind many Western countries at the moment, China’s production structure is becoming increasingly competitive and capable judging by current trends.

22 Industry includes manufacturing.
In short, production reform, especially the emergence of small to medium business and the manufacturing boom, greatly promoted China’s economic power from the perspective of production volume. However, this rising economic power does not indicate a move toward hegemonic status because China’s sectoral composition is rather underdeveloped in comparison to other advanced economies.

6.3. Productivity and Labour

This section examines China’s production power via labour productivity. A strand of the existing literature has been studying the improvement of China’s productivity in relation to overall economic development. Historically, productivity has been used as an indicator of China’s economic development in a number of studies (e.g. Kuan et al., 1988). While Solow (1956) has theoretically explained the effect of productivity on economic growth from the economics perspective, Chinese scholars have also argued that China’s economic growth not only relies on factors of input, but also factors of efficiency (Yi, Fan, and Li, 2003). McMillan, Whalley, and Zhu (1989) found that institutional changes in China, such as the post-1978 HSR, have led to significant productivity growth and, hence, overall improvement in production. Cai, Wang, and Du (2002) argue that regional disparity in China is caused by labour market disorder, illustrating the linking between economic development and labour productivity. Others have found that in order to achieve sustainable social and economic development, China is urged to improve resource productivity (Yuan, Bi, and Moriguichi, 2006).

Although China has been quickly catching up with the West, especially the US, in terms of production volume, the GDP growth of China has been slowing down, returning and stabilising at the point of 7% annual growth in recent years. The reason for this is complex. From the perspective of domestic production, it could be explained by further analysis of factors mainly involving efficiency and productivity.

There are many indicators and methods of studying productivity. This research chooses to explore the aspect of labour productivity to draw a simple and clear picture and compare each of the three sectors in terms of China and the US. Specifically, Wu (2001), by comparing the labour productivity of China and the US, has found an increase in China’s labour productivity, from 3.0 to 7.6 (US=100), between 1952 and 1997. It is also found that due to the market-
oriented economic reform, China shows evidence of catching up with the US in labour productivity since the 1990s after a long period of stagnation at 4.5. More recently, US Bureau of Labor Statistics specifically points out that the number of employees in China’s manufacturing sector is about 4 times more than that of the US during the 2000s; meanwhile, the average wage of these Chinese manufacturing employees is approximately 1/10 of its US counterpart (US. Bureau of Labor Statistics, 2013). Besides the worrying concern of workers treatment in China, these numbers also hint relatively much lower productivity of China’s manufacturing sector.

This section will extend existing knowledge of China’s labour productivity by presenting the most up-to-date productivity data for the three sectors, service, industry, and agriculture, respectively. Pragmatically and contrary to the complexity of assessing multi-factor productivity, which involves collating wide-ranging sources of or the difficulty of acquiring accurate data on energy consumption, statistics on a labour force and value-added can be easily retrieved from annual household surveys.

Overall, the finding is that, for all the sectors examined in this part of the thesis, China’s labour productivity is lagging significantly behind its American counterpart and growing at a slower rate than that of the US. This has thus become a major obstacle standing between China and comprehensive hegemonic power.

The OECD Statistics Directorate has provided guidance on calculating labour productivity. The formula is

\[
\text{Labour productivity} = \frac{\text{volume measure of output}}{\text{measure of input use}}
\]

The volume measure of output is measured either by gross domestic product (GDP) or gross value added (GVA), while labour input is measured either by the total number of hours worked of all persons employed or total employment (headcount); (Freeman, 2008:5). Because this section will explore labour productivity in each sector, the calculation is

\[
\text{Sectoral labour productivity} = \frac{\text{sectoral value-added}}{\text{sectoral employment}}
\]

The data of sectoral value-added for both countries is taken from the World Bank database, and the information for sectoral employment (number of employed people in a sector) is found
on both countries’ bureaus of statistics, which can be considered valid and liable. The time coverage of the selected data runs from 2002 to 2014.

6.3.1. The Significance of the Services Sector

As mentioned above, a great institutional transformation has occurred regarding China’s sectoral composition. More precisely, based on World Bank data, this transformation can be identified as mainly a shift of focus from agriculture to the other two sectors. In addition to this, and for a very long time, value-added by industry had been taking the largest share of total GDP, until 2012 when it was surpassed by services. Though the services sector takes up more than half of the total GDP of China and is keeping a rapid development momentum, the current composition of sectors in relation to China’s production structure is insufficient to maintain this short-lived high growth rate.

As empirical wisdom has already proven, the degree of development for a country’s tertiary sector, namely its services sector, is, according to the Fisher-Clark classification of sectors (Wolfe, 1955), the clearest indicator for measuring that country’s economic development and production level, as well as the level of modernization (Park and Chan, 1989; Wang, 2000; Joshi, 2004).

This is because first, only when productivity and efficiency of the first two sectors reach a certain level can more labour and resources be put into developing its services industry; and second, conversely, a more advanced service industry can promote the economic performance of the first two sectors, for example, providing transportation, insurance, and communication for the industrial revolution (Gemmell, 1982; Miles, 1993). As mentioned in the previous section, the importance of the tertiary sector has also been acknowledged by the Chinese government.

With a further comparison between China and the US in value added by different sectors, taking 2014 as an example (Table 6.3), it can be seen that the value added by services sector of the US in 2014 is about 1.6 times more than that of China, whilst China’s advantage in the first two sectors is relatively weak. Meanwhile, China’s labour force participating in the tertiary sector is 2.66 times that of the US (Table 6.4).
In other words, in terms of value-added per unit of the labour force, the US efficiency of services value added is about 7 times its counterpart, with the absolute value of this gap being 94,911.15 current US$ per labour force unit in 2014. This means that the average US service worker adds $94,911 more value annually than average Chinese service worker.

Some may argue that although the gap in labour productivity is big, it would take no or very little time before China, with its great potential and resources, could catch up with the US and finalise the hegemonic transition. Indeed, a transition is a dynamic process rather than a static point in history, and therefore, it is necessary to expand our horizon to take longer periods of time into account while exploring this tendency.

However, existing statistics cannot sufficiently prove this opinion. This trend is nowhere to be seen based on a calculation. Both countries’ labour productivities are shown in Table 6.5 and Figure 6.6. It can be seen that besides the great difference between their productivities, both countries are experiencing an improvement (positive growth) in productivity. Furthermore, according to the linear function,23 which is based on 8-year figures, the gradient of productivity growth for the US (a=2704.6) is higher than that of China (a=1186.3). This means that China’s
service sector not only has much lower labour productivity but also a slower growth rate compared to its US counterpart.

Table 6.5. Service sector labour, value-added, and productivity, China and US, 2002-2014

<table>
<thead>
<tr>
<th></th>
<th>US Labour (million)</th>
<th>US Value added (Current US$)</th>
<th>US Productivity (V/L)</th>
<th>China Labour (million)</th>
<th>China Value added (Current US$)</th>
<th>CN productivity (V/L)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>104.812</td>
<td>8252007</td>
<td>78731.5098</td>
<td>209.5808</td>
<td>618448.713</td>
<td>2950.8844</td>
</tr>
<tr>
<td>2003</td>
<td>107.895</td>
<td>8623739</td>
<td>79927.1421</td>
<td>216.04648</td>
<td>694401.353</td>
<td>3214.12945</td>
</tr>
<tr>
<td>2004</td>
<td>109.229</td>
<td>9141251</td>
<td>83688.8647</td>
<td>227.24784</td>
<td>800826.406</td>
<td>3524.02208</td>
</tr>
<tr>
<td>2005</td>
<td>111.459</td>
<td>9734295</td>
<td>87335.2085</td>
<td>234.39158</td>
<td>939249.234</td>
<td>4007.17993</td>
</tr>
<tr>
<td>2006</td>
<td>113.409</td>
<td>10255997</td>
<td>90433.7134</td>
<td>241.42916</td>
<td>1143553.57</td>
<td>4736.60085</td>
</tr>
<tr>
<td>2007</td>
<td>115.057</td>
<td>10751999</td>
<td>93449.3251</td>
<td>244.04004</td>
<td>1512860.99</td>
<td>6199.23269</td>
</tr>
<tr>
<td>2008</td>
<td>115.498</td>
<td>10997687</td>
<td>95219.7181</td>
<td>250.87248</td>
<td>1955860.81</td>
<td>7796.235</td>
</tr>
<tr>
<td>2009</td>
<td>113.163</td>
<td>11014404</td>
<td>97332.2022</td>
<td>258.57348</td>
<td>2248808.44</td>
<td>8696.98023</td>
</tr>
<tr>
<td>2010</td>
<td>112.969</td>
<td>11380637</td>
<td>100741.239</td>
<td>263.3233</td>
<td>2669651.27</td>
<td>10138.3025</td>
</tr>
<tr>
<td>2011</td>
<td>113.422</td>
<td>11729656</td>
<td>103416.057</td>
<td>272.82</td>
<td>3320899.17</td>
<td>12172.4917</td>
</tr>
<tr>
<td>2012</td>
<td>115.675</td>
<td>12239015</td>
<td>105805.187</td>
<td>276.9</td>
<td>3850101.86</td>
<td>13904.3043</td>
</tr>
<tr>
<td>2013</td>
<td>116.594</td>
<td>12561392</td>
<td>107736.179</td>
<td>296.36</td>
<td>4452807.39</td>
<td>15024.9946</td>
</tr>
<tr>
<td>2014</td>
<td>118.1</td>
<td>13083640</td>
<td>110784.42</td>
<td>313.6</td>
<td>4977857.54</td>
<td>15873.2702</td>
</tr>
</tbody>
</table>

Source: (PRC. National Bureau of Statistics, nd; US. Bureau of Labor Statistics, nd; World Bank, nd)

Figure 6.6 Service sector productivity, China and US, 2002-2014

The productivity growth gap is kept in positive figures, which means that the disparity between China and the US, in terms of productivity, is, in fact, getting bigger and bigger. Based on this data and from the perspective of productivity in the tertiary sector, there is no sign of a decline in US production, neither is there the potential that the US will be surpassed by China. The foundation of China’s hegemonic rise is lacking significant support by the tertiary sector.
6.3.2. Industry and Productivity

Among a total of 31 industrial sectors, manufacturing takes up more than 30% of the total GDP, and, along with other sections from the industry sector, is problematic by itself, even facing severe challenges. The reason for this is somehow institutional and rooted in China’s grand strategy for production. Within a market built under ‘socialism with Chinese characteristics’, there are two major types of players: large-scale enterprises which are also state-owned at the same time, along with relatively smaller privately owned and invested companies. This section below examines the productivity of China’s industry sector in comparison with the US.

On the one hand, state-owned enterprises are often referred to as ‘zombie’, because of their rigid bureaucracy and low efficiency and productivity (Wildau, 2016); on the other, private companies are developing faster dynamics in China’s industry sector. However, they are vulnerable to some extent because of excessive external dependence that will be analysed in the later on section. As a whole, the situation of China’s industry sector is often described as a slow and clumsy giant with a regional, sectoral, and social imbalance (Wei, 2002; Huang and Wang, 2010).

Using a similar approach to the calculation in the service sector, productivity levels in the secondary sector of both China and the US for 2002-2014 are subsequently analysed (Table 6.6 and Figure 6.7). According to statistics from the World Bank database (World Bank, nd), China’s production in relation to industry (including manufacturing) has recently surpassed the US, turning it into the leading world figure. However, in terms of productivity in this sector, a similar pattern to the service sector can be found.

Table 6.6 Industry sector labour, value-added, and productivity, China and US, 2002-2014

<table>
<thead>
<tr>
<th>Year</th>
<th>US Labour (million)</th>
<th>US Value added (Current US$)</th>
<th>US Productivity (V/L)</th>
<th>China Labour (million)</th>
<th>China Value added (Current US$)</th>
<th>China productivity (V/L)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>28.332</td>
<td>2258241</td>
<td>79706.3744</td>
<td>156.819</td>
<td>647872.418</td>
<td>4131.33879</td>
</tr>
<tr>
<td>2003</td>
<td>27.565</td>
<td>2380882</td>
<td>86373.372</td>
<td>159.27</td>
<td>750523.136</td>
<td>4712.26933</td>
</tr>
<tr>
<td>2004</td>
<td>27.791</td>
<td>2570422</td>
<td>92491.1662</td>
<td>167.094</td>
<td>888384.4</td>
<td>5316.67445</td>
</tr>
<tr>
<td>2005</td>
<td>28.074</td>
<td>2776876</td>
<td>98912.7306</td>
<td>177.66</td>
<td>1063267.15</td>
<td>5984.84267</td>
</tr>
<tr>
<td>2006</td>
<td>28.813</td>
<td>2990419</td>
<td>103787.145</td>
<td>188.945</td>
<td>1293845.79</td>
<td>6847.73763</td>
</tr>
</tbody>
</table>

Despite achievements in production volume, when divided by the volume of labour force in the corresponding industry, a huge disparity between the two countries emerges. According to these figures, this disparity in productivity has maintained a level of more than 110,000 (current US$ per unit of labour force) in the recent 5 years. Meanwhile, the numbers for productivity growth show that the growth of US industry productivity is slowing down, with the growth of China’s industry productivity relatively stable at around 1000 (current US$ per unit of labour force).

These statistics mean that a potential decline in the US industry sector could be happening shortly, but slowly, and meanwhile there is more possibility that China will catch up with the US, in terms of industry productivity, when compared to the result of productivity in the tertiary sector. Nonetheless, the current trend of China’s industry sector development shows that, for this possibility to become reality would take a rather long time. Combining this with the previous analysis on the tertiary sector, since these two sectors take up almost 90% of China’s
domestic production and the level of productivity for both sectors are relatively much lower than that of the US, it would be quite difficult to see China as a rising hegemonic power on an unbalanced economic foundation.

Furthermore, according to the data and report published by the National Bureau of Statistics of China, between January and August 2016, industry enterprise profits reached the highest of the year in August, 19.5% more than for August 2015. However, this is because there were a series of economic traumas in 2015, including declined demand, rising cost, stock market dramas, and so on. In other words, the reason for month-on-month growth being seemingly so high was due to the economic downturn of 2015; if using 2014 as the benchmark, profit growth between 2014-2016 was merely 4.4% (He, 2016). The report continues by stating that from the macro point of view, the foundation supporting fast development of the industry sector is not yet consolidated enough.

Most importantly, traditional industries are facing the challenge of overcapacity (Lin, Cai, and Li, 2003; Zhang, 2014), especially in relation to the manufacturing of steel, cement, and photovoltaic glass, which may seriously undermine China’s production structure. Emerging industries, including industries relating to wind power, photovoltaic, carbon cellulose, are also showing signs of overcapacity materialising in the near future following a similar developmental approach as the traditional ones (Yin, 2018). In order to overcome the challenge of overcapacity, a series of actions, solutions, and suggestions will be discussed in the next section.

6.3.3. Agriculture

Labour productivity levels for the agricultural sector in both China and the US are calculated in the same manner as the previous two (see Table 6.7 and Figure 6.8). The result of sectoral productivity is rather similar to the other two as well. With about 100 times more labour involved in agricultural production, in 2014, China’s labour productivity in the realm of agriculture was about 30 times lower than that of the US.
Table 6.7 Agriculture sector labour, value-added, and productivity, China and US, 2002-2014

<table>
<thead>
<tr>
<th>Year</th>
<th>US Labour (million)</th>
<th>US Value added (Current US$)</th>
<th>US Productivity (V/L)</th>
<th>China Labour (million)</th>
<th>China Value added (Current US$)</th>
<th>CN productivity (V/L)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>3.34</td>
<td>106400</td>
<td>31856.2874</td>
<td>366.4</td>
<td>195585.357</td>
<td>533.80283</td>
</tr>
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<td>2003</td>
<td>2.275</td>
<td>130076</td>
<td>57176.2637</td>
<td>362.044</td>
<td>205005.437</td>
<td>566.244536</td>
</tr>
<tr>
<td>2004</td>
<td>2.232</td>
<td>153599</td>
<td>68816.7563</td>
<td>348.298</td>
<td>252534.796</td>
<td>725.03822</td>
</tr>
<tr>
<td>2005</td>
<td>2.197</td>
<td>149270</td>
<td>67942.6491</td>
<td>334.419</td>
<td>266081.3</td>
<td>795.652461</td>
</tr>
<tr>
<td>2007</td>
<td>2.095</td>
<td>152255</td>
<td>72675.4177</td>
<td>307.31</td>
<td>365205.389</td>
<td>1188.3941</td>
</tr>
<tr>
<td>2008</td>
<td>2.168</td>
<td>164224</td>
<td>75749.0775</td>
<td>299.233</td>
<td>471268.007</td>
<td>1574.9199</td>
</tr>
<tr>
<td>2009</td>
<td>2.103</td>
<td>147777</td>
<td>70269.6148</td>
<td>288.905</td>
<td>499956.085</td>
<td>1730.52071</td>
</tr>
<tr>
<td>2010</td>
<td>2.206</td>
<td>170356</td>
<td>77223.9347</td>
<td>279.305</td>
<td>581282.956</td>
<td>2081.17634</td>
</tr>
<tr>
<td>2011</td>
<td>2.254</td>
<td>205527</td>
<td>91183.2298</td>
<td>265.942</td>
<td>714281.514</td>
<td>2685.85449</td>
</tr>
<tr>
<td>2012</td>
<td>2.186</td>
<td>194255</td>
<td>88663.2205</td>
<td>257.73</td>
<td>806246.376</td>
<td>3128.25971</td>
</tr>
<tr>
<td>2013</td>
<td>2.13</td>
<td>234079</td>
<td>109896.244</td>
<td>241.71</td>
<td>892890.506</td>
<td>3694.05695</td>
</tr>
<tr>
<td>2014</td>
<td>2.237</td>
<td>223860</td>
<td>100071.524</td>
<td>227.9</td>
<td>949573.526</td>
<td>4166.62363</td>
</tr>
</tbody>
</table>

Source: (PRC. National Bureau of Statistics, nd; US. Bureau of Labor Statistics, nd; World Bank, nd)

Figure 6.8 Agriculture sector productivity, China and US, 2002-2014

The general trend that can be observed from 2002 to 2014 is that the gap between the two countries is widening. One significant difference in this sector, and not shown in the previous two, is that China is maintaining a growth rate of 0.1-0.3%, whereas its counterpart the US is much more unstable, jumping between positive (0.2%) and negative (-0.1%) growth. It can be assumed that China’s growth in terms of labour productivity is higher than the US based on these numbers; however, with a much lower starting point, it would also take a longer period of time - than within the foreseeable future - for China to level with the US in the agricultural sector.
The fact is that although China’s total production and value-added in agricultural commodities are the highest in the world, Chinese production methods are still mainly based on rural family groups with small-sized lands as their ‘responsibility’. In very few cases, mainly in the east and central part of China, machinery has been introduced in agriculture production with support from collective groups or subsidies from the government (Fan, Zhang, and Robinson, 2003). With a large portion of the rural population still relying on human and animal labour, it is difficult to make a dramatic improvement in productivity. Furthermore, as the agricultural sector takes up merely a tiny portion of total GDP and is decreasing its share every year, any changes, regardless of improvement or downturn, would not be of great significance to the whole picture of China’s overall productivity.

6.3.4. Summary

Many existing reports and studies provide facts and insights into other aspects of China’s low productivity levels. For example, the Penn World Table 9.0 provides data on total factor productivity (TFP), along with an indicator called ‘TFP level at current PPPs (USA=1)’ (CTFP). This looks at TFP levels in relation to purchasing power when compared to the US. Between 1950-2014, the numbers for China’s CTFP were under 0.5 at all times (PWT, 2017) compared to the US.

The reason for China’s low productivity is two-fold – on the one hand, the Chinese production method is rather crude, mainly relying on the input of massive natural resources and the advantages of low land and labour costs with high energy consumption and much pollution (Sinton, Levine, and Qingyi, 1998). On the other hand, there is also a lack of technological innovation in China’s production structure, which falls behind the US, particularly regarding new material, heavy machinery manufacturing, and core technologies (Lu, 2005). These factors lead to a relatively low value being added to products during the production process. Though China participates in and occupies a large share of the global market, in fact, it occupies the lowest end of the whole industrial chain for certain kinds of products or services.

In the aftermath of the ‘One-Child Policy’ which was initiated in the 1980s, China has become an ageing society. With the overall population continuing to expand, the overall labour force is experiencing a slow-down in growth. This means as the labour-population ratio reduces, the trend for the cost of labour is rising. The crude production method that relies so heavily on an
abundant and cheap labour force, once an advantage, is likely to create challenges for China’s production sector in the near future (Zhang, Yang, and Wang, 2011).

Therefore, a further transformation of the sectoral composition is urgent for China to continue the industrial upgrade, from labour – and resource-oriented to technology-oriented, while promoting its own leading brands. Only with this can China close the gap with the US, and this cannot be achieved quickly. Without these problems being solved in the coming years, it would be unlikely for China’s production pillar to develop a healthier growth mode and surpass the US, let alone approach a hegemonic transition.

Overall, through the analysis of this section, it is found that productivity is a major constraint on China’s economic power. Based on the current statistics, China’s production structure exhibits unbalanced development, lacks support from the most value-adding sectors, and shows no evidence that such economic foundation is capable of sustaining a rising hegemonic power.

6.4. China’s Production Strategy and External Dependence

As was introduced in the second section of this chapter, external activity is an important factor to consider when analysing the productive power of a country. Certain levels of external activity can be beneficial and even greatly enhance one’s economic performance, therefore creating the opportunity for hegemonic ascendancy. Meanwhile, excessive external dependence may lead to high vulnerability and consequently hamper or even undermine a country’s economic power. This section of the chapter explores China’s historical and current external activities to evaluate the level of external dependence, and determines whether this is likely to contribute or hinder China’s rising economic power.

This section consists of two major topics, with existing literature suggesting that external dependence can relate to strategic weaknesses in relation both to investment and trade – that China’s production relies on foreign capitals and foreign markets (e.g. Lake, 2002; Gamble, 2002; Norrlof, 2010). The paragraphs below first review the dynamics associated with China’s inward foreign direct investment, which shows the country’s production to be dependent on foreign capital. The other is exportation, which refers to China’s production output to other parts of the world and China’s increasing reliance on exportation. Together these two aspects
can indicate the level of dependence on external actors that are experienced by China’s production structure. By comparing it with previous hegemons, this section can, therefore, evaluate the advantages and vulnerability of China’s production, as well as its potential for hegemonic ascendency.

6.4.1. ‘Open Door’ Policy and FDI

The opening up of the market was necessary in order for China to move on to transnational activities. China’s massive population, meaning cheap labour, and relatively abundant materials have become an attraction for many foreign companies. Many scholars have suggested that China’s spectacular growth rate is partly due to its ‘open door’ policy and surging FDI inflow (e.g. Prime, Subrahmanyam, and Lin, 2012; Braodman and Sun, 1997).

During mid-1988, the No.7 Order of the State Council of China, also called Provisions on Encouraging Foreign Investment, laid down some general guidance on this issue with immediate effect. Apart from the cheap labour force, materials, and attractive market size that China naturally possesses, the No.7 Order also made several preferential policies for foreign investors looking to invest in enterprises that ‘produce to export…; or/and introduce advance scientific technology or are in the innovation industries’ (PRC. State Council, 1988). These preferential policies include discounts on administrative fees, social insurance responsibilities, taxation, and priority in registration. These policies are still in effect today. As a result of this ‘open door’ policy, FDI received by China has tripled in the recent decade, from $37.521 billion in 1995 to $119.562 billion in 2014 (PRC. National Bureau of Statistics, nd). Investments made in manufacture, though gradually reducing, have taken the biggest share of all, with real estate slowly expanding, while the situation for other industries is staying relatively stable.

In the early 2000s, The Development Research Centre of the State Council of China concluded that foreign investment was an organic and healthy component of China’s economic development. It referred to IMF statistics showing that in relation to China’s 10.1% GDP growth rate in the 90s, FDI had contributed 3%. By introducing FDI into China’s production structure, there was a great benefit to the gross domestic capital formation (GCF), productivity and value-added, exportation, foreign exchange, employment, scientific advancement, and taxation (Chen, 2004; Sun, 2012; Qu et al., 2013).
In the latest report from China’s Bureau of Statistics, other researchers have suggested that China’s foreign investment is also growing steadily (Xu et al., 2016) – the industrial and regional structure of the foreign economy is constantly being optimised. Due to preferential policies, a technology spillover effect has begun, further improving the quality of China's foreign capital. Meanwhile, though FDI has been constantly increasing, its share in total domestic investment, as well as the number of registered enterprises and employment, are decreasing.

More recently, the State Council made the decision to popularise and further simplify the governmental registration and administrative management of foreign-invested enterprises, after success in four ‘test areas’. Commentators believe that this will further promote China’s economic development, although it also means a challenge to the government’s management capacity (Zhu, 2016).

Some studies have suggested that FDI could have a negative impact on production, depending on the type of investment, sector, scale, duration, location, and density of local firms. Therefore, a country should not blindly apply pro-FDI policies as ‘FDI might serve not only a way of doing money, but also a way of acquiring a certain control, both economic and political, in the host country’ (Žilinskė, 2010:335). Others have suggested that whether or not FDI will create a negative impact depends on the internal environment of the host country, as well as greenfield investment, meaning investing in an undeveloped area is more beneficial than investments made in the form of mergers and acquisitions (Moura and Forte, 2010).

That is to say, the most positively effective way to use FDI is by focusing on the potential of technology, labour, and education spill-over. Applying these suggestions to the case of China, it can be assumed that China does indeed greatly benefit from the technological innovations of FDI. However, this effect has decreased, compared to the late 1990s and early 2000s when about 70% of FDI went to manufacturing industries.

To date, the focus of FDI is shifting from manufacture to real estate and financial services. There is hardly any spill-over effect in the real estate industry despite 30% growth of total FDI. Meanwhile, the risk of foreign actors gaining control in a host country, and suggested by Žilinskė (2010), is unlikely to happen in China, either. As mentioned above, though with a
growing actual amount, the share of FDI among total investments, and the ratio between FDI and GDP are in fact decreasing.25

As the World Bank has suggested, China’s approach in terms of introducing FDI to its production realm is successful and cautious, as it maintains a health synchronisation between foreign investment and institutional capacity (World Bank, 2010). In conclusion, in the case of China, foreign direct investment does not cause external China’s production structure to experience vulnerability or excessive dependence; neither does it generate great benefits that are enough to push it forward to hegemonic ascendancy because of the tiny portion it occupies in China’s overall production structure.

6.4.2. Exportation

Another widely acknowledged factor that boosted China’s production and economic growth is its intensive focus on exports. Besides the ‘open door’ policy which welcomes foreign investment in, a set of ‘going out’ strategies have also been encouraging exportation and outward investment since the late 1980s, providing exporting companies with preferential policies. This focus and reliance on exports reached a peak during the late 1990s when China saw massive growth in exportation and a plunge in its RMB exchange rate. To further boost sales overseas, the PBOC deliberately and unilaterally devalued the RMB in 1996-1998.

The advantage of China’s exportation is founded on cost competitiveness. China’s huge population, massive landmass, relatively abundant resources, and the advantage of a depreciated currency mean that the cost for manufacturing and processing can be much lower than elsewhere. The Chinese economy has been described as benefitting from ‘export-oriented’ growth (Kahrl and Roland-Holst, 2008).

At the China Economists Forum in 2009, scholars suggested that the ratio between exportation and GDP had become bigger than it should be – export volume grows at the speed 1.5 times as GDP growth and is not sustainable (Sina Finance, 2009). During the period 1980-2010, annual exportation growth was, on average, 1.5 times the annual GDP growth rate, while the highest record of exportation-GDP ratio was 35.65% in 2006 (iFeng, 2009). More recently, in 2015, the

25 A mere 2.5% on average from 2005-2010 and still decreasing, see (World Bank, nd)
share of exportation for China’s GDP dropped to 22.37%. However, this number is nearly twice as much as that as the US (see Figure 6.9). It is also found that although China’s dependence on exporting labour-intensive products and services has relatively declined and that on electronic equipment has increased by the late 2000s (Xie and Zhao, 2014), China’s production is still heavily relying on foreign technology (Grimes and Sun, 2014). This signifies an unbalanced trade pattern with high value-added imports and low value-added exports (Liu et al., 2011). The value-added in China’s exportation remains rather low within the global value-added chain.

Figure 6.9 Export of goods and services (% of GDP) by country

Source: (World Bank, nd)

As mentioned at the beginning of the chapter, hegemonic leadership needs to be founded on leadership in high value-added economic sectors. In the contemporary international political economy, manufacturing has been surpassed in this regard. It was also suggested by the Power Transition Theory that emerging powers must rise through ‘internal development’. These days, the focus of economic development is moving from traditional production to services, particularly financial activity. This makes an export-oriented economy even less likely to succeed in terms of hegemonic ascendancy.

Further to the unlikeliness of hegemonic ascendancy, China’s export-oriented economy can be problematic. Indeed, it is questionable whether this growth model is sustainable. As the world’s total market capacity is limited and profit margins already low, it is hard for China to push its exportation further (Guo and N'Diaye, 2009). Some have spotted the disadvantage of China’s
economical over-reliance on an export market, considering it greatly imbalanced and ‘increasingly jeopardized by its “excessive investment” and “over dependence on demand from other countries”’ (Hung, 2008:151).

Being export-oriented indeed leads to vulnerability, for example, being passive and affected by other external factors such as exchange rate and global financial downturns which are often unpredictable. As shown in the aftermath of the 2008 financial crisis worldwide, with the US being especially affected, China’s 2009 exportation suffered a significant $244 billion decrease with negative 10.2% growth. Its annual GDP growth rate also dropped from 14.2% to below 10%, according to the World Bank (Figure 6.1). Since the 2000s, appreciated currency and rising labour price made China’s products less attractive than those from other developing countries as they lose the price advantage (Cegłowski and Golub, 2012). Besides that, China is also facing an increasing number of challenges, including an anti-dumping policy posed by external actors (Zanardi, 2004; Prusa, 2005), requirements for policy transparency (Žilinskė, 2010), and issues over intellectual property protection (Harris, 2008; Evans, 2002).

It is impossible to confirm that there is any potential for hegemonic leadership due to China’s exportation; but rather the contrary, as China has been passively seeking solutions to promote and sustain its exportation and secure economic growth. There are also suggestions that China’s exportation should move away from the cheap labour-oriented and processing-oriented mode and instead towards service industries and technological innovation (Jarreau and Poncet, 2012).

6.4.3. Summary

By analysing the current situation of China’s inward FDI and exportation, the conclusion is that no significant evidence of potential hegemonic power can be found from the aspect of external reliance. China has been receiving sizable FDI, which contributed greatly to its economic growth during the early stages of economic reformation and liberalisation. By drawing the cautious strategy of introducing FDI, China’s economy does not seem excessively dependent on external actors; however, the effect of FDI is relatively small and continues to decline compared to the overall size of China’s economy. As for China’s exportation, there is a great level of dependence as historical data proves, echoing with theoretical analyses provided in the existing literature. Furthermore, scholars have observed incoming challenges for China in terms of further expanding its exportation; these make China’s hegemonic
ascendancy even less likely. Overall, while its ‘open door’ policy and inflowing FDI are no longer a significant factor in China’s economic development, excessive dependence on the export-driven economy is a major weakness of China’s rising economic power.

6.5. Chapter Summary

This chapter has analysed the potential of hegemonic transition regarding China’s production structure, using the aspects of production volume, productivity, and external dependence. These have been selected to be the indicators for analysing a country’s production structure according to existing literature and empirical cases studies on previous instances of hegemonic transition.

Production volume allows for a broad overview of the expansion of economic activity, while the other two aspects explore more in-depth the potential and sustainability of China’s production structure. Generally, productivity reflects the ability of production by each unit of input which is used in many empirical analyses by scholars. External dependence is considered to be a factor that should be kept in balance, as certain levels of external activity can boost production whilst excessive external dependence may hinder and even undermine economic growth.

The overall performance of China’s production structure, as reflected in its GDP and growth rate, is going through an astounding period of rapid development not being seen elsewhere. The reason for its outstanding production volume is, in short, a change in ideological guidance and liberalisation of the market. The reforms in the agricultural and industrial sectors have allowed China to take up a large share of the world’s total production in the corresponding sector. However, reforms in the service sector only started more recently. Although these achievements are great, there is neither facts nor significant potential that point to China surpassing its counterpart in the US. China’s total production volume, as reflected in GDP, still has a sizeable way to go to catch up, although its surprisingly high overall GDP annual growth rate adds a positive assumption.
As for productivity, there is a definite result from the quantitative analysis whereby China’s labour productivity is shown to be much lower than the US in all three production sectors. The growth of China’s labour productivity is also lower than in the US in general, especially within the service sector, which is considered increasingly vital to economic development. This conclusion of China’s low productivity is supported by not only labour productivity but also other related statistics, for example, total factor productivity. There are a number of governmental reports also urging China’s production structure to adopt more high-tech innovations and to keep shifting towards service sectors. At the moment, however, the chance of a US-China hegemonic transition regarding productivity seems very unlikely.

Finally, China’s production structure experiences a certain level of external dependence due to the heavily export-oriented model of economic growth, although no dependence can be identified based on inward FDI. Exportation has taken a much greater share of China’s total GDP in comparison to the US. It has turned its early-stage advantage into a burden for the Chinese economy, which now has to maintain its high-speed growth and massive exportation levels. Scholars have questioned whether this growth mode is even ‘sustainable’.

With a combined view using these three aspects, it is undoubted that there are still great gaps between China and the US from all three perspectives. Despite China’s higher growth rate, this is a growth rate that will gradually slow down and present an increasing amount of new challenges. It is unlikely that those gaps will be reduced within the foreseeable future. While internal reform and development have, overall, intensively promoted China’s economic power, low productivity and excessive reliance on exportation are a significant setback in relation to the production aspect of economic power. Therefore, China’s economic power based upon the production structure cannot move China towards a sufficient hegemonic rise.
7. External Development of the Production Pillar: Resource Diplomacy

This chapter explores the external implications of China’s production structure through an analysis of its resource diplomacy. It is widely acknowledged that resources represent a fundamental part of the development of the economy and that stable access to raw materials provides a foundation of economic expansion from the perspective of production. Acquiring resources is also vital to the survival and sustainability of states. Buckley et al. (2010) also noted that China’s outward direct investment is significantly resource-seeking. Therefore, the ability to acquire stable access to resources is a significant source of strengthening China’s economic power for its hegemonic rise.

Through this chapter, this thesis evaluates the extent to which China’s resource diplomacy has sustained the country’s production and economic development as it contributes to the political and economic dimensions of China’s hegemonic expansion. To do this, the chapter starts by providing a framework defining what indicators are to be looked at and in what way this study should be conducted. This section includes a review of current studies to establish an analytical framework identifying institutional foundation, trade volume, infrastructural development, and challenges to partnership sustainability as key indicators. Then, in order to gain a systematic overview of China’s approach to securing external access to material resources, interactions across the resource-rich regions of Africa, Asia, and Latin America are considered.

The overall observation indicates that China’s resource diplomacy in all three regions is significantly supporting China’s production and economic growth, and hence promoting China’s economic power in relation to the production structure from the external aspect. As is outlined below, important points of difference and similarity are displayed across these regions (Table 7.1). The three regions show different patterns of cooperation. ASEAN has the highest level of cooperation in all aspects, followed by LAC in second place, and then Africa. While trade volume of China in all three regions has declined in recent years, investment, especially investment in resource-related projects, has been increasing. As long as China keeps up its strategy of cooperation, rather than exploitation, and maximises mutual benefits, its resource
diplomacy is secured and promising in these three regions. The current status of China’s resource cooperation can thus continue to contribute to its rising power.

Table 7.1 Key findings of China’s resource diplomacy, 2000-2015

<table>
<thead>
<tr>
<th></th>
<th>Africa</th>
<th>Latin America</th>
<th>ASEAN</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price</td>
<td>Largely following rising international market prices, but with mitigating mechanisms to offset these rises</td>
<td>Medium (LAC to China ~80, China to LAC ~160 in 2015)</td>
<td>High (total ~472.16 in 2015)</td>
</tr>
<tr>
<td>Securing access</td>
<td>Low (Africa to China ~50 in 2015; total ~200 in 2012)</td>
<td>Medium (LAC to China ~80, China to LAC ~160 in 2015)</td>
<td>High (total ~472.16 in 2015)</td>
</tr>
<tr>
<td></td>
<td>Challenge</td>
<td>Medium risk (need industrial upgrade)</td>
<td>Low risk (regional imbalance)</td>
</tr>
<tr>
<td></td>
<td>Infrastructural Investment</td>
<td>High (biggest infrastructure financier and aid)</td>
<td>High (accumulated $296 billion worth projects till 2017, AIIB established)</td>
</tr>
<tr>
<td></td>
<td>Major commodity imported by China</td>
<td>Energy, minerals</td>
<td>Agricultural goods, natural rubber, minerals</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Energy, minerals, agricultural goods</td>
<td></td>
</tr>
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7.1. Operationalising the Study of the Production Pillar: Resource Diplomacy

Within Strange’s conceptualisation of structural power and within associated IPE literature on hegemony, the issue of access to resources featured as a prominent focus of analysis. In the paragraphs below, the literature on the topic of external access to resources and power in IPE are engaged with, to identify and explain the dimensions that are focused on through this chapter. Overall, three topics are drawn from the existing literature. These, namely, are the relation between hegemonic power and resource, indicators to evaluate resource diplomacy, and the case selection of this chapter.

As was established briefly in Chapter 3, predominant scholarship on hegemony and international political economy noted that access to material resources represents an important foundation of expanding power. Existing literature generally agree that early hegemons conquered vast lands for the significant purpose of taking resources from those lands to fuel their own domestic production.
The Romans built mines and started exploitation as soon as they had taken over Britain between AD 43 and 410 (Palmer and Palmer, 1992). For Spanish hegemony, gold and silver from Latin America were once one of its primary colonial targets (Tenace, 2003; Quijano, 2000). For the British Empire, importing massive amounts of raw materials was the essential method of building its hegemonic regime, as these materials supported the industrialisation of the nation, with its prospering fields of manufacturing and exportation (Lake, 2002).

As the current world hegemon, the US might seem less interested in precious metals than its predecessors. Instead, its aim is energy and fuels, as these are the new lifeblood of industrial development, proven by its military strategy in the Persian Gulf (Bromley, 1998). China, currently one of the major countries seeking promotion on the political and economic world stage, has a huge demand for resources due to its massive population and fast-paced level of economic development (Kambara, 1992). In its pursuit of power, therefore, resource-related diplomatic activities are urged for the purpose of maintaining and upgrading its rapidly expanding production structure.

Theoretically speaking, the relationship between resources and power has been identified and supported by several international political economy classics. The realist school believes that material, manifesting in the control and access of resources, is a direct indicator of state power (Krasner, 1976; Kitchen, 2010). Hegel considers property as the tool for defining dignity; with the ‘property’ in question considered equal to ‘material’ (Antonio, 1981; Stillman, 1988). Marxism and the later critical theories developed upon Hegelian materialism add that institutions that control the most resources possess the most power (Stillman, 1983; Migdal, Kohli and Shue, 1994). This was discussed in more detail in Chapter 3 that introduced the two-pillar approach. The significance of repeatedly mentioning this relationship here in this chapter is to clarify how resources can affect a rising hegemonic power.

Resources, here generally considered as natural resources, are exclusive and rivalrous (Grafton et al., 2004), because one player taking more resources can lead to less access for others, and one can forbid others from taking from the same supply. Due to this excludability and rivalry, there are naturally competitions between states over accessing resources. As for the question of hegemonic transition, the pre-existing hegemon would be threatened if a potential successor began seizing an increasing amount of resources and narrowing the capacity of the former’s
resource access. When this occurred, conflicts would become inevitable. Therefore, resources have a direct correlation with shifts in power.

Although resources may be the cause of conflict, they do not always trigger a direct or immediate military reaction, especially in the circumstances when the two conflicting parties are super states and big powers. Rather, in the modern era, diplomacy is the most favoured method, and this is when ‘resource diplomacy’ comes into the picture.

By taking ideas from existing literature below, this thesis has established a systematic approach to evaluate China’s resource diplomacy. The correlating factors are trade volume, institutional foundation of partnership, infrastructural investment, and potential challenges to sustainability, which will be reviewed in the following paragraphs.

According to Zweig (2006:2), resource diplomacy can be defined as:

... diplomatic activity designed to enhance a nation’s access to resources and its energy security ... (1) insuring a stable supply of energy and resources; (2) keeping resource supplies at acceptable prices; and (3) being able to transfer those resources to fixed locations, not necessarily to the home country, where they are processed or consumed.

This kind of activities will be the target of the analyses within this chapter. The major question now is how to analyse and evaluate a country’s resource diplomacy; while later, the question becomes how to analyse and evaluate China’s resource diplomacy for the purpose of answering if such activities are pushing forward a power shift.

There are two distinct methods for analysing resource diplomacy, as Krasner (1976; 1978) considers it, the deductive approach and the inductive approach. The logical deductive approach simply analyses state behaviour based on theories that comply to some fundamental principles such as having ‘rational players’ in an ‘international system of interdependency and anarchy’ (Krasner, 1978). This approach can be applied when making general explanations and predictions, however, it struggles to make sense if the state behaves against a direct interest. This circumstance could happen when the various interests of the state, different external parties, and other internal players from within the national society, clash.
The empirical inductive approach, on the other hand, can solve this problem. National interests are often complex and possess more than one target. It is with the inductive approach that the rationale of state behaviour can be identified. The inductive approach can apprehend the top priority among different interests by studying historical state behaviours. Through studying cases of US resource diplomacy, Krasner concludes that generally, across time, there have always been three themes within resource diplomacy: 1) a continued relationship between resources and economic performance; 2) resource policy always relating to national defence; 3) an individual’s wellbeing should always be reflected. In other words, the themes here are minimisation of price by maximisation of competitiveness, security of supply, and national security in the order of increasing importance (Krasner, 1978:52:331).

Notably, one major difference between Krasner’s cases and China’s is that the US is defined as a ‘weak state’ while China is the opposite. A weak state means that governmental institutions not only meet difficulties from external players, but also need to cope with challenges from within their own society under a liberal-capitalism ideology. Firms and enterprises have greater leverage in counterbalancing state power and operating with greater freedom. This could complicate the case study due to the participation of non-state actors and private businesses.

In contrast, China exerts highly concentrated central control over political and economic activities. With the government and enterprises’ behaviour strategically unified and usually acting as one, modern-day China is often referred to as an example of ‘state capitalism’ (Li, Li, and Zhang, 2000; Szamosszegi and Kyle, 2011). Therefore, case studies on China’s resource diplomacy can, in fact, be simpler and more straightforward because individual utilities and preferences are of no concern. Krasner’s statist perspective can be applied to case studies of China with less problematic ‘internal interest clashes’ as individual wellbeing is considered included in and reflected by national interests.

That is to say, a sensible way to study China’s resource diplomacy is to adopt largely the same manner – a deductive approach to existing cases to identify what is given as the priorities of national interest, while making an evaluation using an inductive analysis on how this has contributed or will contribute to China’s domestic economic performance, foreign relations, and international influence.
To sum up, a few parameters can be applied to evaluate resource diplomacy according to the existing literature. As Zweig (2006) has already pointed out, it concerns three elements: stable access, stable price, and the ability to physically transfer materials.

During the case study, it is found that the price of materials purchased by China from overseas is mostly determined by the international market price except in some very rare occasions. A study on China’s impact on Latin America’s export shows that China’s ever greater demand for commodities has been constantly pushing up global commodity prices (Jenkins, 2011). For another example, the global oil price shock has impacted China’s manufacturing index and the stock price of oil companies, just as it did to other industrialised countries (Cong et al., 2008). In another observation, China’s demand for resources has also raised commodity prices exported by Africa, ‘particularly for oil and metals from Africa’ (Zafar, 2007).

Figure 7.10 World Commodity Price Index, all index, 2000-2015

Figure 7.11 Commodity Import Price Index, China, 2000-2015
Figure 7.12 World Commodity Price Index, by commodities, 2000-2015

Figure 7.13 Key Commodity Import Price, China, 2000-2015

Figure 7.10 and Figure 7.11 present the commodity price index worldwide and import price index of China between 2000 and 2015 provided by the IMF, evidencing that the price at which China’s import of goods generally follows the global trend. A comparison of commodity/import price by commodities (Figure 7.12 and Figure 7.13) also shows that for some of the key products China import, it is unlikely that China can manipulate the price element. Through these existing researches, it can be concluded that China is not exempted from the demand-supply principle of the market and is not acquiring resources at a de facto much lower or favoured price.
This does not mean that China can only passively accept the price set by the global market. Instead, there are many mitigating mechanisms over price. China has been actively engaging with resource-rich countries on a state level or even regional level, building trade regimes and negotiating deals to bring down tariff and transactional cost (Ikenberry, 2008; Antkiewicz and Whalley, 2011; Song and Yuan, 2012; Kwei, 2013). Later part of this chapter found out that the trending approach of investing and carrying out joint ventures with resource-rich countries is gradually replacing the traditional buyer-seller relations. Rapport-building became crucial and can often bring down the total cost of acquiring resources.

The element of transferring materials will be examined by looking at investment and infrastructure development. More specifically, this means looking at China’s investment in exporters’ infrastructure development, which aims to safeguard Chinese firms’ acquisitions and control over materials, as well as provide lower cost and a more convenient means by which to ‘transfer materials to fixed locations’. By participating in the local infrastructure development, China is able to safeguard the means to transport resource to where it is needed and to trade resource with infrastructure in some cases (Alves, 2013). Further to the purpose of transferring materials, China’s offshore infrastructural development projects are also vital to resolve domestic overcapacity and overstocking, which many economists already observe happening in China as mentioned in the previous chapter (Lin, Cai, and Li, 2003; Zhang, 2014; Yin, 2018). Statistical facts present a straightforward picture of the current condition of China’s trade and cooperation with target regions.

Stable access to resources will be analysed from three aspects. First, it is evaluated through statistical data relating to trade volume. Trade volume is a direct indicator to review the intensity of resource-oriented diplomatic activity, as found in much of the existing literature on resource strategy (e.g. Søberg, 2000; Taylor, 2009; Zhang, 2016).

Second, the nature of the inter-state agreements underpinning the resource flows is assessed. Specifically, this involves reviewing the institutional framework and exploring the political foundation of the partnership. It is about providing an understanding of the non-economic factors that facilitate cooperation, such as political alliances and free trade agreements at a governmental level. It is found in a range of existing literature that formalised political framework can effectively stabilise cooperative partnership (e.g. Pekkanen, Solís, and Katada,
2007; Gleason, 2010). To explore this factor, this chapter focuses on the development bilateral and regional trade framework between China and the target countries. Although multilateral trade organisation is a undeniably a topic related to China’s trade and production structure, it remains a lesser focus for this chapter as scholars have pointed out China’s reluctance to be the leader of the WTO and a decline of multilateral trade regime under the contemporary world politics context (Scott and Wilkinson, 2013; Bishop and Zhang, 2019).

Third, sustainability of the partnership will be evaluated by focusing on potential challenges to the exiting trade partnership. Zhao (2008), with the example of Asia-Pacific relations, points out that China’s resource diplomacy not only means opportunity but also a source of conflict for its trade partners. These factors, according to the existing literature on China’s resource strategy, include, but are not limited to, concerns about neo-imperialism, moral standards, and balancing mutual interests (e.g. Taylor, 2007; Berger and Wissenbach, 2007; Cheru and Obi, 2010).

Through the main body of the chapter, this study applies the framework outlined above to China’s resource diplomacy in three regions: Africa, Latin America, and Southeast Asia. Broadly speaking, these regions have been selected on the basis of being resource-rich developing regions. In the paragraphs below, this study expands upon this rationale.

To date, diplomacy is often associated with the term ‘geo-political strategy’; therefore, it is a reasonable consideration to analyse resource diplomacy based on geographical locations. The selection of case studies for this chapter targeted developing countries and regions that are rich in natural resources and/or primary commodities, while also having developed a strategic partnership with China. The reasons are, on one hand, that the countries fulfilling this requirement have direct activities that involve trading in raw materials, and on the other, that being developing economies means most of these countries rely heavily on the exportation of raw materials to fuel their economic development, thus catering to China’s needs.

The areas of interest include Africa, Latin America, and Southeast Asia. This selection provides a straightforward description of China’s resource strategy. With these suitable cases, this research will be able to proceed to further analysis with updated information and materials, thus providing a more thorough overall understanding of China’s resource diplomacy. For rising powers like China, over-populated and seeking continuous growth, these three resource-
rich regions are strategically significant in relation to economic development and political strength (Tietenberg and Lewis, 2016; Sachs and Warner, 1999).

This research does not intend to include the Middle East in the analysis of this chapter, albeit China’s increasingly intense engagement with the Middle East since the OBOR initiative and President Xi’s first visit to the region (Luft, 2016). This is mainly because the case study areas were selected according to their significance to the time period. While China’s multilateral negotiation and a few rounds of strategic partnership dialogues with these oil-rich countries took place since 2010, effort to achieve a free trade agreement with the Gulf Cooperation Council was fruitless. The negotiation only just restarted in 2016 and not yet produced any solid result as of mid-2019 (Qian and Fulton, 2017; Fulton, 2019). In contrast, steady progress on official and non-official forums, bilateral and multilateral free trade agreements, and significant outcome of infrastructure development could be found since the Millennium in other regions studied in this chapter. While acknowledging that China’s engagement with the Middle East is trending and promising, for the purpose of this chapter, the approach used in this chapter, and time period focused, analysis on China-Middle East resource cooperation is more speculation than evaluation.

Some scholars have pointed out that since the end of the Cold War, China has been experiencing an increasing need to ‘secure natural resources and raw materials, most notably energy and minerals such as iron ore, copper, and aluminium’ (Friedberg, 2006:6). As a result, China’s central government has pursued a grand strategy to promote China’s foreign trade and thus acquire and secure access to an abundance of materials.

For a long time now, scholars have been studying China’s grand strategy in Africa. The trend in recent years has resulted in stable but increasingly intense cooperation between the two. Besides metals and other minerals, China has a growing interest in obtaining oil from Africa. Western scholars consider this pursuit fuelled by two purposes: firstly, the securing of oil supply in the short term for national economic development, and; secondly, acquiring power and respect as a ‘great state’ on the global stage (Taylor, 2007). The China-Africa relationship was built upon two foundational elements. One is the large scale of investment and aid sent to Africa for constructing infrastructures as well as humanitarian aid, the other is a consensus on standing against Western ‘imperialism’ (Brookes and Shin, 2006); the latter gives China an advantage when competing with Western importers over African countries’ favours.
Meanwhile, China’s interest in Latin America has been emerging in recent years as well (Dumbaugh and Sullivan, 2005). Traditionally, Latin America has had close strategic cooperation with the US in terms of its supply of trade and raw material. With Brazil and Mexico as two major emerging economies, Latin America’s own foreign policies have gradually shifted focus and its cooperation with China is becoming increasingly more frequent. The population of China means a stable long-term demand for natural resources. Further to that, China’s foreign policy is run on a ‘non-interference’ principle, contrary to the US. For most emerging economies and developing countries, efficiency is often given the top priority; moreover, the non-interfering attitude taken by China is often welcomed by Latin American businesses (Domínguez, 2006). Therefore, regarding the acquisition of stable access to resources at a reasonable cost from overseas, this chapter will explore how China’s strategy can secure its access, to what extent such cooperation is open to expansion, and how this may implicate China’s economic development and, therefore, competitiveness, in terms of a potential power transition.

The last case involves China’s relationship with its southeast neighbour, ASEAN. The China-ASEAN free trade agreement is the only regional trade regime China has participated in. This establishment represents a frequent exchange of goods and strong interdependency. ASEAN member states, because of the countries’ geographic location and tropical climate, produce an abundant amount of mineral ores, natural rubber, and agricultural products which are all of interest to China.

While trade and other forms of cooperation are climbing each year, some disputes have simultaneously emerged over the potentially resource-rich South China Sea. Many ASEAN member states are, at the same time, claimants of the disputed territory, among which the Philippines has already filed and won an arbitration case, along with support from the wider international society. It is intriguing to understand what the potential cause can be for this temporarily shelved dispute to be brought up at this point, and used against China, and the reaction from both sides. This incident signals that the pattern of China’s engagement with ASEAN countries, especially the Philippines, should be changed; at the same time, questions remain about what kind of adjustments should be made and how these adjustments may affect China’s future resource diplomacy in the ASEAN region.
To sum up, by synthesising indicators predominantly mentioned in the existing literature, this chapter studies China’s resource diplomacy in Africa, Latin America, and Southeast Asia by exploring the existing institutional framework of China’s trading activities, statistics on trade volume, infrastructure development, and reflections on the sustainability of cooperation. The conclusion of this chapter will overall indicate the extent to which China’s resource diplomacy support its rising economic power.

7.2. China’s Oil Strategy in Africa

In order to understand China’s engagement with Africa in the pursuit of natural resources, this research has applied the framework outlined above. After a brief recap on the historical foundation of diplomatic relations, this section examines China’s strategy in Africa by looking at its institutional foundation, trade volume, infrastructural development, and sustainability. The suggestion is that China’s access to African raw material is overall stable. Although this cooperation has the least trade volume and institutional foundation among all three geographic regions studied, this region also has great potential and there is room for development. Besides this, China’s aid and infrastructural development in Africa offer the biggest advantage for consolidating the China-African partnership.

China is involved in long term strategic cooperation with many African countries. And as stated by the government, China’s diplomatic activities are always carried out based on the ‘Five Principles of Peaceful Coexistence’ and the ‘Eight Principles of China’s Foreign Assistance’. In the early stages of building this relationship, when Chinese politics was focused on class struggle – that is, before 1979 - the major purpose of establishing diplomatic relations was to obtain enough support to acquire a legitimate seat for the People’s Republic within the United Nations. Although it experienced difficulties in terms of restoring its national economy, China in return, provided both moral and material support for the liberation and development of African nations. Such cooperation was established upon the common ground of anti-imperialism and decolonisation (PRC. Ministry of Foreign Affairs, 2000).

According to the Ministry of Foreign Affairs for the PRC, since its economic reform and opening-up, China has rapidly entered the era of rising power, with its strategy towards Africa
gradually shifting alongside. Themes of communication have become dynamic as various forms of trading, as well as cultural and educational cooperation, have taken place. To date, the diplomatic activities and cooperation between the two are becoming more entwined than ever, and one of the areas of interest is China’s resource strategy (Rotbery, 2009).

In recent studies, scholars have noted that China possesses an increasing interest in the African oil industry. This is apart from traditional trade goods such as metal ores, as nine out of the top ten African partners trading with China have a dominant oil-oriented industry within their economies (Taylor, 2007). As oil products are the essentials that fuel industrialisation, it is particularly significant for China to acquire stable access to these and thus continue with its fast-paced economic development.

Three decades ago, China was a large net oil exporter. The circumstances have been reversed as China has come to experience a rather severe form of import dependency regarding natural resources, especially oil (Wu and Storey, 2008). According to the National Bureau of Statistics and Chinese customs authority, China’s demand for imported crude oil in 2016 was 5.5 times what it was in 2000 (see figure 7.1). Such oil import dependency may greatly threaten China’s resource security.

Figure 7.1 China’s import volume of selected commodities 1997-2016

Meanwhile, many oil resorts have been discovered on the continent of Africa with increasing production each year (Ka-Ho Yu and Zhou Yunheng, 2016). Hence, China’s diplomatic activities in Africa can be considered as strategically oil-oriented. In the relevant studies, scholars point that of China’s total imported oil, more than a quarter comes from Africa, a number that keeps climbing each year (Yan, 2007). This section examines China-Africa resource cooperation using its institutional foundation, statistics, infrastructure development, and the sustainability of such cooperation.

7.2.1. Institutional Foundation of the China-Africa Resource Relationship

From the literature reviewed above, institutional foundation was found to be an important dimension to resource diplomacy. The paragraphs below assess the foundations of the China-Africa resource relationship, focusing specifically on the formation of state-level official cooperation frameworks.

China was able to build on in order to maintain its cooperation with Africa through multiple channels of communication and cooperation. Throughout the history of China-Africa relation, China has maintained its ‘principles’ of diplomacy mentioned above. The core of these principles is an attitude of non-interference, which refers to mutual respect between sovereignties and territories, non-invasion, equality, and coexistence.

Alongside the independence and decolonisation, African heads of states were experiencing pressure from the West, having to promote democracy and human rights as universal values and internal instability of social transition (Tull, 2006). The situation for China at that time was somehow similar, as the West considered the government’s conduct - in the form of its ‘class struggle’ – a serious violation of human rights. According to the Ministry of Foreign Affairs, some common ground thus occurred between China and Africa, where anti-West consensus was constructed naturally (PRC. Ministry of Foreign Affairs, 2000), with the West having ‘thinly veiled imperialistic manoeuvres intent on interfering in the domestic politics of developing states, and undermining their stability and progress at large’ (Tull, 2006:461). As China presented itself as a country seeking development and holding a similar identity to African countries, the attitude of its ‘non-interference’ was particularly welcomed by African countries, contrary to that for the West.
In the first version of China’s Africa Policy Paper, published in 2006, resource cooperation was listed among other common courses. It declared the aim of ‘enhancing information exchange and cooperation between China and Africa regarding resources’, in a way where ‘Chinese government encourages and supports competent Chinese enterprises to develop and rationally utilise resources in various forms of cooperating with African countries in accordance with the principles of mutual benefit and common development, so as to help African countries to transform their resources into competitiveness’ (PRC. Ministry of Foreign Affairs, 2006). More recently, in 2015, the second China’s Africa Policy Paper stated its intention of deepening cooperation in terms of resource extraction and infrastructure construction (PRC. Ministry of Foreign Affairs, 2015). The White Paper on China-Africa Economic and Trade Cooperation which was published in 2013 repeatedly emphasises the principle of mutual respect and the direction of future development.

China’s pursuit of foreign oil may not only ease the crisis of domestic oil production and the upsurge in demand, but it is also an example of what Chinese political leaders consider as China’s ‘going out’ strategy. Despite the lack of an officially established trade regime between China and Africa, in 2001, the Forum of China-Africa Cooperation (FOCAC) was formed, with the participation of fifty-one African countries.

The first ministerial meeting of the forum set up both an agreed cooperation programme and follow-up mechanism programme calling for three types of meeting – ministerial meetings every three years, senior officials’ follow-up meetings twice every three years, and an African embassy in China meeting with the Chinese Follow-up Committee secretariat twice a year. This forum extended China’s economic engagement with African countries from trade to other fields, such as investment in local the community, production, science, and education projects (FOCAC, 2013). A series of official documents were also produced to provide both long-term and short-term directions.

A secondary forum – the Forum on China-Africa Local Government Cooperation was founded in 2012, and this focuses on the practical issues involved in operating joint projects. These two forums have come to form the institutional framework behind China’s cooperation with Africa. The frequent meetings correspond to the dynamic development of Africa allowing a certain level of flexibility and for prompt adjustments during the process of cooperation, while their
officially set principles provide a solid foundation and wide recognition for their cooperative relationship.

7.2.2. Trade Volume in China-Africa Resource Relationship

Trading activity between China and Africa shows significant mutual benefit (Looy, 2006; Anshan, 2007). China occupies an increasing share of the African market and has become Africa’s second-largest trading partner following the US (Taylor, 2009). From 2009, China took over the first position, while in 2014, the trade volume of China-Africa reached $222 billion, twenty times more than in 2000 (Hu, 2016).

Figure 7.2 China-Africa Trade volume 2000-2012

Source: (PRC. State Council, 2013)

The beginning of this chapter mentions that China is facing industrial overcapacity and has a relatively high level of external dependency regarding its production structure. Conversely, African countries, as late starters to modernisation, have a great demand for manufactured goods and basic infrastructure, thus allowing them to progress further in terms of industrialisation. They also require access to sufficient levels of education, health, security, and technology. Manufactured products exported from China, from daily necessities to machines and high-tech devices, are supplied at a lower price and larger amount due to the labour-
intensive style of its economy (Tull, 2006). The materialised benefits and amicable relationship that emerged thanks to the initial win-win situation, allowed cooperation to snowball; as a result, China-Africa trade volume rocketed, alongside a number of trade-related institutes, governmental or non-governmental, that were established in recent years. Detailed trade flows can be found in Figure 7.2 and 7.3.

A negative balance of trade indicates that China’s demand for African resources is beyond the value of manufactured goods it sells to Africa. A detailed graph on China’s importation with its major African partners is shown below. According to the OEC database, 10 of the eighteen selected countries export a dominant proportion of petroleum products to China and seven of them export mainly metals, including iron ore, copper and refined copper, and precious metals. A few countries, like Kenya and Madagascar, experienced an obvious trend of growth in exporting to China and a switch from food, wood, and textile products to mining products. This means that China has been actively seeking resources in African countries as part of its energy security strategy.

Figure 7.3. China’s Import Volume from Major African Partners, 2003-2015

![China's Import Volume from Major African Partners](image)

Source: (OEC, nd)

In order to acquire access to resources, besides purchasing the end products directly, one major approach is for Chinese enterprises to form an alliance with local African oil corporations, with help and support from the Chinese central government. In some cases, China holds a large
share of the ownership of oil and gas-related investment projects in countries that include Algeria, Angola, Chad, Gabon, Nigeria, Sudan, and Equatorial Guinea (Yan, 2007). This is due to the fact that many African countries are still in the process of industrialisation and development and, therefore, have a rather limited ability to operate large oil extraction projects on their own; instead, Chinese companies, such as Sinopec, CNOOC and CNPC (PetroChina), which are large state-owned enterprises, capable of carrying out these projects, are used.

The projects in Africa led by these three Chinese oil giants involve oilfield exploration, drilling, mining, crude oil supply, refining, transportation, and oilfield ownership (Yan, 2007:28). Scholars have pointed out that even though China does not possess cutting edge technology, what it has is sufficient and useful enough for African oil (Taylor, 2009). In addition to the relatively cheap equipment provided as well as the backdrop of governmental cooperation, Chinese companies, therefore, find it easy enough to obtain contracts with their African counterparts.

7.2.3. China’s Infrastructure Development in Africa

China’s African policy also contains a great amount of aid and investment, particularly in relation to infrastructure construction. China’s infrastructural aid covers a variety of sectors, including telecommunication, seaports, railroads, road networks, and power generation (Edoho, 2011). More than 5000 kilometres of railways have been built in Africa due to China’s participation, and such projects have also provided the chance to train more than 160,000 personnel. For another example, China also participated in building the Ofankor-Nsawam section of the Accra-Kumasi road and the National Theatre in Ghana (Tan-Mullins, Mohan, and Power, 2010).

Among these infrastructure projects, the largest single projects include the railway between Addis Ababa and Djibouti, known as the Yaji Railway in Chinese. Another 480km connection between Nairobi and Mombasa was 90% financed by the Export-Import Bank of China (Li and Liu, 2017). Others include the Tanzania Zambia Railway, multiple projects in Nigeria, the Benguela railway, and the whole East African railway network. Other infrastructure development projects include construction regarding road traffic, harbours, schools and hospitals, making China the largest infrastructure financiers in Africa with an accumulated financial commitment of $15.968 billion up to 2007 (Foster et al., 2009:19).
More recently, Chinese scholars have suggested that China’s African infrastructure projects should gradually shift the focus to energy and electricity in order to catch up with the fast-pace of industrialisation and to aid the wellbeing of local communities (Liu, 2017). Such infrastructure development not only promotes people’s wellbeing, but it is also designed to provide safe and convenient conditions in which to transport goods in and out of Africa.

Furthermore, by receiving aid for infrastructure development, the traditional and common practice is for African countries to provide the investors with the ‘right of use’ for certain natural resources. This practice dates back to as early as 1926 when Libya repaid a debt with access to its rubber plantations, which is still in use today (Wells, 2013). With China’s current role as being the biggest infrastructure financiers in Africa, this practice certainly contributes to its seeking access to resources for two reasons: one is trading infrastructure off for resource and the other is the creation of easier means for transporting resources.

On the other hand, financial aid is provided in the form of low-interest loans and debt cancellation. Between January 2006 and July 2014, China’s indirect investment in Africa rose to $150.4 billion. During the 2015 Johannesburg Summit of FOCAC, Chinese President Xi Jinping announced a further three-year plan focusing on ten cooperative development projects with a total of $60 billion in funding. Of this, 5 billion would be used as direct aid and an interest-free loan, with another 35 billion for preferential loans and export credit (Xi, 2015).

Notably, these ten projects include an initiative regarding poverty reduction and social welfare.26 Two hundred ‘Happy Life Projects’ where women and children are the major beneficiaries were allocated, and in his Summit speech, Xi particularly confirmed the cancellation of debt of several poorly developed countries thus reducing the worries behind local infrastructure development – that is, worries of totally giving away the ‘right of use’ or, for example, some scholars’ concerns regarding the use of Kenya’s debt in exchange for the construction of the Nairobi-Mombasa railway (Onjala, 2017).

26 All ten aspects include industrialisation, agriculture modernisation, infrastructure construction, financial cooperation, green development, investment and trade facilitation, poverty reduction and welfare, public health, cultural exchange, and peace and security.
Together with one strategic cooperation partnership and the five principles of China’s diplomacy, the upgraded China-Africa relationship that followed the 2015 Johannesburg Summit was concluded as the ‘1+5+10’ framework. Lin Songtian, director of the Africa Department of the Ministry of Foreign Affairs, reviewed the Summit, commenting on the promising nature of such cooperation, and how a great number of results were achieved within the first year (Lin, 2016). Most significantly, a China-Africa Production Capacity Cooperation Fund with an initial capital of $10 billion was set up shortly after the Summit, in early 2016, representing the positive momentum achieved by continuous cooperation and bilateral rapport (PRC. PBOC, 2016b).

7.2.4. Challenge to the China-Africa Resource Relationship – Neo-Colonialism?

The paragraphs below review the biggest challenge to and suggestions of China-Africa relationship. Notably, opposite voices exist through China-Africa’s resource-oriented cooperation.

Scholars, mainly from the West, consider China’s diplomatic activities in Africa as an example of neo-colonialism, using the ‘Angola model’ to illuminate the exploitation of local resources (Corkin, 2011; Lumumba-Kasongo; 2011; Mohan and Lampert, 2013). Furthermore, scholars from China and the West have both pointed out that to avoid criticism, China would have to spare more effort in supporting the progress of Africa’s industrialisation, in terms of providing technology, training, environmental protection, and so on (Taylor, 2009; Ofodile, 2008; Alden and Wu, 2016); that is, rather than committing predatory exploitation as happened during the old colonial period. Otherwise, the problem is that frustration will grow among local people who think such China-Africa oil deals jeopardise people’s welfare and manipulate local politics (Runge, 2016).

Chinese think tanks consider that this speculation is merely made up of doubts produced by the Western media and is due to a lack of publicity from the Chinese perspective. Hu (2016) argues that so-called ‘neo-colonialism’ is in fact a financing method, which requires payment in oil for infrastructure construction projects. China particularly stresses that such payment is strictly pegged to the international market price of oil in addition to the large amount of investments put in for the construction of infrastructure; therefore, there is no room for unfair advantages.
This model has also been adopted by Western investors as well, and ‘China is merely one suitor among many’ (Frynas and Paulo, 2007:240).

It is inappropriate to claim arbitrarily whether or not China’s diplomatic activities in Africa constitute ‘neo-colonialism’; neither is it simple to evaluate the situation based on who is the bigger winner or if someone is losing in the cooperation. Then it would be an even more complicated puzzle in terms of defining winning and losing. It is certain that Africa has a great need for social development and modernisation, which represents massive opportunities for itself and for those who are willing to participate and provide help. To an extent, China’s involvement in Africa has come about because ‘many African government appear fundamentally unable to manage their own resources’ (Taylor, 2009:55).

It would be unfair to claim that China is the only player trying to ‘exploit’ Africa. As mentioned above, the resources in Africa are also of interest to others, such as ExxonMobil and BP who possess projects operating in South Africa and other East Africa countries. China’s strategy for African oil is to ‘go places for oil where [US] and European companies are not present’ (Washington Post, Dec 22, 2004, as cited in Taylor, 2009), which makes up a relatively small proportion of the total of African resources. On the other hand, whether or not cooperation can be sustained is supported by a number of different claims. If African governments sense unfairness or feel bitter about being ‘exploited’, they can always switch to other partners. This kind of situation has indeed happened, with some countries swinging between the People’s Republic and Taiwan in order to obtain a better aid or trade deal (Grimm, Kim, and Anthony, 2007; He, 2007).

Generally, the cooperation between China and Africa looks promising. Sudanese veteran political reporter Yahya Mustafa commented that China has great potential and capability for initiating developmental projects, not only in Africa but all over the world (FOCAC, 2017a). Namibian politician Elia Kaiyamo particularly points out that the era when Africa relied heavily on resource exportation has long gone, instead, countries are focusing more on the development of high value-added industries, technology development, and technology transfer; while ‘China and Africa have the willingness and have reached bilateral cooperation to share technology many times. and China's support for African development is not accompanied by any conditions’ (FOCAC, 2017b).
Since the Johannesburg Summit, China has adjusted and refined its Africa policy which aims to provide more diverse and comprehensive support and can be summarised as the ‘1+5+10’. As pointed out previously, the cooperative framework between China and Africa not only officialises the cooperation, but more importantly, provides a flexible solution and direction for practical issues. Therefore, with frequent meetings and multiple channels of communication, whenever there are voices against China’s engagement that concern local African wellbeing, over time, certain adjustments can be made to maintain the cooperative rapport.

7.2.5. Summary

Africa is of strategic importance for China, both politically and economically. China-Africa cooperation was established alongside the founding of the People’s Republic and has recently been brought up to a new level, following the FOCAC 2015 Johannesburg Summit. Besides being a major customer for China’s manufacturing goods, Africa is a long-term supplier of raw materials and has been continuously providing the lifeblood to China’s fast-paced economic development. Traditionally, the African goods exported to China include metal ore, and recently, with increasing significance, crude oil and other oil products.

There is an obvious trend whereby China’s increasing interest and diplomatic activities in Africa are oil oriented. A general model can be found in the China-Africa cooperation, where China provides financial aid, trained personnel, technology, and intellectual support for local projects such as infrastructural construction, health services, social welfare, and poverty reduction; and various forms of access to resources are provided to China in exchange.

Some have described this model of cooperation as ‘link[ing] access to acreage [with] state-backed financial deals, where acreage is provided in return for soft credit used to purchase Chinese goods and services’ (Tjønneland et al., 2006). The transparency of China’s decision-making and project planning is questionable; however, it has been proven to be an advantage from the particular aspect of efficiency, just as it has been to China’s own economic development.

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27 One strategic cooperation partnership, five principles of China’s diplomacy, ten projects, introduced in the previous section.
Scholars have commented that the speed of Chinese aid materialising in the African landscape is beyond the capability of Western players and international institutions like the World Bank; for their aid or loans are often conditional, with limitations on the amount (Yan, 2007). This advantage has granted the Chinese government and enterprises priority status when accessing oil fields and obtaining contracts. Despite criticism from the West and some minor African entities, China’s access to African oil is generally secure as long as it is able to adjust its African strategy to meet current needs.

In principle, China can largely avoid neo-colonialism by promoting certain areas of aid such as skilled worker training, knowledge transferring, and investment. Chinese authorities have acknowledged the need of strategic adjustment, as reflected in the Summit; and increasing significance has been shifted onto the sustainability of African development, as aid is coming in more diverse forms than the traditional method of simply giving away money.

Furthermore, as China’s own oil giants participate in the process of fracking, extracting, and, in some cases, refining oil, the cost for China to acquire oil products can be greatly reduced – and even if it is not, as mentioned earlier, in some cases oil can be purchased with credit exchanged for construction aid at an international market price. Generally, it is extremely unlikely that China would have to face an outrageously higher oil price than others. Finally, with long-lasting China-Africa rapport and infrastructures such as railway systems and harbours developed by China, the transferability of African resources is significantly high.

As a result, China’s resource diplomacy has unparalleled advantages and priorities within Africa. As long as China endeavour to promote the overall welfare of Africa rather than overtly exploit African resources, the China-Africa resource relationship can continue to fuel China’s rapidly growing production and be a stable source of China’s growing economic power.

7.3. China’s Trade Strategy in Latin America

Another dimension of China’s production structure extends to its increasingly intensive interactions with Latin American and Caribbean (LAC) countries. Although Latin America has
been the ‘backyard’ of the US and historically a long-term supplier of many natural resources for the US, the abundance of this region’s resources can potentially attract the interest of many other great economies (Hakim, 2006).

This section examines China’s economic engagement with Latin America. Following the analytical method defined in the opening of the chapter, this section will provide a thorough understanding of the current trade volume between China and LAC, the institutional foundation of the cooperation, and current investment and infrastructure development. Overall, it is suggested that the China-LAC partnership has made good progress on trade, as well as reaching a free trade agreement and carrying out infrastructural investment projects; on the other hand, both entities need an industrial upgrade for China to further consolidate its partnership with LAC. This is because China faces production overcapacity and some LAC countries are suffering from resource-driven vulnerability and poverty.

It is estimated that Latin America possesses 13.5% of the world’s total oil reserve, for instance (Bajpaee, 2005). Apart from crude petroleum and mineral ore, agricultural products from LAC are also proven to be a significant part of China’s importation, supporting the lives of the latter’s huge population. China, on the other hand, has become the second biggest exporter to LAC, mainly of manufactured products (PRC. Ministry of Commerce, 2015a), which for China, is a key process in fuelling its continuous industrial development and wealth generation. Scholars believe that China’s grand strategy in Latin America is no less important than its interest in other regions, especially from the aspect of economic development – securing future access to vital resources and maintaining its global market share (Zweig and Bi, 2005). Further to that, it is also believed that the additional political alliance between China and LAC can significantly reshape power distribution across the globe.

7.3.1. Institutional Foundation of the China-LAC Resource Relationship

The following paragraphs analyse the China-LAC resource relationship from the aspect of institutional foundation, including state-level diplomatic activities and the creation of official cooperation frameworks, as an important dimension of China’s resource diplomacy.
One initial factor contributing to the China-LAC strategic partnership is politics. At the early stage of China’s foreign policy, mutual political interest played an important role. Similar to China’s relationship with Africa, its diplomatic interaction with Latin America was seeking, to a great extent, South-South cooperation and, in this case, to curb the US monopoly in many areas (Cheng, 2006).

During the 1970s and 1980s, left-wing parties in Latin America contributed significantly to the social transformation of LAC, expelling the dictatorship (Weyland, Madrid, and Hunter, 2010). In the 90s, a leftist leadership came into power in many LAC due to public opposition to the free market and repugnancy regarding US ‘manipulation’, despite the downfall of the Soviet Union (Castañeda, 2006). China, meanwhile, as the only communist oriented country in the UNSC, aimed to win support from a ‘Third World alliance’. This situation promoted communication between China and many LAC, in addition to the economic interest, and later began to safeguard the partnership from a political perspective.

In 2009, China was among the top five exporters for most LAC (Berger, 2012). Further to the soaring volume of trade between China and LAC, it is worth mentioning that China has also been working on free trade agreements with its partners, aiming to lower tariffs in order to further boost trading activities.

To date, China has already established a bilateral free trade agreement with Peru, Chile, and Costa Rica, and Chinese think tanks are researching how to ‘upgrade’ the existing agreements and arrange free trade with Colombia as their most recent target (PRC. Ministry of Commerce, nd). These free trade agreements lay down regulations regarding several aspects, including tariff deduction on different categories of goods, rules of origin, customs procedures, sanitary and phytosanitary, protections of intellectual property, and dispute settlement mechanisms. The setting up of these mechanisms has provided convenience and protection for importers and exporters, attracting trade activities with these countries to flourish. More importantly, it has also sets up some good examples and future references by which other Latin American countries may also establish trading bonds with China.

Besides the free trade agreement with a small number of individual countries, a China-CELAC Forum was officially founded in 2015, signifying a deepened and comprehensive partnership established to promote equality, mutual benefit, and common development (PRC. Ministry of
Foreign Affairs, 2017). CELAC stands for the Community of Latin American and Caribbean States, which consists of 33 countries in total, including 20 South American countries.

This forum contains a few different levels of meetings and communication – ministerial meetings, dialogue between foreign ministers of China and the ‘Quartet’ of CELAC, and the meeting of national coordinators (China-LAC Forum, 2015). Apart from the official meetings, a series of specialist forums and meetings using the China-CELAC Forum framework, are also aiming to provide practical approaches to operationalise cooperation from various business viewpoints: infrastructure development, social research, scientific research, and local community bonding. The Chinese Academy of Social Sciences, the leading Chinese think tank, is one of the participants in these specialist forums. There is also the call for further multilateralization and regionalisation of China-LAC cooperation following a similar approach of existing platforms, such as the Mercosur and the Pacific Alliance, to further formalise relevant rules (Melguizo, 2017).

7.3.2. Trade Volume in China-LAC Resource Relationship

China’s trade and cooperation with Latin America scaled up dramatically in the very late 1980s. During this period, China’s financial reformation and market opening-up were fully activated. As mentioned in previous chapters, freeing capital allowed small to medium-sized companies to emerge on a large scale. Hence, high demand for industrial raw materials made China the ‘most sought-after market’ in the world; and it is believed that a strategy of some LAC, including Brazil and Mexico, was to set up a trade route to China (Mora, 1997:35-36).

In spite of a setback regarding China’s exportation to LAC in 2009, potentially due to the worldwide financial crisis, trade volume on commodities between China and LAC has grown sharply each year (Berger, 2012). This is especially the case for the volume of products exported from LAC to China. According to the Chinese Ministry of Commerce, in 2014, trade volume between China and Latin America, including Caribbean countries, was $269 billion. Detailed graphs on the history of China-LAC import and export volumes are shown as follows (Figure 7.4 and 7.5).
According to the Observatory of Economic Complexity database (OEC, nd), the top five commodities exported from LAC to China were soybeans, iron minerals, crude petroleum, cooper minerals, and refined copper; whereas the majority of imported goods from China were machines, textiles, and transportation vehicles. The database also reveals that many small countries, such as Bolivia and Panama, who traditionally exported agricultural products, have
gradually switched to exporting petroleum and other mining products as major commodities. In short, according to the Ministry of Commerce, China has not only become the third biggest buyer of Latin America’s raw materials, but also the second-largest exporter to LAC (PRC. Ministry of Commerce, 2015a).

7.3.3. China’s Infrastructure Development in LAC

The major factor facilitating China-LAC cooperation is mutual economic benefits. The traditional exchange of material with China, the ‘most sought-after market’, accelerated the accumulation of wealth for LAC, when raw materials turned into cash with little effort in terms of processing; from there on, exportation to China provided the initial funding needed by LAC for proceeding into the industrial age. On the other hand, scholars have pointed out that one key strategy of China, as a supersized entity, is to guarantee an abundance of raw materials and agricultural products in order to sustain its own industrial development and the wellbeing of its population (Ferchen, 2011).

To achieve the goal of promoting infrastructure, one approach is to construct infrastructures including harbours, roads and railways for the exporter, in order to provide greater convenience and reliability in transporting trade goods. For example, in Argentina, China confirmed an investment of $25 million for building transportation hubs aim at transporting crops, and another 250 million on roads between Argentina and Chile so that raw materials from Argentina can eventually be shipped from Chilean harbours to China via a waterway (Santiso, Blázquez, and Rodríguez, 2006).

Furthermore, when loans are difficult to acquire from international organisations or other major Western countries due to bad credit ratings, China still offered more than $100 billion loans to LAC between 2005 and 2013, including Venezuela, Argentina, Brazil, and Ecuador (Hill, 2014). Financial assistance in other forms is also available, for example, when funding goes directly via Chinese enterprises to fund local production projects.

To date, China’s policy banks are the biggest financier of LAC. Funds provided by China in 2014, $22.1 billion, were more than the finance provided by the World Bank and the Inter-American Development Bank combined (Gallagher and Yuan, 2015, as cited in Ray and Gallagher, 2015:16). During the period, 2010 to 2014, China provided a total of $93.7 billion
in loans to LAC, most of it to be spent on infrastructural development including transportation (16.5%), hydropower (12.4%), mining (10.1%), housing (4.1), other energy (11.5%), and other infrastructures (29.5%) (Gallagher and Myers, 2014, as cited in Ray and Gallagher, 2015:17).

Through the 2000s, the China-LAC partnership reached a higher level and formed multiple channels of cooperative projects besides traditional material trading. Besides providing direct loans, one significant new channel of cooperation became investment, including methods of acquisition, merging, cooperatives, and joint projects, mostly resource related.

Up until 2001, China had invested more than $1 billion in Latin America in the form of about 300 enterprises and businesses. The largest single investment was carried out by Baosteel, China’s leading iron and steel company, to Brazil with a funding of $1.5 billion. It is also reported that in 2016, $8.4 billion worth of Chinese projects in Brazil were confirmed compared to the $7.4 billion of 2015 (CEBC, 2016). China’s investment has also reached Peru, in the case of iron minerals, Ecuador, for petroleum, and Venezuela, for fuel and gold mines (Santiso, Blázquez, and Rodríguez, 2006).

According to the statistics, during the period 1990 to 2009, $7 billion of China’s investment landed in Latin America; nonetheless, 2010 was the watershed when a total of more than $14 billion worth of investments were allocated to LAC (PRC. Ministry of Commerce, 2015b). These investments took up 11% of the total inflow FDI Latin America received that year and were twice as much as in the past two decades together. It is also reported that three quarters of the total investments were taken by two major petroleum projects in Argentina operated by Sinopec and CNOOC. Nowadays, LAC receive around $10 billion worth of Chinese investments each year according to the Chinese Ministry of Commerce, for example $9.7 billion in 2013, which took up 5-6% of the Latin America region’s total inflow FDI (Ibid.).

Among all investments, four leading areas of interest can be identified: natural resources, infrastructure, agriculture, and light industry manufacture. Around 90% of China’s outflow FDI to Latin America is targeting projects involving raw materials, including petroleum and metal ore – these projects are mostly in the forms of mergers, acquisitions, joint ventures, and occasionally, sole proprietorships (CNPC, nd.; Chen, 2017; Zhao, 2009). Meanwhile, China’s state-owned agricultural enterprises, for example, the Chongqing Food Group and the
Heilongjiang Reclamation Group, have been opening up plantations in Argentina besides providing machinery and technology.

The Chinese government and businesses generally believe that investments in extracting natural resources, agriculture, and infrastructure construction are necessary to secure China’s access to local raw materials as well as to boost Latin America’s exportation (García-Herrero and Santabárbara, 2007). Lastly, light industry manufacture as a more recently developed direction, takes up an insignificant proportion of China’s outflow investment to LAC; however, some suggest that it can potentially become the platform for China to access the US market to a greater extent (Feng, 2015).

This pattern of partnership can also be found in China’s engagement in Africa, as mentioned previously, and other regions. China’s investments, both in industrial development and infrastructure construction, have more recently provided a platform for industrial upgrades in LAC, while also providing reliable production volume and transportation for Chinese firms.

Theoretically, the existence of these infrastructures can consequently promote industrial deepening in LAC and encourage the emergence of high value-added industries. Such cooperation can potentially prevent countries from becoming over-dependent on primary products trading as their major income and avoid the negative impact of the volatile international market price of raw materials (Ray et al., 2017). However, in practice, not all partnerships can be carried out strictly following the ideal model. Some studies argue that the trap is whether LAC aim for long-term development or short-term flourishes, because wealth can be easily acquired by exporting primary products in bulk rather than building higher value-added processing lines from scratch (Gallagher and Porzecanski, 2008). Among many LAC countries, Venezuela is most representative of a single-product economy leading to an economic recession. Despite China’s investment in transportation and refinery infrastructures (Bajpaee, 2005), an extreme imbalance in sectoral composition eventually contributed to Venezuela’s economic failure.

7.3.4. Challenge to the China-LAC Resource Relationship: Industrial Transform?

Current statistics show a decrease in trade volume between China and Latin America. Importation from LAC to China dropped by 10% in 2014 whilst China’s exportation to Latin
America increased by 3% (PRC. Ministry of Commerce, 2015a). This phenomenon corresponds to China’s overcapacity issue, as stated in the previous chapter. Reduction in the demand for raw material been driven by overcapacity in industries involving steel, coal, aluminium, and cement, where capacity utilisation is below 70% (PRC. State Council, 2016) – greatly affecting the exportation volume of iron ore and iron oxides from Brazil and Honduras, and aluminium oxides from Brazil, as well as petroleum from Venezuela, Argentina, and Colombia, which are needed to operate machines in the process of production.

China’s production volume for these overcapacity goods is greatly beyond the capacity of domestic consumption; furthermore, due to the worldwide economic downturn and price drop within the international market, China’s state council has ordered that certain industries be slashed as they are facing significant overcapacity. Indeed, the Chinese government is calling for further reformation of sectoral composition and initiating ‘Made in China 2025’, which is a Chinese vision by Industry 4.0 that aims to optimise production methods, resource allocation, and environmental protection (PRC. State Council, 2015).

Generally, for Latin America, too much reliance on China will not accelerate the industrial advancement of these countries, because they need to seek transformation in terms of sectoral composition while China is perusing a further industrial upgrade. As soon as China pushes into the Industry 4.0 era on full power and becomes less reliant on raw material, it will be devastating for countries relying on commodity exportation.

Scholars researching this area specifically point out that ‘as China’s economy slows, this [dependency] will have repercussions on Latin American exporters, and countries could see a fall in their exports by volume as well as deterioration in their terms of trade on the back of lower commodity prices’ (Casanova, Xia, and Ferreira, 2016:15). Instead, they suggest that Latin America could utilise its geopolitical significance as leverage to direct China-LAC partnerships into making more investments into industrial upgrades.

The concerns raised from this political alliance are mainly about the recent social instability and economic recessions in some LAC. Due to China’s great demand, international market prices of many commodities soared shortly after the millennia. Some LAC governments had prioritised mining and exporting raw materials rather than considering a potential price drop and environmental destruction (Wang, 2016b). Western scholars and media have severely
criticised the resource management of Latin American leftists and their dependence on China; problems identified due to poverty and the dissatisfaction of locals have also led to issues of political and social instability (Locatelli, 2011).

In responses to the situation, the mainstream opinion in China is rather optimistic. For example, in the case of Venezuela, the Chinese think tank predicts that debt default is unlikely to happen; and it is also reported that the Chinese government is considering delivery of further financial aid, including loans and investment (Lu, 2016). Some others believe cooperation with China, the second-largest world economy, is, in any event, very attractive. Besides this, political or ideological recognition is not necessarily the vital foundation of an economic partnership – China’s pragmatic foreign policy and strategy are generally welcomed by both Latin American leftists and their opponents (Wang, 2016b).

Nevertheless, it is fair to argue that reformation and transformation are necessary for any future China-LAC cooperation, particularly in terms of governmental transparency and local policymaking when introducing new investment projects.

In addition to political instability, however, there are also a few other social problems arising from China’s activities in Latin America that concern the future of this partnership. Criticism mainly comes from Western scholarship, suggesting a lack of moral sense within Chinese business in other developing countries. Similar to the criticism regarding China’s activities in Africa, it is considered that China exploits local resources in an unsustainable manner – quick money coming at the price of deforestation (Ray et al., 2017). China’s huge population means that its inflexible demands for agricultural products will remain a key commodity for Latin American exporters; meanwhile, seeking industrialisation, many LAC countries are transforming areas of rainforest into sawmills and factories with funding from foreign investment.

Moreover, Chinese firms investing in Latin America usually set rather low or no requirements regarding human right protections when choosing their local contractors. Some firms bring along their own employees from China and worsen the local unemployment situation, as reported in some studies, although this problem is not universally acknowledged. More recent evidence shows that, for example, Shougang Hierro, one of China’s steel giant branches in Peru, performs no worse than its US counterparts in Latin America in terms of labour and
environmental practices (Irwin and Gallagher, 2013). The concerns regarding the environment and human rights could be raised against any foreign investment project, including but not limited to China.

Regardless of nationality, the common practice of business is to achieve the maximum profit within the limits of regulations. Hence, the key to solve this issue is not by requiring actions from the Chinese government or business, but is up to the local Latin American governments in setting firmer rules and regulations when soliciting partnership.

7.3.5. Summary

To sum up, China’s economic cooperation with Latin America became increasingly heated in recent years when China quickly raised to the top among LAC trade partners. China’s resource diplomacy is overall successful in this region. Trade volume soared intensively especially since the 2000s, and China is seeking to construct further free trade agreements with more LAC countries, besides the three existing ones and the regional forums. Latin America has also become the new attraction for Chinese infrastructural loans and investments. This cooperation has greatly supported China’s continuous production growth and enhanced its international influence, although reforms are still needed on both sides.

There are two key themes relating to economic activities within this relationship – one is the traditional one of export and import, the other is investment. Initially, communication between China and LAC intensified when results from China’s economic reformation emerged and China became the most wanted foreign market for raw materials from Latin America (Santisso, 2007). Since the millennia, hoping to further secure its access to resources, China initiated a series of investment projects focused at the oil industry and infrastructure, as well as infrastructural development in Latin America, through the provision of significant financial assistance for better transportation and energy services.

The many concerns raised against the China-LAC partnership can be concluded into simply one general question – how will China’s impact in Latin America affect the direction of future cooperation? The opportunities for Latin America exporters to access the Chinese market often come alongside challenges as dependency on exportation can also lead to vulnerability, a lesson the Chinese manufacturing industry learned a few decades ago. With an economic and political
crisis hitting some LAC countries, how can the situation be fixed and what role can China play in it?

Nowadays, the focus of the China-LAC partnership has gradually shifted from commodity trade to industrial and infrastructure investment. By doing so, the upgraded partnership can comprehensively and theoretically promote industrialisation in those Latin American countries, and help them to escape the vicious circle of dependency on exporting raw material. Although in practice, there is huge room for improvement regarding local policymaking, governmental transparency, human rights protection, and environmental protection, such cooperation can be considered beneficial both in the short and long term.

Overall, China’s resource diplomacy in Latin American countries sufficiently stable access to materials necessary for sustaining China’s industrial production, including minerals and petroleum products. Chinese investment has also contributed to some infrastructural development projects, mostly resource-related projects, in Latin America to further consolidate the trade partnership. The China-LAC resource relationship has been an important component of China’s rising economic power.

7.4. China’s Resource Strategy in Southeast Asia

China-ASEAN cooperation offers a similar case as for the other regions mentioned previously, in which China acquires raw materials in exchange for investment in local industrial development and infrastructure construction. The free trade agreement between China and the Association of Southeast Asian Nations (ASEAN) forms the third biggest regional trade regime with the largest population involved. However, China’s diplomatic activities have not always been carried out smoothly, especially when they involve territorial disputes with much more at stake.

This section explores the foundation and trajectory of how the China-ASEAN cooperation was developed by looking at the structure of the free trade agreement, trade volumes, infrastructure development, and the sustainability of cooperation. The first part includes an overview of the set up of the free trade regime as an institutional foundation of China-ASEAN cooperation. The second and third parts present the numbers and status of trade and investment, reflecting
on the degree of interdependency. The last part aims to reflect on the sustainability of this relationship by looking at current issues of regional imbalance that can potentially harm the development of cooperation.

The overall suggestion is that China has the most intense economic cooperation in all aspects, with ASEAN countries among the three regions examined in this chapter. China benefits from a continuously upgrading partnership which continues to support its rapid economic growth and growing influence. As noted below, these relationships across the ASEAN region provide an important pillar of China’s economic power in the contemporary era.

7.4.1. Institutional Foundation of the China-ASEAN Resource Relationship

As noted previously, institutional foundation plays an important role in China’s resource diplomacy as the safeguard to trade activities. The paragraphs below examine the institutional foundation of the China-ASEAN relationship, mainly focusing on the governmental level framework and the formation of free trade agreements.

China’s partnership with ASEAN can be considered a great success in terms of regional economic cooperation. In 2002, China and the ten members of ASEAN signed the Framework Agreement on Comprehensive Economic Co-operation (the Framework Agreement) which came into force in 2003, followed by detailed agreements regarding trade in goods, trade in services, and investment activated in 2004, 2007, and 2009, respectively. The free trade agreement between China and ASEAN is the first and only agreement with a regional organisation that China has ever engaged in.

Southeast Asia’s unique climate and strong tradition of cultivation allows ASEAN member states to specialise in a wide range of agricultural products. Initially, when signing the free trade agreement, ASEAN countries believed it would give them preferential access to the Chinese market in addition to pre-existing frequent trading; whereas, for China, the ongoing transformation of sectoral composition led to a continuing decrease in the proportion of the primary sector, meaning that China will have a growing demand for planted products as a result of its industrial upgrade.
Natural rubber is one of the leading commodities that Southeast Asia exports to China, as well as other crops and food such as rice, tropical fruits, and sugar (Tongzon, 2005). Moreover, Southeast Asia also possesses a considerable quantity of natural minerals which have drawn China’s attention. Along with its progress of industrialisation, ASEAN has started exporting mineral ore, processed metal parts, and petroleum products to China in more recent years, whereas China is seeking economic gain from exporting affordable light industry manufactures.

The establishment of the China-ASEAN free trade agreement (CAFTA) followed a few steps in order to become accomplished. Upon the Agreement entering into force, the WTO MFN tariff rate was applied, signifying that an official trading channel had been created to regulate trading activities between China and ASEAN countries. After a few years of adjustment and deduction, by 2006, a zero-tariff was applied to agricultural products within the CAFTA. In 2010, between China and ASEAN founding member states, the tariff for ‘common products’ was eliminated, whilst newer members aimed to achieve a zero tariff by 2015.

The benefit of CAFTA is not only to boost exports and imports by bringing down tariff, but also includes a protection mechanism. If any member state considers its interests threatened by dumping, a criticism often received by China, this member can activate emergency anti-dumping duty. Overall, the CAFTA has provided a fair playground where participants can benefit from mutual economic interests (Song and Wu, 2006). The total trade volume of CAFTA in 2014 reached $480 billion, almost four times as much as it was in 2005 ($130 billion) during the early stages of the free trade regime. Despite the setback in 2009, potentially the aftermath of the 2008 financial crisis, the trade volume between China and ASEAN has become one of stable growth.

7.4.2. Trade Volume in China-ASEAN Resource Relationship

The Chinese media reported an aspiring 18.5% growth rate for trade volume within the CAFTA during the period 1991 to 2015. Figure 7.6 shows the statistics of China-ASEAN trade volume.

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28 Any product unless specified as ‘sensitive’ in the annex. Each country can submit a list of sensitive products that apply to a special tariff.

between 2005 and 2014, which presents an overall trend of expansion. However, trade volume in 2015 was, notably, $472.16 billion – a few billion short compared to the year before. The latest statistics show that a decrease in trade is trending – according to the Chinese Ministry of Commerce, between January and May 2016, the trade volume of the CAFTA was $173.57 billion, a 7.1% decrease compared to the same period in 2015. Experts suggested that the China-ASEAN trade would drop by 2.6% in the first half of 2016 (People.cn, 2016); as it turned out, the trade volume for the whole of 2016 dropped by 4.2% compared to 2015 (China News, 2017).

Figure 7.6 China-ASEAN Trade Volume 2005-2014

This is not necessarily a negative outcome and there are a few reasons contributing to this result. First of all, China’s production structure relies heavily on the labour-intense manufacturing industry, including cheap end products and parts, as its current status. It also has a great external dependency, as analysed in the previous chapter, meaning that when external demand decreases China will experience lower demand for raw materials.

Secondly, ASEAN countries are seeking industrial development and have adopted restrictions on the exportation of certain materials. For example, in 2014, for the purpose of promoting domestic industries using processed metal products, the Indonesian government banned...
exportation of several minerals and ores, which were either not allowed to be exported or were subject to higher duty (CNBC, 2014). This led to a certain decrease in trade volume and caused a shock to the global market as Indonesia is a leading exporter of nickel and bauxite; fortunately, Indonesia has amended this rushed decision and eased the exportation ban in 2017 (Asmarini and Munthe, 2017).

Thirdly, since 2014, reduced trade volume could be subject to the decreasing international market price for raw materials and a climbing USD price. Therefore, even if the amount of materials traded stayed the same, trade volume could decrease in number.

Finally, and most importantly, Chinese companies pursuing the ‘going out’ strategy may be the key reason for the decreased trade volume. Southeast Asia has a similar condition for industrialisation as China had where a huge population leads to cheaper labour; whereas China, to date, is facing the aftermath of the One-Child Policy. China’s working population is lessening while wages are going up. More Chinese companies are choosing to invest overseas, especially in neighbouring Southeast Asia. While trade volume decreases, investments grow. What was previously classified as trade is now included in a different category – returns of investment. As Figure 7.7 shows, there is a booming trend in China’s outflow direct investments and these are growing at a much faster manner compared to inflow investment. The China-ASEAN free trade regime is turning into an example of investment-oriented cooperation. With both parties seeking the optimal allocation and utilisation of resources through new forms of cooperation, this regional partnership may bring further mutual benefits and higher efficiency.
7.4.3. China’s Infrastructure Development in ASEAN

Among all China’s trade partners, since it is geographically linked, China-ASEAN should have the great advantage of low transportation costs. China shares borders with Vietnam, Laos, and Myanmar, whose railway and highway systems are, however, the least developed (Park, Park, and Estrada, 2009). At the early stage of the CAFTA, the infrastructure condition between China and ASEAN, as well as within ASEAN, was awaiting improvement because it was believed that ‘infrastructural development will lead to a reduction in the economic distance between the integrating countries… [and] reduces trade costs by 5% [that] would lead to a resulting increase in intra CAFTA trade of 5%’ (Roberts, 2004:349).

Echoing the academic suggestion, in 2012, China took infrastructure development in ASEAN as a significant goal by forming a China-ASEAN Infrastructure Cooperation Forum under the framework of the China-ASEAN Exposition. This, with the participation of governmental officials, has brought the issue of infrastructure to a higher level, the state level; while previous to this, Chinese contractors had already spent more than ten years working on ASEAN construction projects.
For example, in 2011, revenue for Chinese construction in ASEAN and the value of new contracts signed were $21.5 billion and $16.6 billion respectively, taking up 21% and 11.7% of the corresponding figures for China’s total number of overseas construction projects (China-ASEAN EXPO, 2012). By 2014, China’s infrastructure contracts in ASEAN had reached an accumulated value of $180 billion and a $125 billion revenue, with most projects involving energy and transportation (China-ASEAN EXPO, 2014). By May 2017, the total value of China’s infrastructure contracts in ASEAN climbed to $296.27 billion, and $204 billion worth of projects have been accomplished (Wang, 2017). During the most recent forum meeting in September 2017, ASEAN officials and counsellors released a series of new contracts, including 11.3-14.6 billion Singaporean dollar worth of civil engineering projects in Singapore (China-ASEAN EXOP, 2017).

On the other hand, and as proposed by China, the newly founded Asian Infrastructure Investment Bank has the aim of helping ASEAN countries’ infrastructure projects in terms of supplying financial means. The mechanism of this institution is still under negotiation and will be analysed in the chapter on China’s external finance structure.

Overall, by providing funding for infrastructure projects and undertaking construction contracts, China’s participation in ASEAN development has turned out to be fruitful. The mutual benefits include convenient transportation with lower costs and industrial upgrades for local areas. For China, taking infrastructure contracts in neighbouring countries is also a great solution for consumer products that are facing domestic overcapacity. With this aspect of resource diplomacy flourishing, China-ASEAN trade activities also have promising prospects.

7.4.4. Challenge to the China-ASEAN resource relationship: Regional rebalancing

In 2016, the arbitration case over the South China Sea brought up by the Philippines set off a wave of discussion on how the future relationship between China and Southeast Asia may turn out. Moreover, many appeared to be seeking solutions to resolve the issue or to rebalance the distribution of power within the Asia-Pacific region. The case triggered heated discussion on the tensions and future in this region. The dispute not only concerned China and the Philippines, but also a few other ASEAN countries as they can claim sovereignty over disputed territory. The US also voiced its support to the verdict of the arbitration by sending navy vessels into the nearby waters.
The political tension between China and ASEAN claimants over the South China Sea is certainly a point of interest and much analysis has been done on this topic since the dispute emerged in the 1970s (e.g. Rowan, 2005; Storey, 1999; Yu, 2016; Fravel, 2012); however, this part of the section will analyse the issue from an economic perspective to provide alternative insights into power rebalancing within the China-ASEAN partnership.

Economic factors may have played a dominant role in the Philippines filing an arbitration case. Disputes over the South China Sea have a decades’ long history but were eased in 2002 with the signing of the Declaration on the Conduct of Parties in the South China Sea (the Declaration), with peaceful negotiation as the chosen solution. The Declaration also paved the way for regional economic cooperation between China and ASEAN, such as the Framework Agreement.

When the arbitration case was filed in early 2013, a few years after the financial crisis, the Philippine’s cooperation with China had not yet recovered. Looking back at the graph of trade volume between China and ASEAN member states (Figure 7.6), prior to 2008, the Philippines was in fourth place. It was also the member state whose trade revenue suffered the most during the 2008 financial crisis. By 2010 and up until 2014, its trading activity with China had recovered but was eventually outrun by Indonesia and Vietnam. By 2014, most ASEAN members had seen their trade volumes double compared to pre-2008 whilst the Philippines, for some reason, had failed to catch up. Further to the ASEAN economic setback, China came to experience relatively stable and faster economic growth when compared to ASEAN states, although the financial crisis did slow down the growth rate of China’s GDP (Figure 7.8 and 7.9).
In general, the economic imbalance has emerged in spite of the mutual development promised by the free trade agreement and other forms of cooperation. Therefore, it can be identified as reasonable for small and less developed states to bring up historical issues as leverage against a great power. In this case, the South China Sea dispute, with the support of the International
Arbitration Tribunal and the US, offered ideal leverage for bargaining with China for more economic benefits. The South China Sea possesses vast amounts of unexploited oil reserves in addition to other rich marine resources, which is strategically significant for states in the contemporary global structure as oil and relevant products are considered the lifeblood of industrialisation (Buszynski and Sazlan, 2007).

For any party involved in this dispute as well as other claimants, the resources held in the South China Sea are great national interests that one should defend. The action from the US can also be explained through the economic aspects. Besides its long-term competition with China over the power of global influence, the US is the biggest trade partner with ASEAN (Buszynski, 2012). If the case eventually settles with a result in the Philippines favour, as a major economic ally of the Philippines, the US can potentially take a share of its resources.

It is not to say that there are no political factors at all involved in the South China Sea issue – indeed, the solution is often seen as political. The dispute cannot be settled with the verdict of arbitration because international society has no authority to enforce the tribunal’s decision. China has taken a very tough stance of non-acceptance and non-participation in the dispute with support from the national navy. The Chinese Ministry of Foreign Affairs has also emphasised the legally binding nature of the UN Convention on the Law of the Sea and the Declaration, insisting that arbitration is void and the dispute should be resolved via negotiation (Wang, 2016a; PRC. Ministry of Foreign Affairs, 2016). Furthermore, despite an arbitration verdict was made, international society does not have the power to enforce the result, making the verdict a mere formality.

Gao (1994) has pointed out much before the arbitration took place that instead of conflict, there would always be the possibility for China to jointly develop the natural resources in the disputed territory. As expected, the Philippines new president Duterte has taken a rather different attitude than his predecessor by showing willingness for further cooperation with China (Beech, 2016). The verdict of this arbitration, as an example of economic leverage, in fact, has urged more negotiation between China and ASEAN in terms of fairer trade deals and investment.

For example, most recently, Duterte expressed the idea of fair joint gas exploration in disputed waters surrounding the Spratly Islands which was appreciated by Wang Yi, the Chinese
Minister of Foreign Affairs (Mogota, 2017). With the Philippines as a precedent and with the backing from the arbitration verdict, other ASEAN claimants can also ask for the same fairness in issues of future cooperation. As China and ASEAN becoming increasingly interdependent, continuous conflict can only turn out to be a no-win situation (Hong, 2013). If China wishes not to completely lose its interests in the South China Sea and its economic cooperation with ASEAN, the only option is to allow a bigger share to be given to claimants, thus producing a win-win solution.

7.4.5. Summary

To sum up, trade and cooperation between China and ASEAN countries have a long history and both been booming in the recent two decades according to statistics tracking trade flow. The profound institutional foundation, including several tiers of regional agreements, and China’s heavy investment in ASEAN infrastructure have further consolidated the partnership. Although minor episodes of disputes have occurred, overall, China’s resource diplomacy with ASEAN is successful and promising. A few factors contribute to this thriving partnership.

Firstly, the establishment of regional free trade agreements in the early 2000s has lowered trade barriers with means such as tariff deduction. It also created the conditions for standardised and regulated trading activities by setting up principles and practices related to customs, intellectual property rights, anti-dumping protection, and dispute settlement.

Secondly, China has been the biggest contractor for ASEAN’s infrastructure upgrade. This cooperation on construction is now also carried out under certain institutional frameworks relating to governmental level forums. This undertaking not only benefits China with contractual revenue and is a solution to overcapacity, but also provides further reductions in transportation costs and time, thus increasing trade volume for both parties.

Lastly, the tension between China and ASEAN over the South China Sea issue could be the major setback in maintaining the trade partnership. Economically, the previous easing of tension was due to a regional imbalance that followed the 2008 global financial crisis. Overall, ASEAN countries experience much slower economic growth than China and trade volume has also decreased, reportedly due to China’s industrial reform. The territorial issue raised China’s awareness of creating a fairer ground for the continuing partnership, initiating a joint resource
exploiting project and making better deals when distributing interests. The political tension can be interpreted as a bargaining chip for weaker states to safeguard their benefits but does not necessarily signify a definite breakdown of the partnership.

In short, with its institutional foundation and frequent communication at all levels, China-ASEAN’s cooperation is likely to be maintained, and with magnificent prospects as long as fair conditions are provided. This cooperation is a significant cornerstone of China’s external influence through the production pillar and an important source of China’s rising economic power.

7.5. Chapter Summary

The analysis above has demonstrated that, across the three regions studied, China’s external dependence on resource flows has increased substantially. By exploring the institutional foundation, trade volume, infrastructural development, and potential challenges of these developing relationships, it has been shown that overall that this dependence has not translated into vulnerability. China’s resource diplomacy has effectively supported its continuing pursuit of economic power from the production perspective. Beneath this headline observation, interesting patterns of similarity and difference across the regions can be observed. These similarities and differences are captured in Table 7.1 at the beginning of this chapter, which is reviewed below.

China has been maintaining a long term diplomatic rapport and cooperative relationship with African countries, providing the latter with capital and technology for the construction of local infrastructure; in return, these African countries are China’s stable access to the petroleum and minerals sustaining China’s domestic economic development. The cooperation between China and Latin American countries has also intensified recently, particularly with other emerging economies, such as Brazil and Venezuela, who was once considered the ‘backyard’ of US hegemony. As for Southeast Asia (or ASEAN), the focus is on China’s long-term strategic partnership in trade and investment versus its territorial disputes with ASEAN claimants over the South China Seas involvement in potential oil deposits.
By looking systematically at the three case studies on China’s resource diplomacy from the aspects of institutional foundation, trade volume, infrastructure development, and sustainability, a few patterns can be discerned.

The track of trade flow shows that China saw fast-paced growth in trade volume with all three regions up until 2015, with ASEAN being the top trade partner followed by LAC and then Africa. In general, the growth in trade volume corresponds to China’s GDP growth, with the expanding capacity of the Chinese market brought about by this growth attracting further trading activities. The decreased trade volume in 2015 can be explained in two ways: firstly, in relation to China’s decision to optimise sectoral composition for tackling the overcapacity issue as mentioned in the previous chapter; secondly, is the strategy switch from trade to direct investment which belongs to a different revenue catalogue. However, it is not evident that China is losing access to resources in those regions based merely on the statistics.

In all three regions, China has established different institutional foundation extents for its resource diplomacy. China’s cooperation with ASEAN, due to geographic proximity, has a long history providing the conditions for forming a regional free trade agreement. Bilateral free trade agreements have also been established between China and individual Latin American countries, including Peru, Chile, and Costa Rica, besides a China-Colombia free trade agreement that is still under negotiation. Free trade agreements are an instrument for facilitating trading activities by laying down standardised rules and regulations to safeguard the legitimate interests of trade partners.

China has also formed regional cooperation forums with all three regions. These forums are channels of communication where detailed and practical cooperative strategies are jointly made. The framework of these forums extends from trade to other areas of cooperation, such as infrastructure development, education and vocational training, as well as direct investment. It does not directly facilitate trade, but its dynamic themes and flexible operation can effectively tighten the bond between China and its partners from multiple aspects, eventually benefitting China’s resource strategy.

Furthermore, China has actively participated in local infrastructure development across all three regions. In African and ASEAN countries, China has been the leading developer of civil engineering projects, including railways, roads, and ports, besides other development in energy,
telecommunication, and community facilities. The unique Chinese economic model is highly efficient at fundraising and operation in comparison to many Western investors and international institutions like the World Bank. These projects greatly enhance the condition of local transportation, not only for the wellbeing of locals but also for the benefit of trading activities that depend on cheaper and faster transportation. Moreover, in the specific case of Africa, some local governments have received Chinese construction help in exchange for access to resources at the construction site.

Meanwhile, Chinese infrastructural projects in Latin America are relatively less significant. The China-LAC infrastructure cooperation forum has three years of history, so is much younger in comparison to China’s engagement with ASEAN, for instance. In Latin America, China provides approximately $20 billion in loans for infrastructural construction every year. There is also another $10 billion investment in resource-related projects, mainly industrial facilities which directly involve a production process for petroleum and metal products. The scale of this involvement may not be as much as China’s engagement in ASEAN and Africa, nonetheless, the Chinese bank has become the biggest infrastructure financier for Latin America.

Through the study of these cases, it is found that many concerns and obstacles that may become setbacks in terms of China’s resource diplomacy. Arguments are seen to emerge in a few key areas of interest, mainly in regard to fairness throughout the cooperative relationship. It is suggested that China’s engagement with these resource-rich regions is excessive and is potentially or repugnantely harmful to the local economy.

Governments of these resource-rich countries may be tempted by immediate interests in exporting raw materials and turning their nation into a heavily dependent mono-economy. Such an economy is vulnerable to many situations such as a price drop of the key commodity or decreased demands by importers. The economic crisis of Venezuela can be taken as an illustration as well as the widely criticised ‘Angola mode’. It is of great significance for countries relying on resource exportation to reform and diversify the economic composition. Regarding this concern, financial aid from China as well as improved infrastructure can, in fact, provide conditions and funding for industrialisation in underdeveloped areas.
Furthermore, the distribution of interests can often lead to controversy. Western scholars have criticised China’s acquisition of resources as an instance of neo-colonialism that does not provide long-term solutions for local underdevelopment or address issues of poverty (Sautman and Yan, 2007; Lumumba-Kasongo, 2011). To different extents, it is thus exploitative rather than mutually beneficial. For example, some believe that Chinese firms in Africa and Latin America employ a very limited local labour force, it does not reveal necessary technological support and training, neither does it provide necessary human rights protection.

In ASEAN, the Philippines raising the territorial dispute over the South China Seas can be seen as a consequence of suffering an economic downturn and regional imbalance. However, there is no recognised standard defining the boundary between exploitation and cooperation. It is also found that Chinese firms perform no worse than other leading Western players on the same field, as businesses will always seek maximum profit within the limits of the law. Therefore, to solve this issue, the effort of local government to set up rules on resource-related cooperation projects, is suggested; for example, detailed requirements on training, technology sharing, and contributing to the local employment rate. Certain levels of negotiation can also ease the issues caused by unfairness. The regional forums between China and its partners allow government officials and business representatives to discuss relevant policymaking and can potentially smooth the way towards mutual interests.

In short, the attraction of the Chinese market should not be underestimated, as proven by its trade volume; so long as China can adjust its strategy and adapt to the changing demand of its partners by different means, such as via forums, agreements, and policymaking, the maintenance of long-term partnerships looks promising. These lasting partnerships allow China to keep on fuelling its production output and exportation, which eventually contribute to the growth of China’s economic power in relation to the production structure.
8. Conclusion: Structural Power and the Rise of China

This thesis has examined China’s rising power from the perspective of its finance and production structures, aiming to answer whether China’s power can be described as a ‘rising hegemonic power’. By referring to Susan Strange’s theory of structural power (Strange, 2015b), the study identifies finance and production as the two primary disaggregated structures of China’s rising power, in order to conduct a systematic analysis on China’s variegated development.

The contribution from this thesis has been to amend Susan Strange’s structural power approach to the study of hegemony and IPE, and use the conceptualisation developed as a framework with which to organise a broad range of existing literature and new resources. In her work, Strange notes the need for analytic flexibility to adopt the concept of structural power to circumstances under investigation. This study represents an exercise in applying Strange’s flexible approach to the study of IPE to the important and prominent contemporary topic of the economic rise of China.

New primary data has also been presented relating in particular to domestic financial sector transformation, domestic production sectoral transformations and relative labour productivity, and the shifting nature of external resource dependence as measured by institutional foundation, trade volume, infrastructural development and potential challenges. This primary data has taken the form in particular of official statistics from the Bureau of Statistics of China, US Bureau of Labor Statistics, the OECD, and World Bank, and from the compendium of trade statistics provided by the Massachusetts Institute of Technology’s Observatory of Economic Complexity. Official reports and archives of legislative output from the government of China have provided additional new empirical material.

By bringing together these materials with the structural power perspective, each of the previous four chapters has provided an analysis of the foundations of China’s economic power and to what extent can this foundation develop into a source of hegemonic power. Through this final chapter, these insights are brought together. The overall position reached is that evidence assessed demonstrates that there are significant shortcomings in the hegemonic power of China. While this overall position has been reached elsewhere in the existing literature (e.g. Callahan,
2005; Ikenberry, 2008; Yan, 2011; Breslin, 2007; deLisle and Goldstein, 2017), here the economic power perspective has been used to identify specific elements of the internal and external transformations in the production and financial structure that inhibit the extent of economic power.

The overall conclusion reached is that of the four dimensions studied, China’s resource diplomacy is the most fully developed. In relation to the internal development of the finance and production structures and China’s engagement with international financial institutions, there are clearer weaknesses and vulnerabilities underpinning the rise of China. In spite of a great improvement compared to half a century ago, the development of China’s financial structure is incomplete and still undergoing reform, as the capital market remains unstable as well as significantly lacking in scientific regulations. The current result of financial reform has led to a certain level of financial deepening, with China showing limited hegemonic power in regional, rather than global, financial institutions. Within its production structure, sector composition, productivity, and external dependency are all obstacles China must overcome in order to become an advanced economy, although overall, China has been successful in carrying out resource diplomacy with other developing regions, and thus acquiring materials for continuous production and economic growth. It will thus take a considerably longer period of time before China is ‘hegemonically ready’.

8.1. Existing Overview of the Rise of China

An extensive range of literature has used various perspectives to discuss China’s rising power and its implications on the fast-changing world of global politics. From the economic viewpoint, the majority of the previous research has tried to find the forces driving China’s economic surge. Scholars have identified factors such as SOE reform, township and collectively owned businesses, and export-driven economic strategy as the major contributors to China’s growing power (Goodhart and Xu, 1996; Yan, 2014; Wang, Liu, and Qi, 2014). Others have pointed out the drawbacks and challenges in China’s current economic model, such as over-accumulation and overcapacity (Hung, 2008). It is also stated that the economic growth of China can point to both opportunities and challenges, as well as competition with other countries, regardless developed and developing (Ahn, 2004; Athukorala, 2009; Kumar, DuFresne, and Hahler, 2007).
The most concerning discussion on China’s rising power involves the security aspect, with debates regularly occurring to ask whether China is a security threat to the US, its Asian neighbours, and the existing global order (e.g. Chung, 2009; Callahan, 2005; Banlaoi, 2003; Kim and Gates, 2015). As shown by its economic strength, China can afford an increasing amount of military expenditure, which is worrying for other players in the global regime. Particularly for the US and US-allied Asian countries, China’s growing power can be seen to introduce a new equilibrium to the existing system.

Among this strand from the literature, writing on offensive realism suggests that the US should proactively take action to suppress China’s growth, while others debate over China’s intention (Johnston, 2003). Is it a status quo or revisionist country, as defined in power transition theory, and will China overthrow the established US hegemonic regime? There are also a number of empirical studies analysing East Asian countries’ reaction to China’s growing power. Although opinions vary due to the different approaches adopted, this research largely agrees that the economic mutual benefits China brings cancel out the security threat it poses, especially combined with China’s pragmatic attitude (e.g. Brzezinski, 2013; White, 2005; Nanto and Chanlett-Avery, 2006; Shambaugh, 2004).

The rest of the existing literature focuses on the ideological impact of China’s growth, mainly through the structure of international organisations and regimes (e.g. Art, 2010). Some of the existing literature identifies values and ideologies as key elements of US hegemonic success, pointing out that Bretton Woods institutions were built particularly for the purpose of promoting the values of a liberal capitalist regime (Robinson, 2011). There is some evidence that China’s mode of economic growth and the Beijing Consensus seem appealing to developing countries, leading to speculation on whether China will establish a new global institution using its own set of values (Hung, 2008). On the other hand, some scholars have denied this possibility, stating that China is committed to the Western regime, rather than intent on developing a mature set of values applicable to the world (Ikenberry, 2008). This means a win-win situation for both China and the rest of the world because China embracing the Western liberal system facilitates further economic cooperation with other countries.

The existing literature shows competing conclusion on the status of China’s rising power and its implications for the world without clearly defining the term ‘power’ or ‘hegemonic power’.
In this existing literature, understanding of the different dimensions of China’s power is scattered and inconsistent due to the fact that China is a peculiar case of development containing variegated pattern in different sectors and aspects. Therefore, this research offers an analysis of the variegated aspects of China’s economic power with updated data and materials on the basis of a systematic conceptualisation of hegemonic power.

8.2. Disaggregating Power and China’s Hegemonic Rise

Understanding power is the foundation of this study. Without properly defining hegemonic power, it is difficult to set up the parameters for evaluating power. A few theoretical schools, including both mainstream IPE approaches and critical theory, conceptualise hegemony based on cases of previous and current hegemonic power. These theories observe how power is manifested through the performance and behaviour of hegemons; however, they have not provided a practical approach for analysing power or to clearly identify the components of power.

In this case, Susan Strange’s theory of structural power is introduced in order to construct the analytical framework for this study. As a major contribution to the existing IPE scholarship, the core of this theory suggests that power should be disaggregated into different structures. Strange’s original suggestion covers four primary structures: finance, security, production, and intelligence (Strange, 2015b). Strange also points out that structural power theory is a flexible approach. A study is free to select the structures suitable for the research in accordance with the contemporary global political environment.

Following Strange’s conceptualisation of disaggregated power, this study focused on two structures from Strange’s theory, finance and production, to identify and examine China’s variegated and uneven development. As the existing literature on the rise of China has pointed out, China’s growth is rooted in the economic aspects. It was after the surge of GDP growth and accumulation of wealth in the 1990s and early 21st century that China’s impact on security, global leadership, and other political aspects began to materialise. Case studies on US foreign policy, as well as other countries’ reaction to the rise of China, show that hostility due to China’s pursuit of political power is often compromised by the economic benefits China brings (Brzezinski, 2013; White, 2005; Nanto and Chanlett-Avery, 2006; Kirshner, 2012). Therefore,
within the limited time span and length of this thesis, the research focuses on finance and production structure as the two most fundamental elements of China’s economic power.

Chapter 4 and 5 explore China’s development in terms of its financial structure, internally and externally. Chapter 4 examines the result of China’s financial reform from two perspectives defined by Strange: the ability to generate credit and the ability to manage monetary stability. The reform started with the modernisation of China’s banking system when roles of the central and commercial banks were clearly separated. More recently, a range of financial instruments were introduced to further deepen China’s financial structure. Overall, although great achievements have been made, the Chinese financial structure is rather shallow, according to the standards of hegemonic power.

As the reform initiated, the PBOC began to function as the central bank, responsible for making policy decisions from the macro level, for example, decisions on the interest rate and the exchange rate; the ‘Big Four’ leading state-owned commercial banks were liberalised and effectively reduced the amount of bad SOE loans. This ‘dual-track’ system that followed the banking reform introduced a certain level of freedom to the capital market, and commercial banks became the major financer for small and medium companies. However, such market liberalisation was limited as the government and PBOC continue to maintain a high level of central control due to ideological restrictions.

Other forms of financial instruments, such as the stock exchange and credit rating system, came into existence in the 1990s. Total market capitalisation has shown exponential growth since the opening of the Chinese stock exchange. It also experienced a few major setbacks over the past three decades, exposing deficiencies in the system. The credit rating system emerged even more recently. The relevant Chinese authority has established interim regulations for this new instrument merely on the use of personnel and basic principles, with very few detailed rules of operation introduced. The actual method of credit rating is left blank, with rating agencies defining their own rules. It is confirmed by scholars that credit rating, as a protection mechanism, is beneficial to the development of Chinese bonds and the security market, but it will take time before such a system is properly established. These instruments are still under development as these industries significantly lack scientific management and regulation. Through these instruments, it can be observed that China’s financial deepening remains rather shallow at this point.
The socialist ‘dual-track’ system, a balancing act between macro-control and liberalised institutions, has proven to be effective when managing China’s monetary stability. While opening up its capital market, the relatively high level of macro-control enabled China to withstand the Asian Financial Crisis. A similar strategy was imposed on Hong Kong’s return. With the mainland under a Chinese socialist market economy, Hong Kong was allowed to maintain its status quo financial system for a smooth economic, financial, and political transition on both sides. As China’s ability to manage monetary stability improved, the status of the Chinese currency was also promoted. The RMB is now the second most frequently used currency in international trade settlements and has become part of the SDR basket; however, due to its limited convertibility and liquidity, it is far from being the leading reserve currency in comparison to the use of the US dollar.

Through the series of internal financial development, China obtained enhanced ability to generate credit, to manage monetary stability, and to promote the use of its currency overseas. However, the progress of financial deepening is shallow due to immature regulation and restrained currency policy. Therefore, China’s economic power remains insufficient for a hegemonic rise.

Chapter 5 focuses on the external aspect of China’s financial structure, examining China’s influence through its engagement with international financial institutions, including both Bretton Woods institutions under US hegemony and the newly established China-led institutions.

By studying the formal governance structure and informal influence mechanism of the IMF and the World Bank, it is concluded that China has incremental control over US-led institutions. There is also evidence that China is committed to US-led institutions due to the potential mutual benefit and stability. The overall position of China in these institutions places it in the process of slowly shifting from passive borrower to a mixed role of borrower and lender. Through voice reform and the call for a fairer playing field, G7 leadership was able to expand into G20. Since then, China has been able to exert more power on institutions; however, this increase in China’s power is very limited as the US remains in possession of the power of veto over major decisions.
Meanwhile, China can be found playing a leading role in new institutions, including the Chiang Mai Initiative Multilateralization, the BRICS Contingent Reserve Arrangement, the New Development Bank, and the Asian Infrastructure Development Bank. In all these new institutions, China is the biggest or one of the biggest shareholder(s), taking the largest share of the decision-making power. It is fair to suggest that China demonstrates a regional hegemonic power through these new institutions, as it takes up a large share of the responsibility for maintaining regional monetary stability and funding infrastructural development projects in developing countries. Furthermore, these new institutions do not pose a challenge to the existing US-led institutions. The establishment of the AIIB and CMIM, for example, are complements to the existing order, rather than competitors. Overall then, China’s power within the international financial regime is insufficient as a global hegemonic candidate.

The incremental growth of China’s influence within existing US-led international financial institutions and the relatively minor role of new China-led institutions indicate that China’s economic power is limited in the context of hegemonic transition.

Chapter 6 and 7 analyse the power embedded in China’s production structure. Chapter 5 looks at the internal development of China’s production. The overall findings suggest that a successful resource strategy has been supportive to a production surge; meanwhile, China’s production structure requires further optimisation in terms of sector composition and productivity in order to catch up with other leading world economies.

Chapter 6 identifies three elements as major indicators of China’s production structure: production volume of each sector, productivity of each sector, and external dependency. The economic and market reform that occurred during the late 20th century adopted a series of arrangements, such as the Household Responsibility System for the agricultural sector and encouragement of private businesses, which greatly boosted China’s production volume. Despite China taking second place on the world stage regarding GDP in recent years, its production volume is heavily attributed to the industrial sector – manufacturing, to be more precise. Industry is a sector contributing much less value-added than the service sector. In most advanced economies, the service sector takes up the biggest share of domestic production, for instance, more than three quarters in the US. In China, the service and industry sectors take up 48% and 43% of total value-added, respectively, and the Chinese government has continuingly
promoted the status of the service sector. It would take a reasonable period of time for China’s production structure to be upgraded into an advanced form.

The chapter also found that the productivity of all sectors of China’s production structure, also await improvement. China’s labour productivity is much lower than that of the US. Besides, the Penn World Table 9.0 indicates that China’s total factor productivity level in relation to purchasing power is achieving only a fraction of that of the US and is much lower than most Western countries.

A further discussion on the external dependency of China’s production explores the effect of inflow FDI and exportation. Although existing literature has partially attributed China’s production surge to inflow FDI during the late 20th century, the effect of FDI on China’s production to date has gradually diminished as China’s economy has taken off. On the other hand, China’s exportation remains the lifeblood of its production structure. Its reliance on exporting manufacturing goods also brings vulnerability because if demand from the international market reduces, China may face problems such as overcapacity. Overall then, China shows little convincing hegemonic power through its production structure.

Generally, it is clear that China’s production structure requires a further update in order to catch up with Western leading countries, especially the US as the current hegemon. From the perspective of internal development of the production structure, China’s economic power is insignificant with a relatively weak foundation.

Chapter 7 explores China’s resource diplomacy using three resource-rich regions, Africa, Latin America, and Southeast Asia as the external aspect of its production structure. Resources are identified as a key element of China’s production because they are considered closely related to hegemonic ascendancy, according to cases of both previous and present hegemonic power. Particularly for China, acquiring adequate resources is fundamental in order to fuel its continuous production activities. Therefore, accessing and securing resources can be a measure of the external aspect of China’s production structure; while overall, China’s resource diplomacy has proven to be both effective and successful.

Three elements are considered to be essential in determining resource diplomacy: price, access, and transferability. As in the case of China, price is no longer a major concern, and access is
measured by trade volume, institutional foundations, and challenges to partnership sustainability. Transferability is represented by infrastructure development.

China is the most sought-after market for many resource-rich countries. It has the most frequent and voluminous trade with Southeast Asia, followed by Latin America and then Africa. The institutional foundation aspect echoes trade volume. China has established a regional cooperation framework and regional FTA with ASEAN, bilateral FTA with three LAC countries, and a mere cooperation forum with African countries. The major challenge to China’s resource strategy is that the huge demand for resources leads to ‘exploitation’ of others. The problems may appear differently in different regions and countries, but overall the observation is that China’s seeking of resources can, to different extents, hinder the industrial upgrade of these resource-rich developing countries. As long as both China and its partners proactively seek industrial upgrading, instead of following short-term profits, in principle, this problem can be overcome.

It is also found that China has been investing extensively in infrastructures, such as roads, railways, energy stations, and resource-related projects. China is the biggest infrastructure financer in all three regions. Such investments provide an easier method for extracting and transferring resources. Giving out financial aid and easily-acquired loans is also part of China’s strategy of building rapport with these resource-rich developing regions.

Therefore, China’s resource diplomacy is overall successful in terms of securing raw materials, sustaining rapid production growth, and forming long-term strategic partnerships. Such conducts are essential elements for China to pursue further economic growth and power. From this perspective, China’s economic power shows a positive sign of continuous enhancement for a potential hegemonic rise.

Overall, by synthesising the internal and external development of China’s finance and production pillars, this study concludes that it is not likely for China to acquire hegemonic status based on Strange’s conceptualisation of power. Undeniably, since 1978, China has been carrying out multi-dimensional economic reform, including reform of the financial system and production-related institutions, and has achieved some astounding outcome. Financial reform has freed capitals and created new means of financing, igniting the production boom, particularly in the manufacturing sector. As domestic economy flourishes due to production
surge and the emergence of new financial instruments, such as stocks and security transaction, China’s status within international regimes has been promoted correspondingly, besides the urge of seeking overseas resource and overseas market. However, there are problems found within China’s domestic economic development, such as excessive financial control, low productivity, and heavy external dependence, which have determined its inability of becoming the global leader in the contemporary world.

8.3. Directions for Future Research

This study focuses on analysing China’s rising power. The basis of this research lies in exploring the components of China’s structural power, building from the framework introduced by Strange. This framework has allowed for an assessment to take place of the strength of the internal and external foundations of the political-economic power of China.

This study does not analyse the current status of the US hegemon and is unable to answer if a hegemonic transition is indeed happening. Although initially, it intended to explore the dynamics between China and the US in terms of hegemonic competition, due to the limited time and length of this thesis this became impossible.

A major extension of this work would be to place the study in comparative perspective. This study has argued that while dramatic transformations have taken place in China, some significant structural weakness remains. To gain a sense of where these transformations place China as a global power relative to other players, such a shift towards comparative analysis would be required. Hegemonic transition involves two parties – a relatively growing emerging power and a relatively declining current hegemon. A comparison could be toward the declining power, or to other rising powers.

Besides, a much more complicated set of variables needs to be defined in order to study a transition, because transitions are a process in which time, space, and subjects are constantly changing. It is also very difficult to answer to what extent power has been shifting – it is not like transferring water from bucket to bucket, which can be calculated objectively by volume. After all, there is no consensus on whether we should observe power as relative or absolute.
This is an ongoing debate between realist and liberal theories (Rana, 2015; O’Brien and Williams, 2016). The question then becomes a question of epistemology.

Moreover, this research cannot make a prediction as to what is coming next regarding China’s economic growth or China’s pursuit of hegemonic power. Because of the changing nature of international politics, there is a possibility that the world is shifting into a multi-polar regime rather than being hegemonic. This is, in fact, another heated topic of debate (e.g. Wilkinson, 1999; Hurrell, 2006; Amin, 2013; Pieterse, 2017; Voskressenski, 2017). This study has not considered this possibility. Base on the analysis of the current status of China’s economic power, future research on international relations can discuss if the rise of China is pushing towards multi-polarity instead of a hegemonic transition.

Most recently, the world has begun to see unforeseen changes in ideology, in the way people understand international politics. Just as Susan Strange has suggested, the world has changed and will keep on changing. The mainstream approaches used today may not be mainstream in the future. At the moment, it is largely true that China poses great economic attraction to the world, and that this can cancel out the political and military hostility ranged against it. However, this situation may change, and economic attraction might no longer be the trump card China holds.

Contemporary global politics indicates that debate over the rise of China will continue for the foreseeable future. Under President Trump, it appears likely that a more adversarial trade policy may develop, framed in relation to the threat represented by the rise of China and by the ‘bad deals’ from previous US administrations that have supported this rise. The failure of the US to ratify the Trans-Pacific Partnership also signals that the political-economic relationship between the US, China, and the Pacific region will remain dynamic.
Abbreviations

ADB – Asian Development Bank
AIIB – Asian Infrastructure Development Bank
AMRO – ASEAN+3 Macroeconomic Research Office
ASEAN - Association of Southeast Asian Nations
CAFTA – China-ASEAN free trade agreement
CELAC – Community of Latin American and Caribbean States
CMIM – the Chiang Mai Initiative Multilateralization
CNY – Chinese Yuan
CRA – Contingent Reserve Arrangement
CPC – Communist Party of China
CSRC – China Securities Regulatory Commission
ED – executive director
EMD – emerging markets and developing countries
FDI – foreign direct investment
FOCAC – Forum of China-Africa Cooperation
FX – foreign exchange
HRS – Household Responsibility System
IBRD – International Bank for Reconstruction and Development
IDA – International Development Association
IFC – International Finance Corporation
IMFC – International Monetary and Financial Committee
KMT – Kuomintang
LAC – Latin American and Caribbean
MIGA – Multilateral Investment Guarantee Agency
MITI – Ministry of International Trade and Industry
NBS – China National Bureau of Statistics
NDB – New Development Bank
OBOR – One Belt One Road Initiative
PBOC – People’s Bank of China
RCEP – Regional Comprehensive Economic Partnership
RMB – Renminbi
SOE – state-owned enterprise
TPP – Trans-Pacific Partnership
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