

The Other Side of the Global Imbalances: The Politics of Economic Reform in China Under the ‘New Normal’

Chen Xie

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University of York

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Abstract

In the 21st century, the 'rise of China' in the post-financial crisis period is arguably the most important and widely debated topic in politics and international studies. Since, the 2008 financial crisis, compared with the US, whose power appears to have diminished, it seems more and more likely that China will soon become the engine of the world economy and, perhaps, one day the global hegemon. Although the financial crisis may have not, in itself, fundamentally changed the shape of the global order, it has arguably altered perceptions. This is especially so regarding the 'global imbalances' that are said to have provided the macro-economic conditions for the crisis to occur. Equally, the different positions occupied by the US - as the world's largest debtor - and China - as the world's largest creditor - both prior to and after the crisis are suggestive of a fundamental power shift in the global order. In this thesis, I aim to add to existing understandings of the rise of China by examining the relationship between its rise and the global imbalances in the contemporary order.

In order to address my thesis questions, I utilise concepts and arguments about the relationship between power, institutions and the global order provided by different scholars and theoretical traditions in IPE. Based on these, I review the experiences of Britain and the US in three key historical periods of global imbalance in 19th and 20th centuries that are analogous to the role of China in the contemporary global imbalances. Specifically, I highlight the interaction between China's 'internal' imbalances and external pressures in the post-crisis era, and explore the different influences of these in the rebalancing efforts of China's with respect to its economic reform process. Overall, I argue that, although China is often caricatured as a 'free-rider' and beneficiary of the global imbalances, this neglects China's serious internal problems caused by these imbalances due to its trade-oriented and investment-oriented economic model. I suggest that one of the central pillars of China's rebalancing efforts in post-crisis is the economic restructuring through its new so-called Pilot Free Trade Zones (PFTZs), which represent a reform laboratory similar to the role of the Special Economic Zones (SEZs) in the 1980s and 1990s. As such, I provide a review and assessment of the PFTZs and use this to gauge China's changing role in the global economic order.

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Author's Declaration

I declare that this thesis is a presentation of an original work and I am responsible for it. In some parts of this thesis I have adapted material from a paper that I presented at the Hallsworth Conference: China and the Changing Global Order in March 2017. This paper is not published. Footnotes with the chapters indicate where I have drawn on this paper. All sources are acknowledged as References.

Chapter One

Introduction

1.1 Background

The starting point for this thesis is the academic and political debate about the so-called 'rise of China' in post-crisis era and its growing influence on the global economic order. In the immediate postwar period, unlike most developed countries were seriously weakened and damaged by the war, the power of the United States was preponderant accordance with the theory of hegemonic stability theory (HST), American hegemony was synonymous with openness and stability, underpinned by the Bretton Woods institutions - the GATT/WTO, the IMF and World Bank - which both reflected the US interests but also gave measure of satisfaction to subordinate states (Gilpin, 2001:99). Even though during the Cold War, especially in the 1980s, the hegemony of the US faced geopolitical challenges from the Soviet Union and economic challenges the EU and Japan, this did not fundamentally alter the American-centric nature of the global order. As Susan Strange famously argued (1987) the durability of the US' global position did not just, or even primarily, rest on its economic and military superiority, but because it stood at the apex of the production, security, finance and knowledge structure of the global economy. However, in the 21st century, more and more academics and popular commentators are arguing with growing confidence that this century will be a 'Chinese Century' (Fishman, 2006; Shenkar, 2006). Not everyone agrees with this argument. Geoffrey Garrett, for example, has predicted a more complex future in which the destinies of China and US will be increasingly intertwined with the 'G2' forming a new model of global governance (Garrett, 2010). Since, the 2008 global financial crisis (GFC), dynamic nature of the international political economy has become more and more evident. There are actually three elements to this - the decline of the US power, the rise of China, the

GFC itself - that require most discussion.

US Decline. The decline of the US is perhaps the most endless debated topic in international affairs since the second world war. In its most recent phase, however, the declinists appear have the upper hand. For Fisherman (2006:1), in the 21st century the 'the United States will lose the heart of our economic strength and see a rapid diminution in our standard of living' (Fishman, 2006:1). Joseph Nye (2015), meanwhile, continues to articulate his long standing view the US broadly retain its lead in military and 'soft power' and it is still possible for the US to lead in an increasingly diffuse global system. But this debate is not just an academic one. In 2014, a Pew poll showed that just 28% of Americans thought that the US still stands above all others country, a full 10% less than that number in 2011 (Fortune, March 11, 2015). The economic data also support this. Between 2006-2016, the average annual GDP growth of the US was 1.487%, which was much lower than world average-2.671%¹. Significantly, in the 1980s when decline of US hegemony was first widely debated, its GDP accounted for between 27-33% of world GDP, but by 2011 this figure was just 21.1% but recovering somewhat by 2011 to 24.5%.² The weight of the US dollar in Special Drawing Right (SDR)³ also decreased from 44% in 2005 review to 41.7% in 2010 and lower still to 41.72% in 2015.⁴ The decline of US also relates with its alleged decreased influences in international politics. The G20, for example, is said to be challenge the role of the American-centric G8 in global governance in post-crisis era, with the rising powers, such as BRICs, new international institutions, like the New Development Bank (NDB) and the Contingent Reserve Arrangement (CRA). In sum, the

¹ The data is from The World Bank and is calculated by the author.

² Source from: https://ycharts.com/indicators/us_gdp_as_a_percentage_of_world_gdp and World Bank database.

³ The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. Reference from IMF official website: <https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/51/Special-Drawing-Right-SDR>.

⁴ Data from IMF website: <https://www.imf.org/en/About/Factsheets/Sheets/2016/08/02/19/35/Review-of-the-Special-Drawing-Right-SDR-Currency-Basket> and <https://www.imf.org/en/News/Articles/2015/09/14/01/49/pr05265>.

21st century looks unlikely to match the 20th century with respect to US hegemony.

The Rise of China. Compared with debate about US hegemony, few doubt the scale and significance of rise of China. Since the launching of the reform and opening up process in 1978, China has recorded many economic achievement, its GDP in 2016 reached \$US 11.199 trillion, accounting for 14.77% of world GDP.⁵ The gap between the US and China in GDP has narrowed significantly: in 2005 China's GDP was 17.9% of the GDP of the US, but this had reached 60.13% in 2016. Moreover, China's GDP in PPP terms had surpassed the US since 2013 and reached to US\$21.406 trillion in 2016, about US \$2.785 trillion more than that of the US. Even Nye (2015) agrees that, in terms of sheer economic output, China is well on course to surpass the US in the foreseeable future. Especially in the post-crisis era, China's economic contribution to global growth is more significant, a period in which China always contributed about 30% of world growth. Even facing a slowdown of economic growth since 2012, the shift in global economic power in post-crisis era is difficult to ignore. According to a report by PwC (2015), the shift in global economic power will continue and they predicted that to 2050, the G7 will be replaced by the 'E7'⁶ and China will overtake the US in 2028 despite its projected growth slowdown. With its increasing economic weight, the role of China in global order has become more and more obvious. As Keohane suggests, rise of China and its influence on the existing global order is one of five biggest changes in IPE in 21st century (2009:40-42). Here key milestones include increases in China's IMF voting shares from 2.94% in 2002 to 6.09% in 2016; the renminbi (RMB) joining the SDR; China's contribution to UN 8000 troops to UN peacekeeping efforts, accounting for one fifth of the total UN troops, and a pledged US\$1 billion to establish a UN Peace and Development Trust Fund⁷; the growth popularity of mandarin, with an estimated 40 million people outside China are

⁵ All data of GDP from the World Bank database.

⁶ E7 refers to Emerging 7, including China, India, Brazil, Mexico, Russia, Indonesia, and Turkey.

⁷ Source from United States Institute of Peace: <https://www.usip.org/publications/2016/07/chinas-troop-contributions-un-peacekeeping>

learning the language⁸. Moreover, with the launching of 'One Belt and One Road' (OBOR) initiative, China, in sum, it may be too early to say the Chinese Century but I can at least conclude its rise is a key defining feature of the early 21st century.

The 2008 GFC. If, the decline of the US and the rise of China are the two most important trends of the early 21st century, then the GFC was a key inflection point that accelerated these underlying trends. To the decline of the US power, according to Jonathan Kirshner, the 2008 GFC 'has left the United States vulnerable to the possibility that macroeconomic factors will inhibit ... its capabilities on the world stage - a reversal of the experiences of the past seventy-five years ... [this will lead to a] generally underappreciated shift in the US engagement with the global macroeconomic order ... American power will be relatively diminished due to both ideational and material factors' (2014: 157). Further, some scholars indicated that the 2008 GFC was not just a 'symbolic of a long-term decline of US corporate power', but also showed the rise of China as the economic powerhouse of the future (Klassen, 2015:74). Although the GFC may not in itself have fundamentally change the shape of global order, it has arguable altered perceptions, not least in China itself, where its entire economic strategy can arguably be seen as a response to the global imbalances that were said to be the cause of the crisis (Overholt, 2010:25-33). Indeed, these global imbalances can be seen as a connection between the three key IPE debates reviewed here - the decline of the US, the rise of China and the GFC. In other words, the different positions of the US and China with respect to the global imbalance, in which China is enjoys large twin surpluses in its current account and capital accounts but compared to the US' large deficits, is suggestive of a fundamental power shift in IPE (Summers, 2004; Wade, 2009). As such, these global imbalances form the starting point for this thesis, as I investigate China's economic reforms in the post-crisis era.

⁸ Source from: <http://studenttravelplanningguide.com/global-trends-in-foreign-language-demand-and-proficiency/>

1.2 Research Puzzle

There are three research puzzles addressed in this thesis, each of which is related to the role of China in post-crisis global order. The first puzzle relates to current status of the global order, that is what are the respective positions of the US and China in the global order and do these positions relate to function and form of global regimes and institutions of global governance? Here I intend to put classical theories of IPE to work to help us understand the relationship between the distribution of power and institutional order. In order to examine the rise of China in post-crisis global order, I must first understand, in theoretical terms, what are key concepts, variables and causal relationships. The thesis examines the influence of institutions in the changing global order and, hence, the interactions between powers and institutions. When I refer to institutions, I mean, in general, 'humanly devised constraints that structure political, economy and social interaction' (North, 1991:97). Applied more specifically to international politics and international political economy, I can further define institutions as 'sets of rules that stipulate the ways in which states should cooperate and compete with each other' (Mearsheimer, 1994:8).

The second puzzle is an empirical one and relates to China's influence on the global order and vice versa. In other words, although much is written and said about the rise of China, the puzzle remains - is China's emergence based on Westernisation and assimilation or non-conformism and confrontation. In what ways is China reshaping the international institutional order? Likewise, what evidence is there that China's internal politics, especially its economic reform process, is being shaped by its global role? The answers to this questions are obviously complex. One approach is to consider China as a challenger and 'revisionist' power in the current global order. Considering the differences between China and current western-centric global system in terms of culture, values, ideology and political practices, this approach indicates that the challenges from China to established global institutions will lead to more tension, distrust and even conflict over 'the rules of the game'. Alternatively, another approach

is to view China as a 'state quo' power. This approach would emphasise China's integration into a Western-centric global system, in which it embraces, or at least does not overtly challenge, established global rules, practices, norms and institutions. As Ikenberry puts it, China will 'have no choice but to become a full-fledged member' of current global system and help to maintain the current global order (Ikenberry, 2008: 37). The thesis assess these contrasting interpretations, but does so on the basis of a more specific topic.

This constitutes the third puzzle of the thesis, which is the role of China in the 'global imbalances', which have formed such a key aspect of the pre- and post-GFC order. As suggested, some scholars see China as a pure beneficiary of these global imbalances and conclude that they are symptom of a fundamental power transition from West to East in the post-crisis period. However, the other interpretation is more nuanced and suggested these imbalances are more mixed blessing for China, as they point to the link between China's own imbalances between its export-oriented and domestic sectors. As such, China these internal imbalances continue a serious impediment to the 'normalisation' of the China economy, which external critics see as the key to solving the external imbalances, especially those between the US and China. In short, the point of the thesis is to examine the relationship between external and internal imbalances in the context of the decline of US hegemony, the rise of China and the emerging post-crisis global order.

1.3 Research Questions

Based on the study of global imbalance, the key research question of this thesis is: What is the relationship between the rise of China and the global imbalances in the contemporary order? In seek to answer this question, I ask:

- a) How do key theorists of IPE account for the relationship between changing power structures, trade imbalances and the global order?

- b) What lessons can we draw from the experiences of Britain and the US in managing global imbalances in the 19th and 20th centuries respectively?
- c) What is the role of China with respect to contemporary global imbalances and efforts to reduce these in post-2008 financial crisis period?
- d) What the influence of these efforts at rebalancing affects China's internal economic reform process?

1.4 Argument and Contribution

The central findings and contribution of this thesis can be summarized as follows. By critically reviewing key phases and episodes of global imbalances in their historical context, the thesis explains the role of dominant powers in influencing the extent and form of global imbalances - and, more importantly, the interactions between these dominant powers, international financial system and global order during former episodes of global imbalance. The interactions between powers, institutions and global order in global imbalanced periods do not always follow the same paths and there is no clear causal link between global imbalance and power shifts in global order. However, I find that there is a strong link between the global imbalance and international financial system and serious global imbalance often leads to the collapse of established international financial system, such as the global imbalances in the pre-1914 period and collapse of classical gold standard. This means that global imbalances do not directly lead to power shifts in global order but it applies its influences by bring instabilities to the international financial order. If the leading powers in global order can maintain or rebuild the international financial system, even facing serious global imbalance, the established or leading power is more likely to main its role in global order, such as the case of the US hegemony facing collapse of Bretton Woods System in the 1970s, in response to the global imbalance between 1965 and 1971.

Noteworthy here is that the case of US hegemony in the 1970s is the only exception in which the unravelling of the international financial system did not lead to the power

shifts or sharp decline of hegemonic powers in global order. This is because, compared with former leading powers such as the UK in 19th century, US hegemony related to global order in different and more complex ways. In short, its 'structural power' was more pervasive. Applied to the current global imbalances, the 2008 GFC arguably represented a significant turning point, after which the level of global imbalances sharply decreased, albeit perhaps only temporarily. More important is that the GFC exposed the frailty of post-Bretton Woods, so-called 'Jamaica System' based on the US' debt-financed consumption economic model and the global trend of economic and financial liberalization since the 1980s. Not only this, but equally important for our purposes, the GFC also exposed problems and vulnerabilities associated with China's post-1978 growth model. This thesis finds that the GFC drew attention to the limits of China's trade-oriented and investment-oriented economic model. The external constraints and pressures in post-crisis era have highlighted, and arguably worsened' China's own, internal imbalances, that is: 1) an imbalance between external and domestic demand and between investment and consumption; 2) China's 'twin surpluses' and excessive growth of foreign exchange reserves; 3) China's imbalanced industrial structure dominated by manufactories characterized as 'three high'-high input, high consumption, high pollution and 'two low'-low efficiency and low value added; and 4) China's regional and coastal/urban-rural disparities and urban-rural disparities. These internal imbalances, I will argue, are a key driver of China's rebalancing efforts - a fact often missed in Western account, which generally view these reforms through a Western-centric prism, focusing on US priorities and China's so-called 'free-riding' behaviour'.

China's rebalancing in the post-crisis era, described in Beijing as the 'new normal', the thesis argues, will be critical to the rise of China in post-crisis global order - and hence the shape of the future global order itself. The most direct effect of China's rebalancing to China's rise - if successful - is that the rebalancing reforms will help to promote a more sustainable growth model and improve the quality and efficiency of the Chinese economy. Considering that rapid economic growth is one key source of China's

increasing global influence, a sustainable economic growth model is fundamental to the rise of China in post-crisis global order. In addition, compared with the assimilation versus confrontation paths outlined earlier, the thesis finds a third, more nuanced path is more likely. In other words, China's continued socialization into selected global standards, rules, practices and norms will co-exist 'alongside registering its desire and right to be at the table for rewriting some others' (Chin and Thakur, 2010:120). China's rebalancing under the new normal does not follow the popular western styles as China arguably did in 2009, focusing on orthodox fiscal and monetary policies. Instead, the emphasis under the new normal is on structural reforms. This means that facing global economic problems, China is proposing its own solutions rather than just following the Western paths as it has in the past. China's detailed plans of rebalancing under the new normal involve more than just Western-style ideas for improving capacity and international competitiveness of China's enterprises; they are also tied to the launching of OBOR, arguably designed to chart an alternative, Chinese model for global governance.

As an illustration of these complexities, the thesis focuses on the case of the 'Pilot Free Trade Zones (PFTZs)' as key reforms in China's rebalancing towards the new normal. By comparing the Special Economic Zones (SEZs), which are the representative of China's 'old' economic model, to PFTZs, this thesis finds 'one constant and four changes' between rebalancing reforms and China's former economic reforms, which also further supported the conclusion of how China's rebalancing influence rise of China in post-crisis global order. The 'one constant' is the enduring political philosophy behind the China's model, based on four key features: namely, the one-party system; the role of the state as an economic agent; gradualism and incrementalism with respect to policy innovation and reform; and the assimilation and adoption of foreign practices but only according to local circumstances and custom. The practices in PFTZs in 2010s still follow those four principles of China's in a manner similar to the SEZs in the 1980s. However, under the new normal, the one constant is accompanied with four changes', which are the shift from manufacturing to services; from providing

preferential policies to institutional innovation; from one way to two way opening up that from only about expanding export and attracting foreign direct investment (FDI) to also boosting imports and supporting China's overseas investment; and from adoption and assimilation of established international practices to proactive involvement in the reformulation of global rules. These four changes show that, as the key policy of China's rebalancing under the new normal, the practices and reforms in PFTZs strongly follow the directions of China's rebalancing and China is keeping opening up and further integration into established international system. But they also show China's increasing desires to set Chinese standards and rules in global system.

1.5 The Theoretical Framework

At a theoretical level, the thesis focuses on concepts and arguments about the relationship between power, institutions and the global order. Rather than reviewing these theories according to the specific traditions, I follow Cohen's (2007) model of identifying key thinkers and representatives of the 'American' (Robert Gilpin, Robert Keohane) and 'British' (Susan Strange, Robert Cox) Schools. The overall purpose is to provide an eclectic, theoretical synthesis on the basis of key shared concepts but differing interpretations of the key drivers of continuity and change in the international political economy. Rather than 'testing' the relevance and validity of each, this thesis is more concerned to draw on shared concepts that help us to capture and assess key aspects of China's political economy in post-crisis global order. In addition, I am not seeking to combine theories but lay out key concepts and debates, which can inform key thesis questions. The reason to do this is, in large measure, due to the particularity of China as a rising power. There are two related aspects to this.

First, reviewing the history of past 300 hundreds years, China is the most unfamiliar rising power to modern studies of IPE, which does not follow general models in IPE studies. In political terms, China is a socialist country with a one party system. This may recall the case of Soviet Union but China has a totally different culture and philosophy,

with strong oriental characteristics, such as collectivism, clan culture, people seeing government as a necessary virtue, a strong sense of state unity, and so on. In economic terms, China has a mixed system in which government-owned assets and private actors are both important and often need to be examined case by case. All of this makes a genuine study of China from an IPE standpoint a more inductive enterprise. This can be seen, for example, in the debates about China's model in IPE. Here scholars have fundamentally different ideas about China's model and there is far from consensus whether China is a socialist or capitalist state. Nor is there total agreement in which direction China is heading. As Ding Xueliang (丁学良) puts it, there are more than 20 different descriptions of China's model, including state capitalism, authoritarian capitalism, Leninist corporatism, Party-State capitalism, commercial Leninism, single-party-rule capitalist, developmental state, Confucian capitalism/Leninism, soft authoritarianism, adaptive Leninism, and so on (2011:70-71).

Second, the western-centric character of IPE studies highlight China's particularity. As a discipline independent from International Relations (IR) in the 1960s, the studies of IPE also inherited the theoretical bases of IR and the ideological sources of these ideological bases are all Western, such as the theory of sovereignty of Bodin, international anarchy of Hobbes, balance of power study of Rousseau, rationalism and study of peace of Kant, theory of international conflicts of Clausewitz. The western blood of mainstream IPE studies make the backgrounds, research agendas, paradigms of IPE are very western centric and in theoretical level, rarely considers the systematic differences of research objects around the world. For example, there is a hidden assumption in mainstream IPE studies of state behavior, which they often assume that there is a basic democratic system at the domestic level and the interactions between state actors and non-state actors often embedded in this domestic democratic system. But this is of course not a case in study of China. As some famous Chinese IPE scholars indicates (see Wang Zhengyi 王正毅: 2006, Zha Daojiong 查道炯:2006), in both theoretical and empirical studies in IPE, there is a phenomenon of the 'absence of

China' (中国缺失). Actually, the mainstream also recognizes the importance of China in IPE studies, such as Keohane who sees the rise of China as one of five main changes in 21st century global order. But the western-centric paradigms increases the difficulties of their studying of China. The western-centric feature of IPE studies leads to that any single IPE theory hard to appropriately explain the stories of special and complicated China. Proposing an open theoretical framework will not in itself solve this problem. Yet, I can at least appropriate some general concepts - power, institutions, institutions, hegemony, and ideology - that can be adapted to the peculiarities of the Chinese case.

Moreover, this thesis chooses to review four representative theorists in IPE and this choice is further justified on two grounds. As argued above, the main purpose of the theoretical approach in this thesis is to provide generalisable theoretical explanations suited to the empirical analysis of China in the global order. So covering a certain range of representative theories in various schools of IPE studies is one consideration of design of theoretical framework. The choice of theories is strongly related with the Cohen's (2007) proposal of 'the Transatlantic Divide' in IPE. The four theorists and their theories are the representatives in both two schools and core traditions of realism, liberalism and Marxism. Moreover, unlike, say, the Open Economic Politics (OEP) schools, the four theorists chosen share a common interest and common understanding of the relationship between power or hegemony, institutions and regimes, and changes in the global order, even if they differ in their understanding of these concepts and in their ontological assumptions and epistemological commitments. Finally, the thesis does not set out to settle these differences but to interpret and use the theories more broadly to help capture and understand the empirical matters under investigation.

1.6 Research Methods

Interviews

The empirical material in the thesis draws on a series of elite interviews conducted during field research in China over two periods: 12 weeks in Fujian, 1 week in Shanghai and 10 days in Beijing in mid-2016; and a further 8 days in Beijing in early 2017. According to David Richards, the core purposes of elite interview are to ‘try to assist the political scientist in understanding the theoretical position/s of the interviewee; his/her perceptions, beliefs and ideologies’ (1996:199). To this end, the main function of interviews here were related to two aspects of the research design. First, they helped to glean information about the implementation of rebalancing reforms and policies in PFTZs, including recorded data and documents but not yet published, opinions of Chinese officials in local and central governments, and feedback from professionals, enterprises and supporting agencies. Second, they allowed access and insight into Chinese plans for further reforms, which are not yet on the public record. Elite interview are a long established, excellent way to collect information, especially ‘when thoughts and behavior can be described or expressed only by those who are deeply involved in political processes’ (Johnson and Reynolds, 2008:343). For the study of China, especially related to policy making and implementation, information gleaned is invariably ‘off-the-record’. For this reason, all interviews were conducted anonymously to encourage interviewees to speak more freely, especially about sensitive topics, which in this thesis mainly refers to problems, mistakes, and uncompleted goals in the implementations of policies and reforms in China. Moreover, in order to make the interviewees more comfortable, I only used handwritten notes to record the interviews. In most cases, I wrote up interviews on the day making them to ensure the integrity and reliability of my mind. All interviews were conducted face to face in semi-structured method. In the interviews, I followed a set list of questions, but also let the interviews have a natural flow. As Johnson and Reynolds (2008:343) indicate, advanced preparation helps to avoid collective bias and untruthful data caused by misleading of interviewers. Harrison (2001:96) also points out that a successful interview asks the interviewees to understand what is required of her/him.

So in most cases, I sent the list of questions to my interviewees beforehand⁹ to help to improve efficiency, glean information and double check the accuracy and interpretations of data.

A total of 34 interviews were conducted for this thesis, including with Chinese officials, representatives of enterprises and supporting agencies, and professionals. These included 14 interviews with Chinese officials, including the officials from Administrative Committee of Fujian PFTZ, finance officials from the Committee of Shanghai PFTZ, trade and commercial officials from Fujian government (provincial), trade officials from Fuzhou government (city), an official from Fujian CPPCC (the Chinese People's Political Consultative Conference), trade and finance officials from China's State Council. There were 12 interviews with representatives of enterprises and supporting agencies in PFTZs, including the Chinese enterprises in Shanghai PFTZ and in Fujian PFTZ, the foreign invested trade enterprises in Fujian PFTZ, the foreign invested financial institutions in Shanghai PFTZ, a start-up company in Fujian PFTZ, and supporting agencies in Fujian PFTZ. Finally, 8 interviews with professionals, who are all members of think tanks and government consultants, deeply involved in the policy making of reforms, especially policies of the PFTZs.

In many cases, gaining access to these officials, especially the officials from central government, was difficult. As Burnham et al. point out, the biggest problem of getting access to elites is that they are often too busy that interviewer needs to provide a very convincing motivation to elite interviewees (2008:235). Moreover, in the Chinese case, officials have more concerns about interviews, especially from researchers from foreign research institutions. In my case, getting access to officials by personal connection was one important way to solve this problem and having a well-placed facilitator, often research professionals meet during field work, helped to reduce the

⁹ I also informed my interviewees that this list of questions is just for reference. I might will ask the questions not in the list.

concerns of officials and to make them more willing and comfortable to talk about 'sensitive topics' dealt with in the thesis. In some of the interviews with representatives of enterprises, I encountered difficulties in getting data related with the reliability of the interviewees. According to Richard (1996:201), the information provided by interviewees is often of a 'highly subjective nature'. In this case, in order to ensure the reliability of interviewees, where possible I requested further data from enterprises to support the information they gave in interviews. But in some cases, like one trade enterprises in a Shanghai PFTZ, interviewees rejected the request for further data or documents because commercial sensitivity reasons. In these cases, I have not used the information provided by interviewees that could not be further supported by other sources of information, or I also asked the same questions to other similar interviewees to increase the reliability of information gained.

Process tracing with historical case comparisons

The process tracing is 'the examination of intermediate steps in a process to make inferences about hypotheses on how that process took place and whether and how it generated the outcome of interest' (Bennett and Checkel, 2015:6). Clayton Roberts (1996) further indicates that processes tracing strongly related with historical explanation as he called, which 'helps to reconnect political science with history identifying and describing the historical sequence linking a cause to an effect' (Hague, Harrop and McCormick, 2016:104). In this thesis, this research method is mainly used to examine the historical account of global imbalance in three different periods, including post-1914, interwar, and between 1965-1971, to analyze the relationship between power, the international financial governance and global order in these three episodes. As Bennett and Checkel (2015:29) point out, compared with single case, for process tracing, 'comparative case studies can be more powerful sources of inference'. The comparative methods are also used in here to examine the historical account of global imbalances in three different periods, which is, 'comparing a small number of cases in order to better understand their qualities, and to develop and investigate

hypothesis' (Hague et. al., 2016:91). By comparing three episodes of historical global imbalances, I aim to understand the relationship between global imbalances and changes of global order in the context of different international financial systems. I find that even though that there is not a clear and direct causal link between these two, ruptures in the international financial system are often strongly related with global imbalances, often precursing dramatic changes in global order.

The Case Study

As described, the case study method is used in this thesis to examine Chinese economic reform, in the context of global imbalances and possible power transitions. The case study, as a research method, is a 'detailed study of a particular object ... as well the context within which it exists' (Hague et. al., 2016:92). As Yin (1981:98) indicates, the case study should be used, when 'an empirical inquiry must examine a contemporary phenomenon in its real-life context ... [when] the boundaries between phenomenon and context are not clearly evident'. This thesis uses the case of Pilot Free Trade Zone (PFTZ) to examine the implementation of China's economic rebalancing reforms and to what extent these reforms signify a process of rebalancing. The purpose of case study of the PFTZ is to provide further evidence to gauge the influence of China's rebalancing and the rise of China in post-crisis era. I examine the case of the PFTZ in two ways. One is by comparing the PFTZ with similar trade zone policies - the Special Economic Zones (SEZs) in the 1980s - to see the different approaches and aims of these two policies to show the different purposes and paths of China applying reforms under the new normal. Then I provided detailed analysis of the implementation of particular reforms policies in four key areas - investment liberalization and facilitation; trade facilitation; financial reform; and encouraging innovation - in China's rebalancing, to see progress of China's rebalancing.

For the case study, relying on multiple sources of evidence is a key motive (Yin, 2009:18). As Gillham (2010:20-2) has pointed out, different kinds of evidence should

be covered, including documents, records, interviews, observation, physical artefacts. According to Gillham (2010: 22), evidence is the first concern of case study because research tries to ‘recreate the context and sequence of evidence ... has to use a more overtly narrative format ... evidence needs to be presented for the development and direction of the narrative’. In my thesis, the case study of PFTZs is based on the evidence inferred from policy documents, interviews of officials and representatives of enterprise and professionals, statistical data, participant observation based on my field work in the Fujian and Shanghai PFTZs. As a single case study, it is important for this thesis to clarify the reasons for choosing the Fujian PFTZ. As Yin (2004) and Hancké (2009) observe, for a single case study, selecting a ‘significant’ case and showing the ‘special’ and ‘differential’ nature of your case in contribution to your research questions is important. In this context, the choice of the PFTZ as case study is to the thesis in three main ways. First, since 1978, various economic zones have been the most important testing lab for China’s market-oriented economic reforms. Accordingly, most policies geared towards rebalancing reform under the new normal find expression in the PFTZs. Second, the PFTZs are one important part of recent marketization reform in China, but also strongly related to many other restructuring reforms and long term strategies in rebalancing of China, such as OBOR, supply-side reform and Made in China 2025. Third, the practices of PFTZs follow the four features, or governance philosophies, of China’s model, as mentioned before, that strongly related with the path of China’s influence in the global order in post-crisis era.

Data Analysis

As a qualitative study of China and global imbalances, the data in this thesis is not designed to create a new data set or to do formal data modeling, but to support and confirm data gleaned from the primary research methods described above. In the thesis, most data is secondary data, but I also used primary data collecting from my interviews and meetings I attended in my field work, which is further discussed below. In the thesis, secondary data came from five main sources. First, is the data from

Chinese government sources (both documentary and online datasets), including online databases of bureaus of statistics of local and central governments in China; published statistical yearbooks; government survey data, such as economic forecasts; data from official website of government and so on. Second, the working papers, online databases, and reports from official website of a wide range of international organizations, such as IMF, World Bank, Asian Development Bank, World Intellectual Property Organization and so on. Third, documents and data from commercial and professional bodies, including working papers from multinational corporations, reports from think tanks, annual financial reports of enterprises. Fifth, the thesis also collected data from media reports and journal articles. In order to check the reliability of data, I only used the data from media and journals with strong international reputation and influence, such as the *Financial Times*, *Economics*, *Xinhua*, *China Daily* and *Reuters*. Last but not least, the data from relevant scholarly literatures.

In this thesis, all primary data was collected during my field work by observation, interrogation and participation (see Walliman, 2018:77-8). So most primary data is directed at the case study of PFTZs. For primary data, it helps to provide 'first and most immediate recording of a situation' but it is also important to make sure the reliability of data (Williman, 2018:73, 78). As argued, some data from unpublished working papers are used in my case study. But considering the reliability of data, I just give an approximate data, such as about 20%, but not very specific number, like 23.45%. Then, I also use some data collecting from the interviews and meetings I attended. In the case of 'three in one' approval system in Fujian PFTZ and case of cross-strait base for youth entrepreneurship in Xiamen of Fujian PFTZ in Chapter Seven, I use data collected by myself from meetings and also from interviewees. For example, about the supporting policies in case of youth base, I conducted interviews for two officials of Xiamen PFTZs, and two representatives of start-up enterprises to ensure the reliability of data and information. It needs to clarify that why does not direct reference policies documents. Because in many cases, the start-up enterprises can often benefit from more than one different kinds of supporting policies. So summarizing these policies by

myself can help to tell right stories and then I use the interviews to support this. For the data collection by interviews, before using I have used other ways to examine the reliability of them as argued in section of interviews. For the data collecting from meetings I attended, it is more difficult to verify because most data are about some periodical evaluating data of implementation of particular policies collected by government or enterprises, which is often off-the-record. So I do not use them as key evidences or data.

Document Analysis

Document analysis as a qualitative research method is defined as 'a systematic procedure for reviewing or evaluating documents-both printed and electronic material' (Bowen, 2009:29). The purpose of document analysis in this thesis is to provide 'data on the context ... and supplement research data' and help to track change and development and to verify findings and evidence from other sources (Bowen, 2009:29-30). This thesis will only use the written record, especially the running record (both printed and electronic), defined by Johnson and Reynolds (2008:271) as documents produced by organizations, which is carefully stored, easily accessed, and available for long time. The documents are analyzed in this thesis, including laws and administrative documents of particular policies from Chinese government, published and unpublished working papers of various levels of government in China, documents from enterprises and supporting agencies in PFTZs, and reports from international organization and multinational cooperation about particular reforms and indexes of China.

There are three concerns of document analysis in this thesis. One is that I will use two unpublished internal government files in my case study to support the analysis there of particular reforms or policies implementation. But my use of these unpublished files can be justified in two ways. First, the information or data from these files are not used as key evidences in my case study. Then, all sources from these unpublished files used

in the thesis are supported by other sources of evidence. Another concern here is that most documents to analyze in this thesis are in Chinese and lots of documents or laws of particular policies does not have official version in English. So I do not direct quote these documents but just translate particular provisions or policies from them. Last but not least, selecting what kinds of documents to analyze, especially considering the large number of documents here, is important in this thesis. The selection of documents was based on two standards – priority to documents with official version in English and with stronger related with research questions or with stronger significance to understand research objects.

1.7 The Thesis Outline

Chapter Two

In this chapter, I review the dominant literatures of four representative IPE schools on their key debates, which are realist theory of Robert Gilpin, complex interdependence and liberal institutionalism of Robert O. Keohane, structural power and its diffusion of Susan Strange, and theories of states, social forces and world orders of Robert W. Cox. The main aim of this chapter is to understand the approaches to understand the relationship among powers, institutions and global order. As argued before, considering China's particular place in the study of IPE, this chapter create an open theoretical approach to inform key thesis questions that do not seek to combine theories but lay out key conceptual debates. The chapter focuses on several key questions, which mainly includes the definition of power; the ways of hegemony applying their powers in global order; the interaction between powers and institutions in international system and how this shapes the global order. By reviewing this, this chapter tends to provide different approaches to understand the possible way of rise of China to influence global order. The primary reason to leave an open-ending of this theoretical debates in this chapter is that any single theory may struggle to tell the right story of China.

Chapter Three

This chapter is a historical account of global imbalance, which include three parts: Pax Britannica and pre-1914 global imbalance; power shifts and global imbalance in interwar period; and the US hegemony and global imbalance 1965-1971. This chapter first briefly introduces the situations of global imbalance in these episodes and then analyzes the interactions between various countries and institutions under the global imbalance and how this leads to changes in global order in that context. The main aim of this historical account of global imbalance is to examine the relationship between global imbalance, international financial system and power shifts in global order and to provide a historical mirror to current global imbalance. I argue that the interactions between powers, international financial system and global order in the context of global imbalance, did not always follow the same paths and there is no clear causal link between global imbalance and changing global order. However, there was a strong link between global imbalance and changes of international financial system that in historical account, serious global imbalance very nears led to the collapse of established international financial system. Moreover, in the context of global imbalance, if leading powers can maintain or rebuild the international financial system, it would be more possible to maintain its hegemonic role in global order, such as the case of the US to maintain its hegemony with the collapse of Bretton Woods System in the 1970s related with the global imbalance in 1965-1971.

Chapter Four

This chapter is a contextual approach of contemporary global imbalance and the role of China, especially the interaction between its internal imbalances and external pressures in the post-crisis global rebalancing. The contextual analysis of global imbalance relates with three aspects. First, I introduce the development of current episode of global imbalance and considered the current global imbalance was a continued development of two former global imbalances in the late 1970s and 1980s, three of which are all under the Jamaica system. Then by reviewing the debates of causes of current imbalance, I aim to find the 'internal logic' of current global

imbalance, especially relationship among the current global imbalance, economic and financial policies of related countries and international financial system in that context. Moreover, as the turning point of current global imbalance, the 2008 GFC lead to the challenges to established international financial and economic structures based on the dollar primacy and the debt-financed consumption of the US. In the post-crisis era, the end of laissez-fair capitalism and rise of anti-globalization and populism in global order, will also bring more challenges to China's trade-oriented and investment-oriented economic model in global order and highlight China's serious internal imbalances, namely, namely too depending on trade and investment, too excessive growth of FER, imbalanced industrial structure, regional and urban-rural disparities. The purpose to this is to show that China cannot be seen as a 'pure' beneficiary in this context of global imbalance and China has more internal motivations to improve the rebalancing, both in internal and external.

Chapter Five

This chapter is mainly about China's model of development and the political economy of its rebalancing in the post-crisis era. In this chapter, I focus on two parts: features of China's model since 1978 and China's rebalancing under the new normal. First, I examine the four features of China's model of development and the main aim to do this is not about to distinguish China's model from others but is to examine the governance philosophies behind China's model. I argue that these features of China's model are very consistent since 1978 that in post-crisis era will still be the guiding principles in China's rebalancing reforms and moreover will influence China's practices in international level. Then I examine China's rebalancing under the new normal in the post-crisis era. I indicate that the slowdown of economic growth is just one aspect of China's new normal and also need to considered in the context of a 'new mediocre' of world economy in the post-crisis era and four-trillion yuan economic stimulus program by Beijing in 2009. However, I argue that rather than adopting strong stimulus policies as did in 2009, under the new normal, Beijing put economic restructuring in the center of China's rebalancing in post-crisis era, which relates with three key words: 1) new

economic driver: from driving by capital investment and production factors to innovation as pillar of economic development; 2) new composition of growth: from trade and investment-oriented to consumption-driven and from manufactories to services; 3) and environmentally sustainable development including environmental sustainable and economic sustainable. Based on these three key words, there are three core reforms in China's rebalancing under the new normal, which are supply-side structural reform in short term, deepening market reform in medium term, and One Belt One Road (OBOR) in long term. The aim to do this is to give macro picture of approach to reform of China's rebalancing under the new normal.

Chapter Six

In this chapter, I pick up the thread from chapter five of China's rebalancing reforms and choose the Pilot Free Trade Zones (PFTZs) as a case study to further examine the rebalancing reforms under the new normal. As one of the most important policy laboratory of reform under the new normal, many China's rebalancing reforms will be first tested in this 'zone' before national wide implementation. So studying the reforms in PFTZs will help to further and more comprehensively understand approach to reform of China's rebalancing in the post-crisis era. First, this chapter examines the reforms of Special Economic Zones (SEZs) in the 1980s, as the best example of China's export-oriented and investment-oriented economic model, to see its political economic significances in China's marketization reforms as the testing ground. The aim to do this is to show that importance of policy testing lab in China's reform and moreover to compared with reforms of PFTZs, to see the different path of China's reforms in the context of the new normal. Then this chapter briefly introduces the establishments of PFTZs, the features of four operated PFTZs and the main themes of reforms in PFTZs, namely trade facilitation, investment liberalization, financial reforms and streamlining government and delegating authorities (简政放权). More important is to clarify the four key differences between reforms of SEZs and PFTZs - from manufacturing to services industries; from providing preferential policies to

institutional innovation; from one-way to two-way opening up; from introducing market economy mechanisms and in line with international practices to actively participate in international competition and put forward China's proposals of reforms.

Chapter Seven

In this chapter, I will continue to study the PFTZs as the policy laboratory of China's rebalancing. The reforms in PFTZs mainly related with four aspects, including simplified administration for investment, trade facilitation, financial reforms, and improving innovation. This chapter uses some detailed cases to examine the implementation of reforms and policies in PFTZs and to what extent they can help to improve China's rebalancing processes. I also indicate the limitations and weak points of these reforms in PFTZs and how can they be improved to better support China's rebalancing under the new normal. I argue that PFTZs focus on eliminating policy barriers to improve the development of economy. The reforms in PFTZs also not just based on incentives as did in SEZs but more depends on streamlining government and delegating authorities (简政放权), which can be seen very clearly in the reforms in the areas of investment and trade in PFTZs. Compared with investment and trade, Beijing is more prudent in financial reforms and very concerned about the potential risks bring by liberalization of financial sectors. Even though there is a sign of more opening up in financial areas, there is no clear timetable of China's financial liberalization. The innovation is a key part of China's rebalancing and restructuring but also is the weakest point of China in past decades as argued in chapter five. The PFTZs do not play an important role in China's reforms of innovation but the PFTZs innovation policies often target the small and medium-sized enterprises (SMEs), which is the weak point of China's innovation and help to complement policy system of improving innovation in China.

Chapter Eight

In this chapter, I provide an outline of the substantive conclusion from each of the

previous chapters and a discussion of the context of the research puzzles, research questions, the theoretical debates, my arguments and the case study. I conclude that, in the context of global imbalance and rebalancing, China cannot be seen as a pure beneficiary and its internal imbalance motive it to improve the rebalancing reforms under the new normal. This also related with China's role in global imbalance in post-crisis era. I finish the thesis by providing a future research agenda that focus on gaps in this thesis and opportunities for further investigation.

Chapter Two

International Political Economy and the Changing Global Order

'After all, what could be more fascinating than the grand theme of systemic transformation? It was what old-time television host Ed Sullivan might have called a Really Big Question.'

-----Benjamin J. Cohen, 2008:66

2.1 Introduction

As Benjamin Cohen states, in IPE 'every generation is tempted to believe that it is in the midst of an unprecedented historical transition' (2008:66). This thesis believes so too. There are two critical changes in today's IPE, which form the background to this study: the first is globalization and the second the rise of China. The specific focus of this chapter is to provide a systematic review of relevant IPE literature to provide an analytical framework for the substantive questions addressed in subsequent chapters. The chapter will firstly focus on the general accounts of IPE from different approaches and address several key and highly debated questions: What is power? How do powers and global institutions interact? How does this interaction shape the structure change of global order? The chapter will then apply this general account to the specific case of the rise of China and global structural change.

During the last years, various definitions of IPE have been put forward and different characterisations of contending approaches to its study. Here, I use one of the more recent and influential ones - that is Benjamin J. Cohen (2007) notion of a 'transatlantic divide' separating the so-called 'American' school of IPE from the 'British' school of IPE. According to Cohen, even though these two 'schools' share an interest in the

study of states and markets and in the concept of systemic transformation, they differ in terms of ontology, methodology and their research agendas. In this chapter, I will draw on Cohen's schema to organise our review, with a particular focus on the seminal writing of Robert Gilpin, Robert O. Keohane, Susan Strange and Robert Cox, amongst others. The overall purpose is to provide an eclectic, theoretical synthesis on the basis of key shared concepts but differing interpretations of the key drivers of continuity and change in the international political economy.

2.2 Robert Gilpin: A Realist Theory of International Political Economy

Robert Gilpin is identified by Cohen as the scholar most representative of realism in the American School of IPE. Gilpin himself defines IPE as the study of the 'reciprocal and dynamic interaction in international relations of the pursuit of wealth and the pursuit of power' (1975:43). In *War and Change in World Politics*, Gilpin described the state as 'principal mechanism by which society can provide [...] "public goods" and overcome the free-rider problem' (1981:14) Noteworthy here is that Gilpin assumes the state to be rational and self-guarding actor. For Gilpin, the perennial issue in IPE is that of scarcity and the unequal 'distribution of power' that decides the allocation of scarce resources (1975:23). For Gilpin, the primacy of the state remains paramount, even in the era of globalisation. Although Gilpin does not deny the importance of globalisation, he does question its novelty by likening it to an analogous period of 'internationalisation' that occurred in the 19th century (Gilpin and Gilpin, 2002; Hirst and Thompson, 1995). He also points to the unequal reach of globalisation in the contemporary era with the triad of North America, Europe and Asia being the principal beneficiaries of the process (Gilpin 2001: 364).

Gilpin's skepticism of globalisation rests on two key points. The first is that for him the state remains the most effective and legitimate for political organization in the international system. Hence the nature and functions of nation-states in the international system are always 'the most important determinants of the character of

international relationships at any given moment (1981:17-18). This is not deny the importance of other actors, such as multinational corporations (MNC) and international organizations. But Gilpin points out that multinational corporations the 'products of their home economy' because their behavior is decisively affected by their 'domestic roots', including domestic structures, economic ideology, domestic policies, which are 'deeply embedded in their national societies' (2001:298-299). The second key point for Gilpin is that non-state actors that have supposedly usurped the power of nation-states lack independent, coercive power. According to him (Gilpin et. 2002), this lack of coercive power is a by-product of the 'democratic deficit' of global governance institutions. In other words, because coercive power is linked to legitimate authority global institutions, as of yet, do not have the basis for making claims to this.

The concept of the 'market' also figures prominently in Gilpin's work. In the *Political Economy of International Relations* (1987), Gilpin quotes Cournot's definition of market as 'the whole of any region which buyer and sellers are in such free intercourse with one another that the prices of the same goods tend to equality easily and quickly' (1987:18). Gilpin suggests that, even though that there are some connections between the system of 'capitalism' and the 'market, they are two are different. In Gilpin's opinion, the 'market' is an economic-based system, in which individuals and companies are the key actors. In contrast, capitalism is a political-based system, established and overseen by the public authorities. Gilpin's thinking can be distinguished from the liberal tradition, which views the market as a politically neutral entity. For him, whether at the domestic or international levels, the distribution of wealth by market is always greatly influenced by politics and unequal distribution of power. To a large extent, the development of market is affected by the political power and choices of states, with wealth and therefore power concentrated in the advanced market economies of North America and Europe. Further, the unequal distribution of wealth leads not only to interdependence between sovereign nation states, but also hierarchy.

The latter insight provides the basis for the theory of 'hegemony stability' (HST), with which Gilpin is strongly associated. HST was originally proposed by Charles P. Kindleberger (1986) in his book *The World in Depression 1929-1939*. In this book, Kindleberger points out that a responsible and powerful single country is the prerequisite for maintaining the international market and financial system. More specifically, Kindleberger lists four key functions of such a powerful country: to maintain open market, ensure sufficient lending and stable exchange rates, to coordinate the macroeconomic policies and to provide liquidity in times of crisis (1986: 289). After Kindleberger, HST was expanded and modified by Robert Gilpin, who subsequently became its most important advocate. Unlike Kindleberger, Gilpin's provided a more systematic, realist theory of HST. First, Gilpin draws on classical realist notions of anarchy as the defining principle of the international system. According to Gilpin, anarchy means that 'there is no higher authority that compels them to cooperate and to which a state can appeal for succor in times of trouble' (2002:238). Noteworthy here is that the anarchic nature of the international system does not mean that there is not cooperation or order in it. Gilpin also admits that, without hegemony, states can also achieve some cooperation but such efforts are likely to have limited participants and can only be maintained over a relatively short period of time. Even though Gilpin concedes the possibility of spontaneous cooperation under conditions of anarchy, he still insists on the importance of hegemony for international cooperation and hence order.

Second, Gilpin's version of HST also draws on the realist concept of relative gains. Another assumption of Gilpin's IPE is relative gains. Unlike in economics, where the focus is on efficiency and absolute welfare gains in economic activities, realist IPE emphasizes the importance of the distribution of gains in 'zero-sum' or 'Pareto-suboptimal' conditions. In Gilpin's IPE, he assumes that in the international system, all nation-states will pursue relative rather than absolute gains. Gilpin, however, points out that the choices of absolute gains and relative gains need to be considered case by case. But he insists that all participants will enjoy the absolute gains from joining

the international market system, but considering the unequal distribution of gains among states, states will more focus on their relative gains rather than the absolute gains from economic activities (2001:77). So increasing economic interdependence will not straightforwardly foster international cooperation; it is more likely to cause more disputes between states.

On this basis, Gilpin defines hegemony as circumstances in which 'a single powerful state controls or dominates the lesser states in the system.' (1981:29). Gilpin indicates that the dominance of the hegemonic state in the international system rests on both its power and prestige. The main thrust of HST, then, is that in the competitive international system hegemony is a necessary condition for building and maintaining the free and open economy. Conversely, the absence or decline of hegemony is predicted to lead to the weakening and finally fragmenting of the international market economy system. Gilpin sees hegemony as the requirement of maintaining liberal market economic system, but hegemony alone is not sufficient to support this as order also depends on three more conditions: the first is a liberal hegemonic state and other liberal powers which all desire a liberal economic system; the second is a strong connection among liberal states by common interests in security, politics and economic relations; and the third is then leading states need to share a commitment to the ideology of liberalism.

For Kindleberger, the hegemon is necessary for the provision of international public goods, that is, a good that 'is one the consumption of which by an individual, household, or firm does not reduce the amount available for other potential consumers' (1981: 243; Gilpin, 1987: 74). But the problem here is that public goods in international politics are often in short supply. The reason for this is down to problem 'non-excludability' of public goods, i.e. because states can benefit from public goods without paying for them no state has an incentive to do so, leading to the so-called '*free-rider*' problem. To solve this problem, Gilpin points out that it is necessary that there will be 'some agency ... [that] can force consumers to pay for the good' or driven

by its interests will 'assume a disproportionate share of the costs' (1987:74). In the anarchic international society, this kind of agency is the hegemonic state. In HST, the preponderant power of hegemony, which comes from its 'control over raw materials, ... sources of capital, ... markets, and competitive advantage in the production of highly valued goods' (Keohane, 1984:32), makes sure the capability of hegemony is sufficient to provide public goods in order to maintain order in the international system. But the willingness of the hegemony to provide public goods rests not just on their international power and prestige, but also their domestic politics. Noteworthy here is that, for HST, hegemony and therefore order and stability rests on particular forms of power, which is difficult to maintain indefinitely because the inevitable diffusion of wealth, which is a natural feature of the market economy. With the decline of its power, the hegemon will be unwilling and unable to continue to provide public goods, leading to the weakening the open international economic system. Moreover, these circumstances will produce a challenge to the existing global order because the new distribution of power in international system will challenge the status quo.

2.3 Robert O. Keohane: Complex Interdependence and Liberal Institutionalism

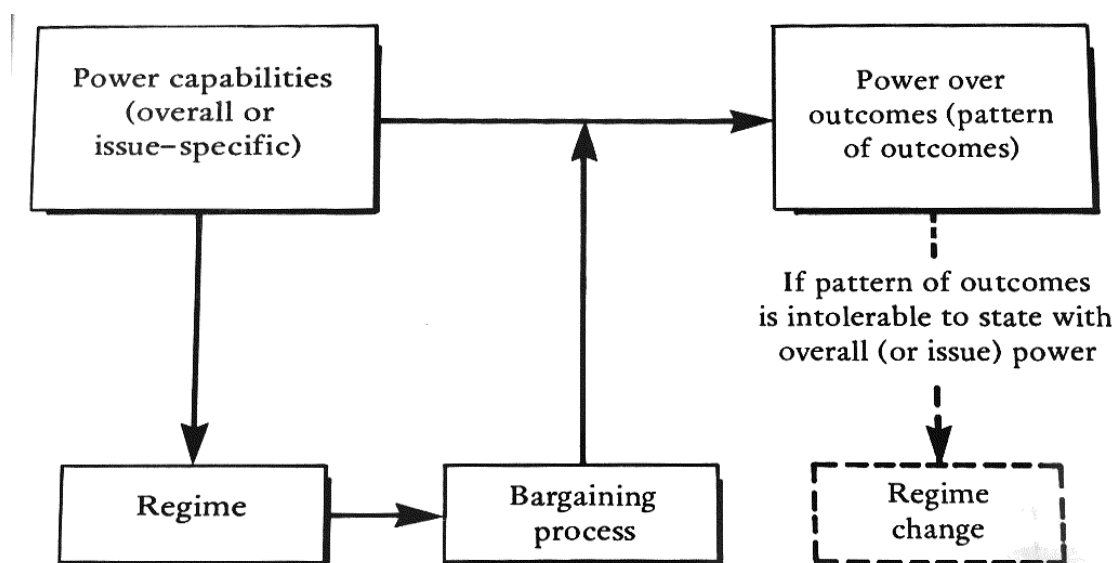
In the 1970s, with the impact of the first oil crisis, as well as the deterioration of the US trade balance vis-a-vis Europe and Japan, the US appeared to be in decline. As I have just argued, according to Gilpin and the tenets of HST the decline of hegemony was predicted to cause a lowering of the degree of openness in the international economic system. The fact that this only happened to a limited extent in the 1970s and 1980s thus posed a problem for the veracity of HST. For liberal-institutionalist scholars, this problem drew attention to the omissions of HST: specifically, its neglect of the growing importance of interdependence between the advanced capitalist states and of the role played by 'international regimes' in mitigating the effects of anarchy in stifling international cooperation. Liberal-institutionalists seized on the discrepancy

between the theoretical predictions of HST and actual events to revive and update classical liberal ideas and break the near monopoly of realism in the study of IR and IPE. As the pioneer and its most influential scholar, Robert O. Keohane is the most representative figure of this intellectual movement.

The starting point for Keohane was the rejection of realism. In the late 1960s, Keohane had already started to criticize some of the key assumptions of realism, as in the book, *Transnational Relations and World Politics (1972)*, edited with Keohane with Joseph S. Nye, JR. Here Keohane and Nye drew attention to growing importance of transnational relations to international politics, especially the relationships among non-state actors, such as MNCs, international organizations and transnational social movements (1972: ix-xxix). They suggested that these relationships represented a new mode of international politics, which was not reducible to states or state power (1972: xxii-xxiii). Later, in 1977, Keohane and Nye published *Power and Interdependence*, which introduced a conceptualisation of interdependence and related this to international cooperation and, crucially, international regimes. Keohane and Nye defined interdependence as 'situations characterized by reciprocal effects among countries or among actors in different countries' (1989:8). The starting point for them was the rejection of the key assumptions of realism, not least the idea that military force is always the primary importance in international politics. For Keohane and Nye, the fluidity of international politics in the 1970s pointed to the declining salience of military force as a policy tool among advanced capitalist states. They also pointed out that, besides interstate relations, there are multiple channels connecting different actors in the international system, including hundreds of non-state actors (1989:24-25). The reason interdependence is 'complex' was, for Keohane and Nye, due to the asymmetry in dependence as a result of the imbalanced distribution of wealth and power among states. In these circumstances, the most pressing question for Keohane and Nye (1989:11;18) was 'who will be more influenced by the changes of relationships?' In order to answer this question, Keohane and Nye then introduced two different dimensions of interdependence: (1) 'sensitivity', that is, 'how quickly do

changes in one country bring costly changes in another, and how great are the costly effects?'; and (2) 'vulnerability', that is, 'an actor's liability to suffer costs imposed by external events even after policies have been altered' (1989:12-13). In other words, the relationship between 'power' and 'interdependence' was down to relative sensitivity and vulnerability of individual states to external policy changes.

Figure 2. 1 Issue Structure Explanation

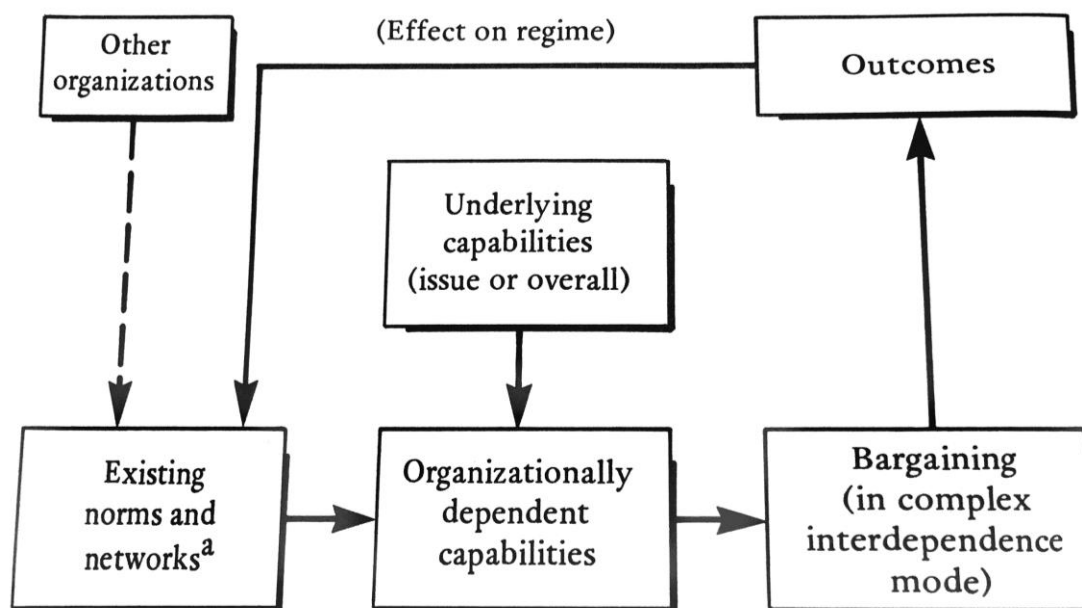


Source from: Keohane and Nye (1989:53)

In *Power and Interdependence*, Keohane and Nye also introduced the concept of 'international regime', which they defined as 'sets of governing arrangements that affect relationships of interdependence' (1989:19). While they conceded that, compared to politics in a domestic system, rules and procedures in international politics are rarely complete or fully and consistently, regimes nevertheless play an important function in facilitating cooperation in conditions of complex interdependence (1989:20). In accounting for the process of regime change, Keohane and Nye outlined for alternative explanatory models - 'economic process', 'overall power structure', 'issue structure' and 'international organizations' - but did not indicate a clear preference for any of these, emphasizing instead the importance of a combination of different explanations in the real world. However, it can be inferred

that their implicit preference was for the ‘issue structure’ and ‘international organization’ models, considering that the ‘economic process’ explanation isolates economic issues from political effects while ‘overall power structure’ explanation (i.e. HST) ignores non-state actors. According to issue structure explanation (see Figure 2.1), changes of international regimes are due to ‘the difference between the influence and benefits under an existing regime and the expectations of dissatisfied states about the effects of new rules’ (1989:52). But because this model separates different issue systems in IPE, it is arguably better used to explain the changes of international regime in specific issue systems, such as oceans or money (1989:51). In contrast, the international organization model (see Figure 2.2) better explains regime changes relative to different actors across different issue areas.

Figure 2.2 International Organization Explanation



Source from: Keohane and Nye (1989: 56)

By studying complex interdependence in ocean and money and in United States relations with Canada and Australia, Keohane and Nye highlighted that some issues and conflicts in world politics can be better explained by the complex interdependence approach than by realism. This insight also provided the basis for Keohane’s later work

on 'cooperation under anarchy' and the school of thought that this subsequently inspired.

During the 1980s, Keohane began to focus on the study of hegemony, international cooperation after hegemony and development of his functional theory of international regimes. Noteworthy here Keohane began a rapprochement with key realist ideas he had earlier criticised. However, Keohane was skeptical of HST, arguing that the obstacles and difficulties of maintaining the liberal economic system was not the lack of a hegemonic state, as HST suggested, but the high costs and asymmetry of information required to make international cooperation work. In *After Hegemony: Cooperation and Discord in the World Political Economy* (1984), Keohane argued that the theory of international regimes required 'intervening variables' between the international system, on the one hand, and states, on the other (Keohane, 1984: 64). Keohane listed the three main functions of international regimes as follow: (1) establishing 'quasi-agreements' that are 'legally unenforceable' but can efficiently 'help organize relationships in mutually beneficial ways'; (2) reducing the transaction costs of 'certain possible bargains' but increasing them for 'illegitimate ones'; and (3) reducing uncertainty by providing symmetric information (1984:88-94). Based on these three functions, Keohane argued that international regimes help to prevent the market failure in world politics and improve mutually beneficial international cooperation.

Noteworthy here is that international regimes may be a product of hegemony, once established, they can operate independently. Keohane emphasizes that, under anarchic conditions, international cooperation and the maintenance of a liberal international economic system is not determined solely by the public goods provided by the hegemon, but also the outcome of institutions and the optimal rational calculations of other key states. Keohane's liberal-institutionalism does, however, accept the realist idea that state preferences are exogenously given and their actions are instrumental and rational. But unlike Gilpin and other realists, Keohane rejects the

idea that, in all circumstance, states pursue “relative’ over ‘absolute’ gains. That is to say, the existence of international regimes helps states, even under anarchy, to realise absolute welfare gains and Pareto-optimal outcomes. In *International Institutions and State Power*, Keohane further developed his thinking, broadening the exchanging of relatively narrow ‘regimes’ concept to the somewhat broader concept of ‘institutions’ - i.e. ‘persistent and connected sets of rules (formal and informal) that prescribe behavioral roles, constrain activity, and shape expectations’ (1989:3). Keohane generally accepts Krasner’s often-used definition of regime as ‘sets of implicit or explicit principles, norms, rules, and decision-making procedures around which actors expectations converge’ (1983:2). But when studying international regimes in world politics, Keohane emphasizes that international regimes are always based on formal intergovernmental agreements and that non-state actors such as MNC sometimes play a decisive role in establishing and maintaining international regimes, for instance in the oil industry. This leads Keohane to a broader concept of international institutions to better reflect both public and private forms of international cooperation in IPE. For Keohane, international institutions take three main forms, which are (1) ‘formal intergovernmental or cross-national nongovernmental organizations; (2) international regimes; and (3) conventions’ (1989:3-4). Noteworthy here is that international regimes here refers to explicit rules agreed by governments, which is different from the established view of international regime.

Compared to Gilpin, who as I have argued is skeptical about the idea of globalization, Keohane takes it more seriously. In the third edition of *Power and Interdependence*, published in 2001, Keohane and Nye revived the concept of complex interdependence to analyze the relationship among power, interdependence, the information age and the globalism. They point out that we are experiencing an ‘information revolution’, which is ‘rapid technological advances in computers, communications, and software that have led to dramatic decreases in the cost of processing and transmitting information.’ (2001:217). Notable here is that, even though the cost of information is much lower now, the information revolution cannot solve the asymmetry of

information because the leading states still have more power in the dissemination of and access to the three different types of information: free information, commercial information and strategic information (2001:219). The political implication of the information revolution is that it makes 'soft power' much more important in today's world politics to manage interdependence among actors. As Keohane and Nye defined, soft power is 'the ability to get desired outcomes because others want what you want; it is the ability to achieve desired outcomes through attraction rather than coercion ... It works by convincing others to follow or getting them to agree to norms and institutions that produce the desired behavior' (2001:220). Then Nye further indicated that compared with traditional hard power that 'induce others to change their position' by inducements or threats, soft power 'rests on the ability to set the political agenda in a way that shapes the preferences of others ... associated with intangible power resources such as an attractive culture, ideology and institutions' (2002:8-9). Moreover, soft power will be greater and last longer because it is not just about influence but more about 'ability to entice and attract ... [that] often leads to acquiescence or imitation' (Nye, 2002:9). The rise of soft power is strongly related with the word – globalism.

Keohane and Nye also discuss the influence of globalism. Firstly, they point out that even though the two concepts 'interdependence' and 'globalization' have many similarities, they are not exactly same. Interdependence is a 'condition, a state of affairs' which can increase or decline but globalization is a trend that can only increase (2001:229). So they prefer the concept 'globalism', which means 'a state of the world involving networks of interdependence at multicontinental distances, linked through flows and influence of capital and goods, information and ideas, people and force, as well as environmentally and biologically relevant substances' (2001:229). The relationship between interdependence, globalism and globalization is that globalization is the increase of globalism and this increase will deepen interdependence among states. Keohane and Nye suggest that globalism is not a new phenomenon and in an era of 'thick' globalism, the US is the center of contemporary

globalization. This American-centric globalization increases the soft power of the U.S. in world system because it makes others want what Americans want (2001:235). So it may be able to say that even that globalization is a multilateral process, more powerful actors are dominating the process of globalization. Vulnerability and sensitivity interdependence are both significant part of globalism. In the era of globalization, vulnerability interdependence is more important in world politics because globalism implies vulnerability 'has more implications for uneven distributions of global power and autonomy than a form of globalism involving only sensitivity' (2001: 238).

2.4 Susan Strange: Structural Power and Its Diffusion

Susan Strange, one of founders of IPE, is the most representative figure in the 'British School' of IPE. In Strange's opinion, IPE should be seen as an interdisciplinary endeavor and is not so much an empirical research field as analytic framework. Based on this, Strange defines her study of IPE as follows: 'it concerns the social, political and economic arrangements affecting the global systems of production, exchange and distribution, and the mix of values reflected therein ... [and such arrangements] are the results of human decisions taken in the context of man-made institutions and sets of self-set rules and customs' (1988a: 18). She then offers a structural explanation of IPE and in her model of the international system, not on the basis of sovereign nation-states, but macro power structures involving both states and markets. Notable here is the similarity between Strange's model and that Robert Cox discussed next. Some scholars indicate that the main difference between Cox and Strange is that Cox is more focused on production while Strange is more focused on finance (Schechter, 2002:17). But in Cox's own opinion, the theories of himself and Strange are best distinguished by their different thoughts on the impetus for changes in IPE (1996: 174-187). In what follows, I review Strange's approach according to four key themes: 1) her criticism of realist and liberal-institutionalist IPE; 2) her theory of structural power; 3) her work on finance; 4) and her reconsideration of state and diffusion of power in IPE.

Strange's work is often described as a kind of 'critical theory' (see Lawton et, 2000) and it is true that much of her work is aimed as a critique of American School of IPE, especially HST and regime theory. Regime theory here mainly refers to the work of Keohane reviewed above, but also Krasner, who I have not yet discussed. Unlike Keohane, Krasner's regime theory is based less on market failure and more on the distribution of power. In Krasner's opinion, states focus on distributional conflicts and the outcome of these conflicts is mainly decided by relative bargaining power of the states involved (1991:336-337). Under the so-called 'tectonic plate' image of the international system, which is concerned with 'the impact of the distribution of state power on various international environments', Krasner points out that the world is not zero-sum but conflict remains crucial in the state pursuit of mutual gains and achievement of cooperation in the international system (1983:356). In Krasner's opinion, the distribution of power is seen as one principal basic causal variable but 'change in power distributions does not always imply [in regimes]...because regimes may function as intervening variables' and follow their own internal logic, which implies that, once established, regimes influence the distribution of power or assessments of state interests in international system (1983:357-358). As he argued, the establishment of regimes needs to be supported by powerful states, which make regimes will also reflect the interests of these states. Overtime, however, regimes will drift away from these states because, compared with the dynamic distribution of power in world, 'the basic principles and norms of regimes are very durable' (1983:357). The autonomy of regimes comes from the lags and feedback of regimes. Lags arise 'because of custom and usage, uncertainty, and cognitive failing', which also ensure the duration of regimes (1983:361-362). Feedbacks, meanwhile, can improve the autonomy of regimes by making regime use by actors as a source of power and increasing regimes' influence on actor capabilities, calculations and alternation of interests in international system (1983:361-366). In conclusion, according to Krasner, in a non-zero-sum world, regimes should be seen as autonomous variables, not just intervening variables.

In her 1982 article, 'Cave! Hic Dragones: a Critique of Regime Analysis', Strange famously criticised regime analysis for woolly and imprecise meaning, its American-centric bias, fixation on the economic 'shocks' of the 1970s and, most importantly, what she saw as its fundamental misunderstanding of US power. This criticism also figured in Strange's other famous article from the 1980s - 'The Persistent Myth of Lost Hegemony' (1987). In this article, Strange argued that the 'declinist' school that informed both HST and regime theory had drawn the wrong conclusions from the economic shocks of the 1970s. Besides providing order and stability, she argued hegemons can have alternative ways to exercise their power than to maintain their governance of global order, such as the US's continued exercise of hegemonic power in economy structure due the preponderance of the U.S. dollar and its enormous domestic market. These structure on which both HST and regime theory was preoccupied (Strange 1987:555). Contrary to the conclusion of the declinist school that hegemonic states will always prefer liberal economic policies, Strange shows that neither Britain nor the U.S were unambiguously committed to liberalism. For Strange, the changes of the 1970s and 1980s were less a result of the decline in US hegemony, and more a reflection 'a series of American managerial decisions of dubious wisdom' (1988b:12).

Strange's biggest contribution to the British School of IPE was her model of structural power'. The starting point for this was to differentiate structural power from what she called 'relational power' and defined as 'the power of A to get B to do something they would not otherwise do' (1988a: 24). Structural power, on the other hand, 'is the power to shape and determine the structures of the global political economy within which other states, their political institutions, their economic enterprises and their scientists and other professional people operate', (1988a:25,18). Strange identified four sources of structural power: security, production, finance and knowledge. Noteworthy here is the subtle interplay between these four structures. In Strange's structural power theory, each structure is independent from but supported by the other three structures. All four structures are equally important and none is more

important. So it can be seen that Strange's structure power is very different from other well-known understandings of structural power, like Marxist, Coxian or Neo-Marxist, that all put structure of production in the most important and dominant role in IPE. Following this, four sources of structural power will be analyzed in turn. Under four structures of power, there are four secondary power structures in world economy, which are transport systems, trade, energy and welfare.

The security structure. Like realists, Strange saw security primarily as survival, but where she differed was in her rejection of the state-centrism of realism. So, while security means survival it does not stop as state survival but also incorporates the security of society and individuals. In such a security structure, even though Strange agrees that nation-states are still the most critical brokers of power, many private actors, such as multinational corporations and international organizations, also wield power. Moreover, unlike realism, Strange is interested about the non-material elements on security structure and the ways in which the security structure interacts with other three structures.

The production structure. Strange defines the production structure largely in Marxian terms as the foundation of both politics and economics, and all organized societies are built on particular modes of production structure. Similar to Cox, Strange points to out that the most important change in the production structure was internationalization. Noteworthy here is that Strange agrees that the power in production structure has become the basis of changes in international society, which means such power can influence not only wealth and security but also culture and ideology. Strange declares that in new century the primary role of states will be to create wealth and prosperity. More importantly, internationalization of production allows corporations to greatly enhance their power in the production structure. Because internationalization of production allows corporations to capture capital and technology markets, they have an advantage over states, which retain control of natural resources and labour mobility. Hence, the internationalisation of production signaled a shift in structural power from

states and towards corporations.

The financial structure. Through reviewing the changes in the postwar financial structure, Strange argued that although that national governments were still responsible for formulating policies, issuing rules and regulations and licenses, she saw the international bankers as most significant actors in the financial structure. But she also suggests that this transformation of power in the financial structure was, to a large extent, with the acquiescence of national governments, especially the United States. Indeed, Strange's work on the financial structure in the 1980s and 1990s is now seen as extremely prescient in anticipating the financial crises in Asia 1997-8 and North American and Europe in 2008. In her classic work from 1986, *Casino Capitalism*, Strange highlighted the role of states by locating the origins of the financial turbulence of the 1970s in the policy decision and 'non-decisions' of the key states during the Bretton Woods era (1944-1971). Strange concluded that the rise of speculative international finance was, as much as anything else, caused by the failure of regulation.

The knowledge structure. Finally, Strange defines the knowledge structure as follows: the 'knowledge structure determines what knowledge is discovered, how it is stored, and who communicates it by what means to whom and on what terms' (1988a: 121). This includes knowledge of science and technology, ideas, ideologies and the modes, channels, means and technologies of spread of them. Similar to Cox, Strange emphasises the importance power is more through 'consent' rather than 'coercion' in her knowledge structure (1988a: 122). It is noteworthy that knowledge structure needs to be combined with any other three structures to have significance in the real world. In other words, the knowledge structure does not influence the world independently but needs to inherent with other structures. Strange's understanding of knowledge is dissimilar with traditional definition of knowledge, which is mainly composed of two parts: ideology and intersubjective knowledge. Instead of intersubjective knowledge, Strange more focuses on knowledge of science and technology and its way of diffusion, which makes people to ask that whether knowledge just

means non-material ideas or is a combination of material tools of knowledge and non-material ideas.

2.5 Robert W. Cox: States, Social Forces and World Orders

Like Strange, Cox's approach to IPE centres on *cui bono, or who benefits?* But rather than structural power, Cox locates his answer in the concept of world order (Cohen, 2008:89). The starting point for Cox's approach is the distinction between 'problem-solving theory' and 'critical theory'. The first attempts to 'solve the problems posed within the terms of the particular perspective' and to maintain the existing order and to defend the beneficiaries of this order, such as the U.S. (1996:88). Cox pointed out that, based on assumptions like anarchy of international society and the rational actor model, problem-solving theory takes the world as given because they see the prevailing order as their given framework for action. Moreover, it is based on 'a form of thought derived from a particular phase of history.... [and assumes] it to be universally valid' (1996:94). In Cox's opinion, a historical perspective should be a crucial component of all social and political studies.

For critical theory, then, Cox is interested how the existing order came about, and what are the possibilities for historical and structural changes in this existing order. Here Cox draws on historical materialism as an important part in his approach. Compared with problem-solving theory, historical materialism offers Cox a more dialectic approach, thus adding a class dimension to power relations between and within the great powers (1996:95). Historical materialism is also concerned with the interactions between the state and civil society, especially the ethical and cultural sources of political action and their links to the significance of the production process (1996:96). As Cox points out, a proper study 'should be able to reveal both the coherence of minds and institutions characteristic of different ages, and the process whereby one such coherent pattern- which we can call a historical structure- succeeds another' (1996:94).

A historical structure is a framework for action in Cox's approach, based on three forms of power: ideas, material capabilities and institutions, and these three forces will interact with each other and then together impose pressure and constraints on individuals and groups, which may oppose and resist but cannot ignore (1996:98). These historical structures influence three levels of human activities, which are social forces, forms of state and world orders (1996:100-101). According to Cox, the form of state is decided by two configurations, one of which is a configuration of social forces and another is the permissiveness of the world order (1987:147-148). Social forces can influence states through the world structure and the structures of world order will affect states' choices of forms. It is noted here that forms of state also influence 'the development of social forces through the kinds of domination they exert' (1996:101). Cox uses the method of historical structure to understand hegemony and world order.

The starting point for Cox's approach to hegemony is Gramsci's concepts of hegemony and historic bloc. Gramsci saw hegemony as a kind of leadership, which fuses coercive power, moral authority and ideological identity. Gramsci pointed out that western capitalist states weathered severe economic crises, not due to the coercive apparatus of the state but because of depth of capitalist hegemony running through civil societies and social relations are assimilated by capitalism. So in capitalist societies, the hegemony of the bourgeoisie is maintained not only by the coercive power of the state but also because they can promote capitalist hegemony through the organs of civil society. For Cox, then, global hegemony is a special configuration of historical structure, which represents a configuration of material power, the prevalent collective image of world order and a set of institutions, which administers the order with a certain semblance of universality (1996:103). Accordingly, hegemony is 'an order based ideologically on a broad measure of consent, functioning according to general principles that in fact ensure the continuing supremacy of the leading state or states and leading social classes but at the same time offer some measure or prospect of satisfaction to the less powerful' (1987:7).

For Cox, there is a strong link between a historic bloc and hegemony in Gramsci's thinking. According to Gramsci, a historic bloc is formed by structure and superstructures, that is, 'the complex contradictory and discordant ensemble of the superstructures is the reflection of the ensemble of the social relations of production' and the key of building of a historical bloc are intellectuals, who are organically connected with a social class and can create a common identity (quoted by Cox, 1996:131-132). In a historical bloc, the hegemonic class maintains its leadership by building universal institutions and ideologies, which actually represent its vital interests and give some satisfaction to subordinate groups (1996:133). In short, the historical bloc is a hegemonic configuration of a historical structure. The relationship between hegemony and historical bloc is that three forces of historical structure is the material and ideational basis of hegemony and the influence of hegemony is presented in three levels of the historical structure.

Cox points out that social forces are the embodiment of structures of production and the nature of state will be determined by relationship of power among domestic social forces, that is, the class structure (1987:6). Social forces can overflow state boundaries and the world can be seen as a pattern of interacting social forces. Notable here is that states are the autonomous actors, which will intermediate relations between global structure of social forces and domestic configurations of social forces. The hegemonic world order is the product of the expansion of the local configurations of social forces within leading states. The internationalization of social orders of hegemonic states happens mainly in two ways. One is that some states, especially developed ones, are connected to the world order through their willingness to accept same forms of social forces and state as hegemonic. But some other countries, such as most developing states, can only adapt to hegemonic world order by 'passive revolution', in which the production in these countries is to offer accumulation for developed countries so the common identity of hegemonic order in these states is much lower than that in states with positive revolution. Cox argues that the mechanism of this hegemonic world order are international organizations and regimes (1996:137-140).

As mentioned before, Cox indicates that the difference between his approach and Strange's IPE is their different thoughts on the source of changes in world order. For Cox, class conflict is the fundamental impetus for global change. In the process of production, different social forces are always in contradiction and in the hegemonic order this kind of contradictions can be released and weakened but cannot be totally solved. And the structural changes in production will stimulate the contradictions between social forces, which will finally cause the elimination of old form of state and world order and the rise of a new one. As Cox says, 'change can occur at all levels –in production relations, in class relations, in the emergence of new historic blocs and of alternative forms of state, and in the structure of world order... Where change does occur, it will be through mutually sustaining relationships at all of these levels' (1987:8). Then by reviewing different historic period, Cox points out that the structural changes of world order are a very complex process, which will involve four main aspects: changes of relative powers of major countries; redistribution of productive capacities among countries; changes of configuration of social forces in society and the rise of new historical bloc; and building new relations of production and the establishment of new mechanisms of capital accumulation. As Cox says 'the qualitative differences between world orders touch the nature and incidence of wars, the manner of resolving disputes, and the creation and distribution of wealth and poverty (1987:7). The differences between two structures of world order are determined by 'the forms of state and of production, and stabilized structures of world order in turn provide a framework conducive to certain forms of state and of production' (1987:7).

Globalization is also a very important aspect of Cox's thinking, especially the relationship between the rise of globalization and the postwar world order. Cox points out that the world order after the World War II was based on the welfare state and the compromise of embedded liberalism but the globalization of production and of the state challenged these two foundations of the existing world order, prompting the shift to a post-hegemonic new world order. In *Production, Power and World Order*, Cox

argues that the welfare state was a product of the Fordist mode of production, from the late 19th century onwards, and also a compromise by bourgeoisie to the rising power of working class. After the World War II, based on the *pax Americana* this compromise was applied internationally through American-centric international organizations, such as IMF, World Bank and GATT. The policies of the organisations nourished the welfare states in the world system, such as IMF's providing financing to deficit countries facing balance of payments problems. Based on this, the contradictions among social forces and classes were released under embedded liberalism. But in the 1960s, the economic crisis gave rise to a new global mode of production with the development of globalization, which referred to changes from Fordist economies of scale to post-Fordist economies of flexibility (1996:31). These changes in the mode of production, Cox argued, fundamentally challenged the two bases of the world order that existed after the World War II, and then caused the intensification of social and class conflicts in the world and the disintegration of the postwar historic bloc (1987:279-282).

According to Cox, the new global mode of production has increased the structural powers of capital and weakened the power of the organized working class, leading to what he called the 'hyperliberal' state. (1996:30-31). Unlike the welfare state under Fordism, which provided a basic guarantee of economic welfare for subordinate groups, the hyperliberal state is focused on the freedom and profits of the transnational capitalist class. Cox argued that hyperliberalism globalization exposed conflicts and contradictions between the transnational ruling group, which includes MNCs, officers in big international organizations, senior officers of authorities, high-income core workers who benefited from globalization, and subordinate groups including the national bourgeoisie, lower-income peripheral workers and other social groups marginalized by globalization. These conflicts and contradictions weaken the subordinate groups' common identity with the dominant global ideology in era of globalization, e.g. competitiveness, deregulation, privatization, and restructuring. Hence the rise of hyperliberalism and globalization produced a global crisis of

legitimacy.

2.6 Conclusion

According to Cohen (2007), a key feature of the ‘transatlantic divide’ is that American and British schools rarely speak to each other’s research agendas. Indeed, the dividing line is as much about *what* to study as about *how* study it. For the American School, represented in this chapter by Gilpin and Keohane, the commitment is to a positivist epistemology and empiricism ontology, whereas the British School, represented in this chapter by Strange and Cox, the commitment is to a post-positivist epistemology and reflectivist, or ‘eclectic’ ontology. This means that, even though the two schools are about many of the key themes important to this thesis - power, institutions, world order and structural change - it is not easy to combine them. Instead, the purpose of this chapter has been to identify key concepts and theories that are relevant to China’s role in the global order and the controversies surrounding the global imbalances. From the American School, I take from Gilpin the importance of power, anarchy, self-interest and free-riding; and from Keohane, the importance of institutions as ‘intervening variables’ that may outlive hegemony and provide states with incentives to cooperate and pursue positive-sum gains. From the British School, I take from Strange the importance of not just relational power but also structural power based on the four primary structures of the international political economy (production, security, finance and knowledge); and from Cox, I take the importance of hegemony and historical blocs as class-based projects based on both coercion and ideological consent.

The thesis argues that these concepts and theories provide the tools for examining the ‘rise of China’ but more importantly the international and domestic politics of the global imbalances. In the next chapter, I turn to this question by examining global imbalances in their historical context and their relationship to hegemony, institutions and global change. Specifically, the thesis focuses on three more key questions, namely:

- 1) What lessons can we draw from the experiences of Britain and the US in managing

global imbalances in the 19th and 20th centuries respectively? 2) What is the role of China with respect to contemporary global imbalances and efforts to reduce these in post-2008 financial crisis period? 3) What the influence of these efforts at rebalancing affects China's internal economic reform process?

Chapter Three

Global Imbalances in Historical Perspective

3.1 Introduction

As I argued in the last chapter, the relationship between hegemony, international regimes and global structural change is a key and reoccurring theme in both the American and British schools of IPE. Applied to the early 21st century, two main sources of structural change can be identified: the first is globalization and the second is the rise of China. Since the 'Open and Reform' process beginning in 1978 China has been increasingly and actively involved in the globalization process, which has not only promoted development of China's economy but the world economy also. But no matter for China or developed countries, globalization does not just bring benefits, it also poses risks and challenges. One specific problem arising from globalization, the so-called 'global imbalances' are considered to be one main cause of the 2008 Global Financial Crisis (GFC) and one main obstacles standing in the way of the recovery in the post-crisis era. Many western commentators see these global imbalances as evidence of the rise of China and, moreover, as symptom of a fundamental power shift in the governance of the international political economy (Summers, 2004; Wade, 2009). However, not all agree with this interpretation. As the Chinese academic, Yu Yongding (2007:3-4) has argued, while compared with the US and the developed countries China seems more like a beneficiary because of its 'twin surpluses' (current account and capital accounts), in reality it is also a victim because the other side of this coin is the huge internal imbalances between the outward- and inward-oriented parts of China's economy. So key question here is that what is the role of China in current global imbalance.

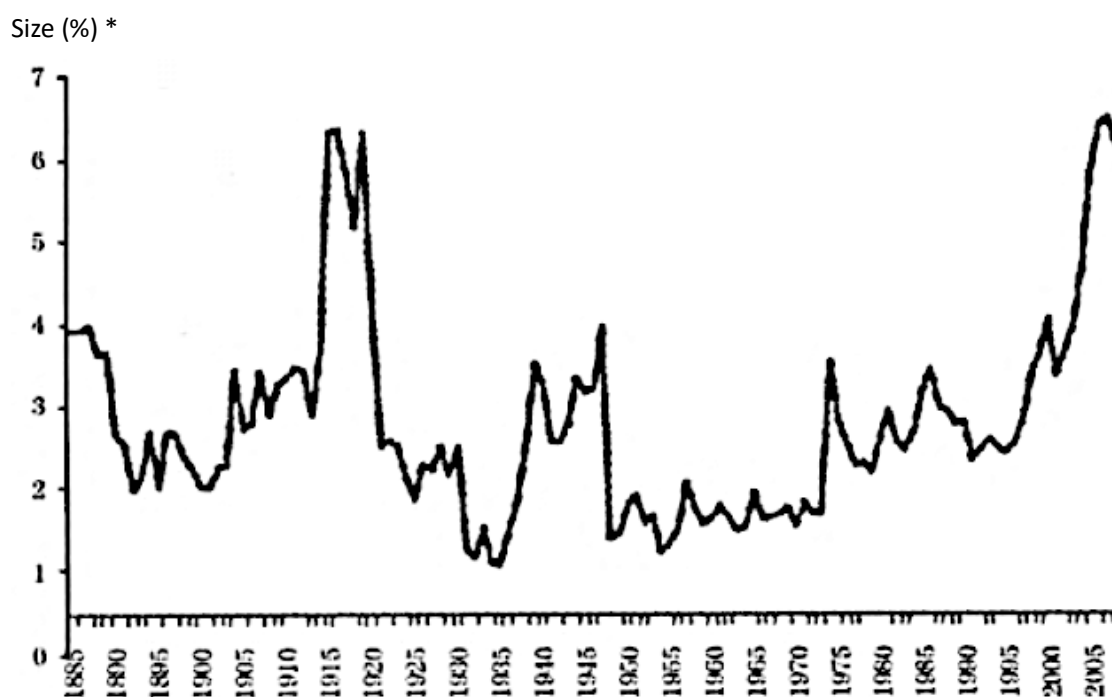
This chapter sets the scene for these questions by examining the relationship between power, institutions and global imbalances in historical perspective. In so doing, it will highlight many of the themes and concepts discussed in the previous chapter, especially hegemonic stability, international regimes and the sources of structural power and ideological hegemony. The chapter argues that, in part, there was a strong relationship between hegemony and the international financial system, both in the 'ascendant' and 'declining' stages of hegemony. The chapter also examines the ways that different states have dealt with adjusting both domestically and internationally to changing stages of financial hegemony and decline. This theme is then picked up in Chapter four, which analyses the contemporary context and China's emergent roles within it.

3.2 Global Imbalances in Historical Perspective

In 2005, Rodrigo de Rato, former Managing Director of the International Monetary Fund, defined global imbalances as follows: 'constellation of large deficits in one country, with counterpart surpluses being concentrated in a few others' (Rato, 2005). He indicated that compared with the US and EU countries carrying large current account and fiscal deficits, surpluses in Japan, certain oil-exporting countries and emerging Asia are growing (Rato, 2005). In Rato's definition, global imbalance mainly refers to the imbalance in world trade - a definition accepted by many American scholars, such as Richard Cooper (2006), and Maurice Obstfeld and Kenneth Rogoff (2009). Mitsuru Taniuchi further points out that global imbalance is not just related to current account but also to capital account. According to him, changes of structures of capital flow should be taken seriously in the study of global imbalances, especially the imbalance between the US and emerging Asia (2006:1-8). Moreover, some Chinese scholars claim that global imbalances also refer to the overall imbalance of global economy. Zhang Yansheng, Secretary General of Academic Committee of National Development and Reform Commission, points out that global imbalances are strongly related with the development of globalization without effective management (Zhang

张, 2006). Global imbalances are not only characterized by its external imbalance but also internal imbalance of countries and imbalance of the international financial system (Huang 黄, 2012). Even though the definition of global imbalance is contested, few doubt the importance of global imbalances in the post-crisis era. This chapter defines global imbalances by the most widely accepted definition: *'meaning imbalances between savings and investment' between the developed countries and emerging powers 'reflected in large and growing current account imbalances'* (Obstfeld and Rogoff, 2009; Smaghi, 2008).

Figure 3.1: Size of Global Imbalance From 1885 to 2005



Note: Size (%) is the ratio of the sum of the absolute value of the balance in current account and the sum of the global GDP

Source from: Tian (田), Xu (徐), Yang(杨), and Mao(茅), (2012)

Global imbalances is a relatively new term, but not a new phenomenon. Since 1885, the world economy witnessed several periods of imbalance (see Figure 3.1). According to Michael Bordo, before the current episode of global imbalance, there were another

four period of imbalance: 1) massive international transfers of capital in the pre-1914 period; 2) the late 1920s and the early 1930s; 3) the breakdown of Bretton Woods system 1965 to 1971'; and 4) the 'dollar crisis' period of 1977-79 (2005:3). In this chapter, however, will review just the first three period because the imbalance of the late 1970s and 1980s, especially after Jamaica Agreement in 1976, should be seen in the context of the contemporary situation, even though the world economy witnessed two periods of short rebalancing in late the 1970s and in 1987-1991. In sum, by reviewing these historical periods I will underline the key relationship between dominant power, the international financial system and changes to the global order.

3.3 Pax Britannica and Pre-1914 Global Imbalances

In the period in 1870-1914, which Bordo calls the 'previous era of financial globalization', there was a 'rapid global buildup of external assets and liabilities' (2005:6-7), and the world economy suffered a long-standing current account imbalance. According to a study by Bordo, Eichengreen and Kim (1998), the pre-1914 imbalance was very persistent, lasting for about 34 years from 1870 to 1914. By using different ways to test, they conclude the pre-1914 episode can be characterized by its 'large size and greater persistence of the current account imbalance' for both the principal capital exporters and recipients (Bordo, 2005: 8; Bordo, Eichengreen and Kim, 1998:14). Moreover, they point out that international market integration was characterized by the "'U" shaped pattern' from pre-1914 to the 1990s, which means the world economy is facing a 'back-to-the-future' scenario of financial integration that is analogous to in the 19th century (Bordo, Eichengreen and Kim, 1998:1-3). Obstfeld and Taylor point out that this kind of U shaped pattern can be also applied to foreign assets and liabilities between pre 1914 to the 2000s (2004). As they declare, by studying the ratio of stocks of foreign capitals (including assets and liabilities) to GDP for selected countries, this ratio of foreign assets reached a peak in around 1900 of 19%, and then quickly decreased to around 5% in 1945 (Obstfeld and Taylor, 2004: 52). But in the 1980s, this ratio experienced a shape increase, which reached the prewar

level in 1985 and then, in 1995, this number reached 57%, much higher than that in pre-1914 era (Obstfeld and Taylor, 2004:51). The data of liabilities also shows a similar U shaped pattern, which peaked in 1914 at 21% to overall GDP, then sharply reduced to 11% in 1938, and again peaked in the 1990s to approximate 50% (Obstfeld and Taylor, 2004: 50-52).

Figure 3.2 Rules of Classical Gold Standard in Pre-1914

THE INTERNATIONAL GOLD STANDARD, 1879–1913

All Countries

- I. Fix an official gold price or “mint parity,” and convert freely between domestic money and gold at that price.
- II. Do not restrict the export or import of gold by private citizens, nor impose any other exchange restrictions on current or capital account transacting.
- III. Back national banknotes and coinage with earmarked gold reserves, and condition long-run growth in deposit money on availability of general gold reserves.
- IV. In short-run liquidity crises from an international gold drain, have the central bank lend freely to domestic banks at higher interest rates (Bagehot’s Rule).
- V. If Rule I is temporarily suspended, restore convertibility at traditional mint parity as soon as practicable—if necessary by deflating the domestic economy.
- VI. Allow the common price level (nominal anchor) to be endogenously determined by the worldwide demand for, and supply of, gold.

Source: Box 1 in Mckinnon (1993:4)

The key of the smooth adjustment of pre-1914 imbalance was the price-specie-flow mechanism, based on the classical gold standard. As Figure 3.2 shows, there were six basic rules for classical gold standard. So the question here is how did it function? As Benjamin Strong explained (quoted by Johnson, 1997), the classical gold standard functioned automatically because:

‘Shipment of gold had the effect of depleting back reserves in the country where prices had advanced too rapidly and overtrading and speculation had developed, thus forcing advances in the rate of discount of the bank of issue and of interest rates generally, which in turn induced borrower to liquidate stocks of goods in

order to pay loans, so again reducing prices and restoring world price equilibrium, Comparatively slight but rapid advances of prices in one country were automatically corrected by these means and a fairly stable level of world price resulted.’ (Johnson, 1997:28)

This mechanism rebalanced trade because it helped to ‘keep overall national price levels in line and to maintain balance of payment equilibrium’ by arbitraging only in gold between nations (Bordo, 1984: 24). Moreover, key of this mechanism is that the ‘policymaker could rely on the gold standard to eliminate external imbalances automatically’ (Eichengreen, 1992:32). But as Clark Johnson criticizes, this argument of function automatically is based on two ‘contradictory forms’: one is that price-specie-flow can ‘automatically raised prices ...in surplus countries and lowered them in deficit countries’; But at the same time it was assumed that following the roles of gold standard, all member central banks would adjust their discount rate with the changes in their gold reserves to make sure the output and price equalize to systemic averages (Johnson, 1997:27). However, both these two forms did not occur consistently in pre-1914. As Johnson points out, by studying pre-1914 transfers, it can be found that ‘prices typically adjusted through arbitrage under the prewar gold standard; hence, the effect of gold flows themselves upon prices was secondary’ (1997: 28-29). Then he says that except the Bank of England, other member central banks in pre-1914 often kept more gold than required and all tended to maintain such positions, which broke the rules of gold standard. Compared with other central banks, more often and efficient domestic discounting policies of Bank of England in response to international gold movements is just because of ‘the huge size and depth of London’s network of finance houses, funds could shift rapidly between local and foreign deployments’, which made others hard to replicate its policies (Johnson, 1997: 30-31). Just as HST indicates, the competitive international system hegemony is a necessary condition for building and maintaining the free and open economy because the hegemon is necessary for the provision of international public goods (Gilpin, 1987; Kindleberger, 1981). Then HST explains that public goods in international politics are

often in short supply, the reason for which is down to problem 'non-excludability' of public goods, i.e. because states can benefit from public goods without paying for them no state has an incentive to do so, leading to the so-called '*free-rider*' problem, just as what happen here. In short, the prewar gold standard did not function that automatically.

Studying the functioning of the international financial system in the pre-1914 period, it immediately becomes clear that Britain's global power was crucially important. As Obstfeld indicates, there are two factors behind the successes of pre 1914 adjustment mechanism: one is 'Britain provided firm and credible economic leadership based on fairly consistent free-trade principles; Second, international financial markets displayed a degree of resilience and efficiency that is impressive even by modern standards' (1993:211-2). As representative scholar of HST, Kindleberger indicates that Britain, as international lender of last resort, was the key to maintaining the stability of the prewar gold standard. This kind of idea is also supported by John Maynard Keynes. In the book *A Treatise of Money*, he says that

'during the latter half of the nineteenth century the influence of London on credit conditions throughout the world was so predominant that the Bank of England could almost have claimed to be the conductor of the international orchestra. By modifying the terms on which she was prepared to lend, aided by her own readiness to vary the volume of her gold reserves and the unreadiness of other Central Banks to vary the volume of theirs, she could to a large extent determine the credit conditions prevailing elsewhere' (1930 Vol II:306-7).

Donald McCloskey and Richard Zecher further indicate that in pre-1914 the Bank of England had more power in the gold standard regime than other Central Banks because she could more strongly influence world prices by changing domestic discount rates, which was based on 'its power to accumulate or disburse gold and other reserves available to support the world's supply of money' (1985:64).

Barry Eichengreen has also studied the role of Britain in prewar gold standard and argues that its dominance of the world economy - what Strange calls 'structural power' - allowed it to rebalance its payments and, moreover, helped sterling become the anchor of the international financial system (2008:41). As mentioned before, the pre-1914 period with rapid growing of international trade, based on its imperial preference system, within which reliance on sterling was greatest, in late 19th century 60% of international trade was in sterling. Moreover overseas demand for British goods, especially in the empire, helped to stabilize its balance of payments by allowing British merchandise exports to chase its capital exports. In other words, primary-producing regions serviced Britain's external debts and helped to adjust its balance of payment (see Figure 3.2) (Eichengreen, 1992:43; 2008:41). Theoretically speaking, this is only partial consistent with HST. Eichengreen's view is closer to Keohane's and tends to emphasize the cooperative and mutually beneficial aspects of the gold standard. He argues that there were two linchpins to prewar gold standard: credibility and cooperation. Credibility is 'the confidence invested by the public in the government's commitment to a policy' and 'the credibility of the prewar gold standard rested on international cooperation' (1992: 5;7). When faced with a serious imbalanced in 1890 and 1907, Britain lost its critical stabilizing role in prewar gold standard and operation of this mechanism relied on cooperation from other central banks, especially the Bank of France and the German Reichsbank (Eichengreen, 1992:8; Johnson, 1997:38).

The dominant role of sterling was always an important source of influence of Britain in prewar gold standard. According to data, as the anchor currency in prewar gold standard, 80% of world foreign exchange reserves were sterling and even in 1938 this ratio was still around 70% (Triffin, 1968). The benefits of sterling's dominance lasted much longer than the other sources of Britain's hegemonic power – a situation not unlike the position of the US today (see Chapter Four). Theoretically, this lag can best be explained by Strange and her concept of structural power, which emphasises the indirect benefits that states accrue due to the position they occupy in the overall

system. And while Keohane's theory helps us to understand the institutional and cooperative aspects of the gold standard, it is clear that most benefits went to the hegemon. This helps to explain why, even by 1914, the role of Britain in this prewar system had not been directly challenged, even though the US by this point held one-fourth of world reserves of gold, one-third of official reserves and had become the world's largest economy. Since late 19th century, even with decline of Britain's economic advantages, the dominant role of sterling in trade made that large portions of foreign trade were still settled through payment in sterling bills, which 'provided a lucrative business for acceptances and discounts in London' (Johnson, 1997:38).

Economists have long debated the reasons for the collapse of the gold standard. For instance, the 'quantity of money' school emphasizes the shortage of gold reserves. As discussed above, the pre-1914 period was characterized by the rapid growth of trade, which fueled the spread of gold convertibility around the world but limited global gold production and reserves could not meet the extra demands for the supply of money. However, this argument is strongly challenged by data that suggest that, even though production of gold reached a low 1883 at 4.7 million ounces, it quickly increased significantly to 9.7 million ounces by 1896 and 20 million in 1907 (Johnson, 1997:40-1). Compared to the rise of production, the Jastram's index for Purchasing Power of Gold in Britain kept declining from 156 during 1894-97 to 114 in 1912-1914 (Jastram, 1977: table 3; Johnson, 1997:40). In other words, the economic interpretation on its own cannot explain the collapse, without consideration of wide political economy analysis.

Here the source of the pre-war global imbalances should be considered. By 1913, two-thirds of world gold reserves were held by the five largest industrial countries, - Britain, France, Germany, Russian and the US - and the ratio of the sum of the absolute value of the balance in current account and the sum of the global GDP reached peak to around 6% in early 1900. This was not only caused by the function of price-specie-flow mechanism to correct world prices and encourage the flow of gold into the industrial

countries. It also need to be consider the increasing use of capital controls and trade protectionism in these countries, especially the US, France and Germany, in violation of the basic rules of prewar gold standard. So the question here is why did these countries break the rules of prewar gold standard? According to HST, this was due to the decline of the hegemonic power of Britain. In other words, declining hegemony made it hard for Britain to police the liberal international order; conversely, the other great powers had an incentive to 'free ride' by breaking with the free trade orthodoxy. Although this was certainly true, cooperation did still prevail even in the 'declinist' phase of British hegemony, such as that between the Bank of England, Bank of France and the German Reichsbank on international loans and discount rates policies, which continued even after 1890.

This international cooperation, however, was insufficient to prevent the eventual collapse of the liberal order. From a liberal-institutionalist standpoint, it can be argued it was not the absence of cooperation but the weaknesses of international institutions. However, the gold standard would appear to meet Keohane's (1984:88-94) definition of a 'quasi-agreement', which although 'legally unenforceable' can 'help organize relationships in mutually beneficial ways'. Susan Strange's structural explanation is perhaps the most persuasive in pointing to the global imbalances and collapse of prewar gold standard as a consequence of the changing balance of power in the four primary structure of the world economy. The outbreak of World War I, the most important consequence of the collapse of prewar gold standard, was the link among these structures.

From the late 19th century, the most significant change in the production structure was the second industrial revolution when capitalism developed from its free competition stage into the monopolized period. Compared with other European countries, Germany was involved in this revolution very early and benefited from 'late development' from economic backwardness (Gerschenkron 1962). This was strongly related to changes in its domestic security structure, namely, the unification of

Germany in the 1870s, which provided a large domestic market and stable political condition for Germany's development. But this also caused a big challenge in the knowledge structure, driven by the ideologies of nationalism and militarism that underpinned Germany's unification. But Germany was not the only great power with ravenous appetites in this period. For Britain reducing advantages in production and soft influences (including advantages in technologies, cultural influence, language and religion), which before were mostly based on the global colonial system of the British Empire, was more threatened by rising Germany and the US after the second industrial revolution. In order to maintain its hegemonic role, Britain increased investments in the military, especially its navy, to maintain its dominant role in the security structure to protect its global colonial system to ensure its benefits in production and knowledge structure were maintained. Russia also felt threatened from the rapid rise of Germany in geopolitics and, with Bismarck's resignation in 1890, Germany more deeply involved in the competition for colonies, which further harmed the interests of Britain and France. This triggered the arms race between European countries, such as Britain's construction of the Dreadnought in 1906 to react to the German Naval Laws of 1900. All these changes in security, production and knowledge continuously compressed spaces for international cooperation in the prewar international financial system and accelerated the erosion of the hegemonic power of Britain. As David Calleo puts it, 'geography and history conspired to make Germany's rise late, rapid, vulnerable, and aggressive. The rest of the world reacted by crushing the upstart' (1978:6). The prewar gold standard totally collapsed in 1914 when it was suddenly interrupted by the World War I in August. Then in the next few months of 1914, facing shortage of gold reserves and in order to prepare for the war, the rival powers started to issue bank notes inconvertible to gold to address the problem of sharp increases in fiscal expenditure. The collapse of prewar gold standard and the World War I are seen as critical points in accelerations British hegemonic decline.

3.4 Power Shifts and Global Imbalances in the Interwar Period

Compared with current global imbalances, the one in the interwar period was far less serious, the sum of which peaked at around 2.5% of global GDP. But the interwar exchange gold standard, as the adjustment mechanism in this period, is very important to IPE because its re-establishment and then collapse were strongly related to power shifts in the global order. As mentioned before, the price-specie-flow adjustment mechanism of pre-1914 era was based on the classical gold standard. The cornerstone of the classical gold standard was the priority attached by governments to defend their gold reserves and maintain the convertibility of the currency, especially the key states of European, Britain, Germany and France (Eichengreen, 2008: 29). The stability of this prewar gold standard was based on a particular set of political and economic circumstances but in the interwar period, most of these disappeared with disastrous consequences for the international economic order.

Although elements of the classical gold standard had been eroded, in order to maintain the function of international financial system, most countries still tried to maintain the gold standard after the war. In 1925, Britain first tried to return to the gold standard but the exchange rate of sterling against the US dollar changed from 3.44 to 4.866. Even though the UK's decision to return to the gold standard was strongly attacked at the time by many economists, including Keynes, Britain was actually following the basic rules of the classical gold standard, especially rule 'V' known as the 'Restoration Rule' (see Figure 3.2). By 1926, almost 39 countries had signed up to a new gold standard, titled the 'gold-exchange standard' (Eichengreen, 1992: 58-59). Facing a shortage of gold, the gold-exchange allowed that most members held most of their foreign reserves in foreign exchange, mainly in dollars, sterling and francs. The core countries, the US, the UK and France, held gold (Bordo, 2005:9). But this new gold standard did not work well and could not smoothly adjust imbalances in the world economy as the classical gold standard did in the pre-1914 era. As Bordo points out, 'countries returned to gold at misaligned real exchange rates', meaning the real exchange rate of a declining Britain was overvalued while the real exchange rates of the US, France and Germany were undervalued (2005:11). This

meant that the US, France and Germany were running persistent surpluses with Britain, which meant most gold flowed into these surplus countries. Between 1927 and 1931, except 1928, Britain continuously ran deficits. Meanwhile, France and Germany absorbed nearly all of the increase in gold reserve while half of war debts of World War I were transferred to the US as principal and interest on wartime debts in the period (Eichengreen, 2008: 62-67). This kind of absorption of gold by France and Germany and gold and capital flows into the US mostly strengthened their balance of payments but it intensified deflationary pressure on other countries, especially interwar Britain, which was described as 'continuously under the harrow' (Eichengreen, 2008: 65-67).

Under the classical gold standard, the member countries were supposed to allow the fluctuation of domestic prices to adjust their external imbalance (Bordo, 2005:11-12). However, in interwar period the US, the most important surplus country, did not follow this price-specie flow model to allow its domestic price to rise; instead it lent its surplus to other countries. In fact, both the US and France 'continuously sterilized their gold flows and prevented adjustment', which led to a concentration of gold in these two countries (Bordo, 2005: 12; Eichengreen, 1990:239-246). The motive for this form of free-riding was the changing political circumstances in the 1920s, that is, 'the growing importance of domestic factors as the final determinant of monetary policies' (Triffin, 1947: 57; Eichengreen, 2008: 71).

In other words, two linchpins of prewar gold standard - credibility and cooperation - were undermined by changes in domestic politics, especially the rising power of the working class. According to Eichengreen, there were two main changes in this period. One was the rise of labor and socialist parties: for instance, in Britain that the tally of Labour Party members increased from 370,000 in the 1911 and to 2,000,000 in 1918. These changes were related to the extension of the franchise and the spread of unionism, encouraged by the adoption of corporatist arrangements by wartime governments (Eichengreen, 1992:9; 92). Eichengreen indicates that, in the pre-1914

period, compared with domestic economic objectives, gold convertibility and currency stability were unquestioned priorities of governments (2008:89). But in the interwar period, 'when employment and balance-of-payments goals clashed, it was no longer clear which would dominate' (Eichengreen and Flandreau, 1997: 15; Eichengreen, 1992:9). The reasons for this was that rising of working class for government it was too costly to neglect the voices of employment-friendly policies. Another domestic change was that election systems were reformed from single-member plurality-based system to proportional representation in Continental and Northern Europe, triggered by rising requests to protect minority rights after World War I, which profoundly impacted party politics (Eichengreen, 1992:93). Eichengreen agrees that proportional representation did not necessarily lead to unstable government, but in almost all these European countries with proportion representation in the 1920s, the consequence was that fragile party coalitions made 'it difficult to form stable governments and complete the process of fiscal stabilization required to restore the gold standard' (1992:93; Hermens, 1941:7). Further, besides the domestic political constraints, international cooperation was also blocked by international political disputes over war debts and reparations among European countries (Eichengreen, 1992:10).

So the question here is how to explain the rise of working class movements and those lasting political conflicts in the interwar period? Karl Polanyi gives his explanations for these movements in his classic book, *The Great Transformation*. According to Polanyi, the nineteenth-century civilization was based on four institutions: the balance-of-power system between the Great Powers, the international gold standard, the self-regulating market and the liberal state (2001:3). He points out that, even though the international gold standard was a crucial aspect of the prewar economic system, its fall led directly to catastrophes in both politics and economies, the disintegration of the global economic system and the collapse of nineteenth-century civilization. As Karl Polanyi says, 'the breakdown of the international gold standard was the invisible link between the disintegration of world economy which started at the turn of the century and the transformation of a whole civilization in the thirties.... the dissolution of the

system of the world economy which had been in progress since 1900 was responsible for the political tension that exploded in 1914' (2001:21-2). In his opinion, under the self-regulation market the economy was 'directed by market prices and nothing but market prices' without outside help or interference and with the development of self-regulation market, the rise of market society became a major trend in the 19th century, which was totally different with any other former societies because it was totally controlled and regulated by the market (2001:45-6).

Polanyi indicates that one serious problem with the rise of market society in 19th century was that the relationship between the market and society was transformed from an 'embedded' to a 'disembedded' one. According to him, before the 19th century the role of the market in the most countries' domestic economics was insignificant as 'man's economy, as a rule, is submerged in his social relationships' and in this kind of societies, the production and distribution was ensured by two principles of behavior-reciprocity and redistribution but not primarily associated with economics (2001: 47-50). But market society undermined these traditional values. As he indicates, 'the control of the economic system by the market is of overwhelming consequence to the whole organization of society: it means no less than the running of society as an adjunct to the market. Instead of economy being embedded in social relations, social relations are embedded in the economic system' (2001: 60).

Moreover, this kind of disembedded transformation would trigger a 'double movement' between the self-regulating market and social protection. Polanyi agrees that the self-regulating market and industrial revolution contributed to progress but also to poverty because their rise destroyed the relatively stable social networks they replaced. Based on this, working class mobilization in the interwar period should be seen as something that 'sprang into being to resist the pernicious effect of a [unparalleled] market-controlled economy', which was strongly improved by the aegis of the gold standard in the pre-1914 period and 'society protected itself against the perils inherent in a self-regulation market system-this was the one comprehensive

feature in the history of the age' (Polanyi, 2001:79-80). Then he indicates that one result of this double movement was political conflict, because 'the clash of the organizing principles of economic liberalism and social protection which led to deep-seated institutional strain' (2001:140). The root of political conflict in the interwar period lay in the different positions of the different classes on both two dimensions – the self-regulation market and social protection. The rising working class movement should be seen as that 'the broad class of labor did not shrink from breaking [self-regulating market's] rules and challenging it outright' (2001:200). The political conflicts in interwar period strongly contributed to the collapse of the interwar gold standard, as John Gerard Ruggie explains. In other words, there was a fundamental rebalance between authority and market: 'transformed state-society relation [after completely laissez-faire 19th century], by redefining the legitimate social purposes in pursuit of which state power was expected to be employed in the domestic economy' (1982:386).

In the study of the interwar global order and financial system, the Great Depression must be explored. The resurrection of the gold standard certainly contributed to this. As I have argued, compared with the persistent deficits of other countries, especially Britain, the increasing surplus of the US meant it became the main lender of the world and the capital outflows from the US helped other countries to balance of their external account (Eichengreen, 1992: 12). As the biggest lender in the world, in the summer of 1928 the Federal Reserve increasingly tightened its monetary policy, which not only caused a liquidity crisis but also convertibility crises (Eichengreen, 1992:12; 1990:246). Because of the extremely imbalanced nature of the world economy, other countries were forced to follow suit. After this, the interwar gold standard became an obstacle to economic recovery rather than an adjustment mechanism. More and more countries found that investment, trade, output and employment recovered more quickly and balance-of-payment and price were more stable after abandoning the gold standard (Eichengreen, 1992:21). In 1933, the US left the interwar gold standard to reflate its economy, which marked the end of the gold standard (Meltzer, 2003; Bordo,

2005: 12).

For economists, the link between the gold standard and the Great Depression has figured prominently and has been debated between, broadly speaking, Keynesians and monetarists. For IPE, the most influential account is HST. For Kindleberger (1986), the fact that governments pursued the 'wrong' fiscal, monetary and trade policies, was less important than the overall lack of international leadership. As I argued earlier, Kindleberger identifies 'lender of last resort' as one of the most important roles for the leader, or hegemon. Facing economic crisis, a lender of last resort is necessary to provide liquidity and an import market for distressed goods. However, neither Britain nor the US nor France performed this role in the interwar period. Kindleberger thus concludes that in 1931 the story shows : '1) the inability of Britain to act as a lender of last resort; 2) the unwillingness of the United States to do so, apart from the inadequate effort for Britain, the country of the "special relationship"; 3) the urge of France, with respect to Austria and Germany, to gain political ends; 4) the paranoia of Germany after 1923, preferring anything to a hint of inflation; and 5) the irresponsibility of the smaller countries' (1996:178-9). According to HST, then, the Great Depression was mostly caused by the lack of hegemony to maintain the international economic system, which is because of the decline of British power and the unwillingness of the US (1986: 289). Compared with the 1914 era, Britain was losing its hegemonic power in interwar period. Especially after the World Economic Conference in 1933, Britain 'had turned away from a leading world role ... largely leaving it to the US to devise a world program' (Kindleberger, 1986:295-6). But because of the isolationism of the US, it did not take the responsibility to maintain the international economic system, which meant that there was no one to maintain open markets ensure sufficient lending and stable exchange rates, coordinate the macroeconomic politics and provide liquidity in crisis (Kindleberger, 1986: 289; 296-7).

Actually, the interwar gold standard was more like a transitional international monetary mechanism in the background of the power shift between Britain and the

US. The Great Depression strongly weakened the economy of the US but because of the transfer function of the interwar gold standard, the economies of Europe, especially Britain, were more damaged by this crisis. In September 1931, Britain finally abandoned the interwar gold standard allowed the devaluation of the pound. In order to avoid the impact of the unilateral devaluation of the pound on the US economy, the US also followed suit. The US allowed the dollar to devalue in response to the devaluation of the pound but at the same time tried to increase its gold reserves, which contributed to the mounting international financial system chaos. By April 1932, 41 countries abandoned the gold standard and the system finally collapsed. As mentioned before, in the pre-1914 period based on the classical gold standard, the hegemony of sterling brought lots of benefits to Britain even when experiencing relative economic decline. So after World War I, it is not hard to understand Britain's eagerness to return to the gold standard, which in the British government's opinion would improve the recovery of power of Britain after the World War I especially in the international financial system. Actually at that time this kind of opinion was not whimsical because according to data, in the 1920s most world foreign exchange reserves were still sterling and even to 1938 this ratio was still around 70%. But without considering a series of changes in domestic politics and international relations, the interwar gold standard became incompatible with domestic political needs and international cooperation. Then the collapse of the interwar gold standard to some extent proved the end of sterling's hegemony in international financial system.

Even though role of the US in the global order became more and more important, it was not until after the World War II that it actually assumed hegemonic leadership. The US stopped its policy of competitive devaluation in 1934, as its economy began to recover from the Great Depression. On November 17, 1938, the Anglo-American Trade Agreement was signed, in which Britain made significant concessions to the US in terms of exchange rates and tariffs, which symbolized their changing global roles. But the process of power shift was still ongoing in this period. With the collapse of the interwar gold standard, the US dollar was more and more widely used in international

trade and investment, and in the late 1930s there was a dollar area including the US and its dependencies- Canada, Philippine and many Central and South American countries. In 1939, the tit-for-tat sterling area was established that was composed of the United Kingdom and its dependencies, such as the Irish Republic, Australia, New Zealand, South Africa, India, Pakistan, Iraq and Ceylon. As Kenneth Wright points out, 'the war-born sterling area became a system of cooperative exchange and import controls, restricting transactions with non-sterling countries, but allowing almost complete freedom of payments among the members. One of the purposes of this system was the mobilization and conservation of the means of purchasing outside the area, particularly dollars, for the financial prosecution of the war' (1954:560). The international financial system and global order were still in turmoil.

3.5 The US Hegemony and Global Imbalance 1965-1971

The ending of World War II did not automatically lead to a new more stable international financial system and global. According to E. A. Brett, 'while it should never have been allowed to happen, it had nevertheless demolished an old order and created space on which a new one might be built on more progressive and stable principles' (1985:62). However, negotiating this new order was not straightforward because of the different domestic economic and political situations in postwar recovery period. After World War II, the economies of all Europe and Asia were destroyed, and the postwar recovery period was much longer and more painful than expected. The international monetary system also experienced a long pre-convertibility era until 1958, when the major industrial countries finally reached full convertibility (Bordo, 1993:37). In this pre-convertibility era, the world economy faced two problems, both related to the imbalance of payments: bilateralism and the dollar shortage (Bordo, 1993: 37). In the postwar recovery period, except for the US, all other major industrial countries faced the problem of shortage of key imports, most of which could only be supplied by the US based on its superior rate of productivity. This fueled the rise of bilateral arrangements in trade, including licenses and quotas for trade and

allocation of foreign exchange, and the shortage of dollars, which led to the deficits of the OEEC (Organization for European Economic Cooperation) countries that reached its highest in 1947 of \$9 billion while the US ran large surpluses (Bordo, 1993: 37-41). As Brett points out, the postwar economic debate was more like 'an argument between the USA on the one side representing the interests of the strong surplus countries, and the rest of the world on the other having to deal with the problems of economic reconstruction or underdevelopment' (1985:64). The technical aspects of the imbalances were resolved through the implementation of the Marshall Plan and the establishment of the European Payments Union (EPU) in the late 1940s. However, the political differences that underpinned these imbalances required more negotiation and compromise,

In the postwar settlement, the US saw themselves as the leading protagonist and in order to play this role effectively the US was very eager to establish a widespread agreement on the principles on which it was to be established (Brett, 1985:64). Noteworthy in the first decade of postwar period, the world economy faced a very similar situation to the 1920s, but the US took a very position. So the question here is what caused this change of position? As scholars indicate, this was due to three factors: the first was the lessons drawn from the consequences of inaction after World War I; the second was that with its growing economic superiority the US became more confident in managing the international system; the third was that the domestic foundations became more favorable to internationalism, especially economic interests that increasingly saw free trade and liberalism as in their self-interest (Eichengreen and Kenen, 1994:9-10). But the necessary agreement between the postwar allies was not yet in place. In the US, 'their commitment to liberalisation was associated with, if anything, a more powerful anti-communism dedicated to ensuring that no further expansion of its influence was to take place beyond the limits set by the 'iron curtain' at the end of the war' (Brett, 1985:64). But liberalization and anti-communism were not the primary concerns for Western Europe. Even in Britain, where the commitment of the political elite to liberalism anti-communist was strongest, the new Labour

government was committed to a radical rejection of laissez-faire principles in both domestic and international economic policy (Brett, 1985:64-5). Compared with laissez-faire liberalism, social democratic planning based on Keynesian principles was more popular in Western Europe, especially the policy of monetary and tariff controls to regulate exchanges across the border. In these circumstances, 'any American settlement of the international problems would therefore require an effective compromise with the political and ideological forces represented by this consensus' (Brett, 1985:65).

These differences among industrial countries were reflected in the debate at Bretton Woods, in particular the White plans versus the Keynes plans. The purpose of the two plans was the same, that is, providing a mechanism to maintain stabilization of foreign exchange rates and to grant foreign credits to member countries to maintain the balance-of-payment of member countries in international transactions. The two plans both proposed a new international monetary unit that in Keynes' plan was called 'bancor' and in the White plan was called 'unitas'. This new unit 'would be used for tying the various currencies to gold and to each other.... [this] new unit would be used for accounting but not for circulation' (Riddle, 1943: 2). In both plans, gold would be used in settling international balances and there would be an unlimited market for gold at the established price - and member countries would be allowed to trade gold freely at the fixed value (Riddle, 1943:2). But compared with the White plan in which gold played a more important role as an international standard of value and full two-way convertibility would exist, the Keynes plan suggested one-way convertibility, which meant that gold could be converted into bancor but the converse was not allowed. Keynes further suggested that 'if member countries should prefer to maintain full convertibility for internal purposes, they might permit the export of gold only under license as a protective measure' (Riddle, 1943:2). Both of them established a new international agency to help to stabilize the balance-of-payment of its member countries that in the Keynes plan this was International Clearing Union and in the White plan was the Stabilization Fund, both of which were limited in only dealing with

the central banks, treasuries or fiscal agents of the member countries. However, the main difference between the two plans were their different process of granting credits. As Riddle explains below,

‘The Clearing Union of the Keynes plan, having no funds to begin with, would provide overdraft facilities to member countries. For example, if country A has a debit balance with country B, the Clearing Union would debit A and credit B. A country having a favorable balance of payments with the rest of the world as a whole would find itself building up a credit account with the Clearing Union in terms of bancor ... the creditor countries as a group would, in effect, be extending credits to the debtor countries as a group ... [compared] the Stabilization Fund of the White plan, having assets to begin with, would exchange one currency for another or buy one currency and sell another. The Fund would also have means for increasing its supply of any currency i.e., by borrowing or by selling some of its assets. In both plans measures are contemplated that would limit the amount of credit extended of any country’ (1943:2-3).

In the Keynes plans, in the Clearing Union the increase in debt would need to be matched with an increase in credit to avoid the bankruptcy or suspension of operations. Surplus countries would be forced to provide low interest loans, to encourage them to adjust their balance-of-payments. The responsibility for adjustment therefore fell to surplus countries to solve shortages of effective demand caused by the hoarding of surplus. In the White plan, unitas was just for accounting and could not be used in international settlements. All member countries had responsibility to maintain initial rates of exchange of their currencies to unitas that was decided by the value of their currencies in terms of the US dollar which prevailed on July 1, 1943. After that, any changes in rates needed to be approved by the Fund. Deficit countries were not allowed to borrow directly overdraft from the Fund, but were permitted to borrow from other countries. The overall difference between the two plans was that the White plan represented the interests of the US which

'suggested a world governed by a central, regulative agency charged with the maintenance of a system of open competition and empowered to resist attempts by national government to adopt protectionist policies that would destroy its openness and integration' (Brett, 1985:65). The Keynes plan reflected more the interests of Western Europe, especially Britain, insofar as they 'required an agency capable of guaranteeing the defence of their weaker industries from overseas competition and, even better, some effective redistributive mechanism for providing them with direct financial assistance during the period in which they were building up their industrial capacity' (Brett, 1985:65). But in the postwar period, with the further decline of Britain's power and rapid increase of power of the US, the final Bretton Woods Agreement to some extent showed some American's compromises to the political and ideological forces from Britain and Western Europe (Ikenberry, 1989). The Bretton Woods system (see Figure 3.3) was mainly based on the White plan and could be seen as a great victory of the US because it determined the hegemony of the US dollar in the international financial system.

The adjustment mechanism of Bretton Woods system was very different to the automatic price-specie-flow mechanism under classical gold standard. Under the Bretton Woods system, adjustment 'relied on discretionary monetary and fiscal policy, income policies, and direct trade controls', even though there was some automatic adjustment via changing income and expenditure and also via 'the money supply response to changes in reserves' (Bordo: 1993: 50). In order to combine the advantage of the classical gold standard and floating rates, and to avoid the flaws of fixed exchange rate gold standard and floating rates, the Bretton Woods system finally was set up as 'an adjustable peg system of fixed parities that could be changed only in the event of a fundamental disequilibrium' (Bordo, 1993: 5). The operation of the Bretton Woods system was mainly based on three new bodies established in the Bretton Woods process: the International Monetary Fund (IMF) in 1947¹⁰, the International

¹⁰ The IMF was mostly based on the Stabilization Fund in White plan. In December 1943, the name of Stabilization Fund was changed to the International Monetary Fund following the suggestion from Keynes.

Bank for Reconstruction and Development (IBRD), better known as the World Bank in 1946, and The General Agreement on Tariffs and Trade (GATT) in 1948¹¹ (Heywood, 2011:460). No matter the adjustment mechanism or three main bodies of the Bretton Woods system, they all reflected one dominant paradigm in postwar global economic governance, which was *embedded liberalism*.

Figure 3. 3 The Bretton Woods System Rules

Industrial Countries Other Than the United States

- I. Fix a par value for the national currency with the U.S. dollar as the numeraire, and keep exchange rate within one percent of this par value indefinitely.
- II. Free currency convertibility for current-account payments; use capital controls to insulate domestic financial markets, but begin liberalization.
- III. Use the dollar as the intervention currency, and keep active official exchange reserves in U.S. Treasury Bonds.
- IV. Subordinate long-run growth in the domestic money supply to the fixed exchange rate and to the prevailing rate of price inflation (in tradable goods) in the United States.
- V. Offset substantial short-run losses in exchange reserves by having the central bank purchase domestic assets to partially restore the liquidity of domestic banks and the money supply (Bagehot's Rule).
- VI. Limit current account imbalances by adjusting national fiscal policy (government net saving) to offset any divergences between private saving and investment.

The United States

- VII. Remain passive in the foreign exchanges: practice free trade with neither a balance-of-payments nor an exchange-rate target. Do not hold significant official reserves of foreign exchange.
- VIII. Keep U.S. capital markets open to foreign governments and private residents as borrowers or depositors.
- IX. Maintain position as a net international creditor (in dollar-denominated assets) and limit fiscal deficits.
- X. Anchor the dollar (world) price level for tradable goods by an independently chosen American monetary policy.

Source: Box 3 in Mckinnon (1993:16)

The embedded liberalism concept was mainly developed by John Gerard Ruggie (borrowing heavily from Polyani) in the article 'International Regimes, Transaction, and Change: Embedded Liberalism in the Postwar Economic Order'. There were two key

¹¹ GATT was replaced by the World Trade Organization (WTO) in 1995. GATT is an important part of the Bretton Woods system but it was established by the UN Conference on Trade and Employment (Heywood, 2011:460).

influences on Ruggie's concept – one was Stephen Krasner's definition of regime, as mentioned in the previous chapter, which is 'sets of implicit or explicit principles, norms, rules, and decision-making procedures around which actors' (1983:2); the second was Karl Polanyi's understanding of transformation from 'embedded' to 'disembedded' as discussed previously. On this basis, Ruggie stated that 'the formation and transformation of international regimes may be said to represent a concrete manifestation of the internationalization of political authority' (1982:380). This political authority is shaped by two factors - power and legitimate social purpose - and the form of the international order will be more related with power but the legitimate social purpose contributed more to the content of international orders. To quote Ruggie again, 'to say anything sensible about the content of international economic orders and about the regimes that serve them, it is necessary to look at how power and legitimate social purpose become fused to project political authority into the international system' (1982:382). It may be said that the dominant paradigm of global economic governance mainly reflects the interests of dominant powers¹² but the stability of this dominant paradigm is more decided by the fusion of power and legitimate social purpose. It may help to understand the lasting of embedded liberalism in postwar period even after the collapse of the Bretton Woods system, which will be discussed later.

According to Keohane, in an era of embedded liberalism, 'arrangements facilitating international transactions are "embedded" in acceptance of the domestic welfare state ... the international system must accommodate demands by powerful states to manage their own economies consistently with their social welfare goals' (1984: 189; Ruggie, 1982). In the postwar international monetary mechanism, embedded liberalism can be seen in that the Keynes plan and the White plan shared the same objectives – 'intergovernmental collaboration to facilitate balance-of-payment equilibrium, in an international environment of multilateralism and a domestic context

¹² The dominant powers here represent both dominant power in domestic level, which is dominant class, structure or groups, and hegemonic power in international level.

of full employment (Ruggie, 1982:394-5). In both cases, there was common understanding that both free exchange and stable domestic economy needed to be considered of the same importance. The GATT also reflected embedded liberalism in the sense of insisting on the conjunction of multilateralism and safeguarding domestic stability. Even though in the Bretton Woods process, the Charter of the International Trade Organization (ITO) was stillborn the subsequent GATT rested on the principles of multilateralism and tariff concessions, and principles of immunity, restrictions and exceptions in trade reductions to maintain the balance-of-payment equilibrium and to protect the domestic economy (Ruggie, 1982:396-7). As Richard Gardner puts it, 'the founders of the postwar trading system based on GATT were not free market fundamentalists ... they sought an open multilateral trading system that would be compatible with the achievement of full employment and social justice' (2008: 63).

All told, the Bretton Woods system fully operated between 1959 and 1968, when it helped to solve three key problems: adjustment, liquidity and confidence in post-war international monetary system. Furthermore, the US continuously ran twin surpluses while being responsible for significant amounts of foreign aid and private investment (Bordo, 2005: 13; 1993:50-51; Garber 1993:461). But this did not mean that the Bretton Woods system operated without problems. As some scholars point out, under the Bretton Woods system, throughout the 1960s the European countries and Japan used the US as a financial intermediary that lent credibility to them and chose to undervalue their currencies to accumulate dollars and to improve their export-oriented economies, precisely what the US and France did in the interwar period (Dooley, Folkerts-Landau and Garber, 2003: 1; Bordo, 2005:13). As Ruggie indicates, 'the common tendency to view the postwar regimes as liberal regimes, but with lots of cheating taking place on the domestic side, fails to capture the full complexity of the embedded liberalism compromise' (1982:398). Even though the US ran a large surplus in the first decade of the Bretton Woods system, with the increase of exports of FDI, the US eventually faced the 'Triffin Dilemma'. That was: 'If the United States corrected its persistent balance-of-payments deficits, the growth of world reserves

could not be fed adequately by gold production at \$35 an ounce, but if the United States continued to run deficits, its foreign liabilities would inevitably come to exceed by far its ability to convert dollars into gold upon demand and would bring about a 'gold and dollar crisis' (Triffin 1978:2).

The turning points for Bretton Woods occurred in the late 1960s. The collapse of Bretton Woods system to some extent be attributed to two major flaws: one was that the gold exchange standard put the US 'under threat of a convertibility crisis'. This pushed it to adopt policies to protect its domestic economy but block the international adjustment mechanism. The second was the adjustable peg that 'the system evolved into a reluctant fixed exchange rate system without any effective adjustment mechanism' to counter the increasing costs of discrete changes in parities caused by growing capital mobility (Bordo, 1993:80). The growing imbalance between the US and the rest of world was also a critical reason for the collapse. The rising deficits of the US in the heyday of Bretton Woods was because the capital outflows exceeded the current account surplus, which reduced the dollar liabilities in the international monetary system, affecting market confidence. By 1964, the US monetary gold stock was less than the official dollar liabilities held by foreign monetary authorities (Bordo, 1993: 56). This imbalance forced the Federal Reserve to control dollar outflows but this policy intensified the tension between the US and European industrial countries. Moreover, in 1965 the US government started to follow 'inflationary monetary and fiscal policies to finance the Vietnam War and the Great Society' (Bordo, 2005:14). However, these policies seriously eroded the world's monetary gold stock by 1968, leading to the collapse of the Gold Pool - which was the key 'institutional infrastructure supporting the system of pegged but adjustable exchange rates in the heyday of Bretton Woods' (Eichengreen, 2007:35; Bordo, 1993: 80). This inappropriate policy choice for the US as a key currency country showed its failure to maintain price stability, which not only further challenged the liquidity in international monetary system but also strongly hit the confidence of European industrial countries to follow US leadership. Actually with the growing imbalance in the world economy, the gap

between the interests of the US and other major industrial countries got bigger and bigger. So by the late 1960s, the other major industrial countries were reluctant to revalue their currencies to absorb dollar balances because this conflicted with their national economic interest (Bordo, 1993: 80-83). In the summer of 1971, President Nixon severed the link between gold and the US dollar; most European countries followed this by allowing their currencies to float freely, which ended the fixed exchange rate system. The Bretton Woods system was no more.

One of the fiercely debated questions in IPE is did the collapse of the Bretton Woods system necessarily lead to a sharp decline of the US hegemony in the post Bretton Woods period. As mentioned in the last chapter, HST specifically states that the great advantages of hegemony in the international system are hard to maintain because the inevitable diffusion of wealth, which is a natural feature of the market economy, and the 'free-rider' problem, will inescapably change the distribution of power in international system. With the decline of hegemonic power, the hegemon will become unable and unwilling to continue to provide public goods and then the free and open international economic system will be weakened. Moreover, there will be a reform of existing global order because the new distribution of power in the international system will challenge the existing mode of governance and the rising new power will jump-start the reform to rebalance the global order. Some of these HST arguments seem borne out by the behavior of the European countries and Japan enjoyed the benefits from the system but refused to adjust their increasing surplus, which contributed to the collapse of the Bretton Woods system. Moreover, persistent deficits in the US led to a growing gap between the domestic interests of the US and other industrial countries, which weakened its ability and willingness to maintain the Bretton Woods system. In HST, all these are related with the decline of the US power. But according to HST, in post-1970 period (1971- mid 1980s), the global order would experience fundamental changes caused by a new distribution of power in international system. However, even though there was some temporary disruption, the question of whether a fundamental change in global power occurred in the 1970s is debatable.

Keohane provides an alternative explanation for the global order in the post-1971 period. According to him, the international system may need to be established by the hegemon, but based on international cooperation the system can continue to function without the hegemonic power. This may be used to explain the global order in the post-Bretton Woods system. Even though fixed-exchange rates were abandoned, and the US suffered relative economic decline, the three main bodies of the Bretton Woods still operated because embedded liberalism persisted. After the collapse of Bretton Woods, there was an 'incomplete decline of hegemonic regimes' and the regime principles of Bretton Woods institutions continued (Keohane, 1984:182-5). Keohane suggests, in the international monetary regime, 'despite the fact that explicit, well-defined rules and procedures governing international monetary relations have practically vanished, there has been continuity in regime principle ... [in the trade regime] members of GATT still subscribed in the early 1980s, at least nominally, to the principles of nondiscrimination, liberalization, and reciprocity, though all of these principles had been modified for the less developed countries...' (1984:186-8). As Ruggie indicates, the persistence of embedded liberalism is down to two reasons: one was the 'extraordinary power and perseverance of the United States' and another was that 'multilateralism and the quest for domestic stability were coupled and even conditioned by one another reflecting the shared legitimacy of a set of social objectives to which the industrial world had moved, unevenly but "as a single entity"' (1982:398). It may be concluded that, in the post-1970s period, considering Ruggie reasoning, the persistence of embedded liberalism and the three surviving main bodies of the Bretton Woods in this period to some extent showed the continued American hegemony in global order (Cox, 1981:187). But the global order was kept stable more because the international system did not just represent the interests of the US hegemony but also provided opportunities and brought benefits to other member countries (Cox, 1981; 1987).

Keohane, like the HST theorists, subscribed to the 'declinist' school, but was more

optimistic about the possibilities of international cooperation under embedded liberalism. In contrast, Susan Strange was a notable critic of the 'declinist' school because, as she saw it, these scholars came to the wrong conclusion as to the origins and sources of US hegemony. HST, she argued, ignored the 'alternative ways hegemons exercise power and the alternative uses to which their power may be put' (1987:555). As I have shown, the main source of the American power for Strange is its actual and potential structural power, which helped it to maintain its hegemonic power much longer than predicted. Similarly, in Cox's view, based on its predominant capabilities, the hegemonic power maintains its leadership by building some universal institutions and ideologies, which represent its vital interests whilst giving some satisfaction to the subordinate groups (1996:133). According to Cox, the world order after the World War II was based on the welfare state and the compromise of embedded liberalism. In post Bretton Woods period, however, Cox expected the global order to become more unstable but in a different way than predicted by HST, or by Strange or Keohane. For Cox, the biggest changes in the post-1970s period, came not from the US nor any single rival state or collective of rival states. Rather, under globalisation, power would diffuse to a more globally-oriented capitalist class, involving but not reducible to key political and economic elites in the US and other industrialized states.

3.6 Conclusion

This chapter provides a historical account of global imbalance. Global imbalance is, defined by Rodrigo De Rato (2005), 'constellation of large deficits in one country, with counterpart surpluses being concentrated in a few others'. Global imbalances is a relatively new term, but not a new phenomenon. Since 1885, the world economy witnessed several periods of imbalance. This chapter reviews three periods of global imbalance in history, namely pre-1914, interwar period and in 1965-1971. The main aim of this chapter is to examine the relationship between global imbalance, international financial system and power shifts in global order and to provide a historical mirror to current global imbalance. The very persistent global imbalance in

pre 1914, I argue, was one key cause of collapse of classical gold standard. Because the price-specie-flow mechanism of the classical gold standard indeed helped to correct world prices but encouraged the flow of gold into the industrial countries and the increasing use of capital controls and trade protectionism in these countries, especially the US, France and Germany, in violation of the basic rules of the prewar gold standard. The collapse of prewar gold standard and the World War I that partly related with this collapse of international financial institutions, are seen as critical points in the acceleration of British hegemonic decline.

The global imbalance in the interwar period was far less serious than other episodes of global imbalance, the sum of which peaked at around 2.5% of global GDP. But the interwar exchange gold standard, as the adjustment mechanism in this period, is very important to IPE studies because its re-establishment and then collapse were strongly related to power shifts in the global order. In 1925, Britain first tried to return to the gold standard and by 1926 almost 39 countries had signed up to a new gold standard. But this new gold standard did not work well and could not smoothly adjust imbalances in world economy as the classical gold standard did in the pre-1914 era. Because two linchpins of prewar gold standard - credibility and cooperation – were undermined by changes in domestic politics, especially the rising power of the working class. Moreover, the resurrection of the gold standard certainly contributed to the Great Depression, which weakened the economy of the US, but because of the transfer function of the interwar gold standard, the economies of Europe, especially Britain, were more damaged by this crisis. In September 1931, Britain finally abandoned the interwar gold standard and allowed the devaluation of the pound. With the collapse of the interwar gold standard, the US dollar was more and more widely used in international trade and investment in the late 1930s. The process of power shift was ongoing in this period.

In postwar recovery period, except the US, all other major industrial countries faced the problem of shortage of key imports, most of which could only be supplied by the

US based on its superior rate of productivity. So in the postwar settlement, the US saw themselves as the leading protagonist and in order to play this role effectively the US was very eager to establish a widespread agreement on the principles on which it was to be established. The Bretton Woods system was mainly based on the US's White plan and could be seen as a great victory of the US because it determined the hegemony of the US dollar in the international financial system. The Bretton Woods system fully operated between 1959 and 1968, when it helped to solve three key problems: adjustment, liquidity and confidence in post-war international monetary system. The turning points for Bretton Woods occurred in the late 1960s and the growing imbalance between the US and the rest of world was also a critical reason for its collapse. But the collapse of Bretton Woods system did not lead to the collapse of the US hegemon, which may be related with two aspects. First, if the leading powers in global order can rebuild the international financial system, even facing serious global imbalance, the established or leading power is more likely to maintain its role in the global order, such as the US did in the 1970s that will be discussed in next chapter. Second, compared with former leading powers such as the UK in 19th century, US hegemony related to global order in different and more complex ways.

In sum, the interactions between powers, institutions and global order in global imbalanced periods do not always follow the same paths and there is no clear causal link between global imbalance and power shifts in global order. However, I find that there is a strong link between the global imbalance and international financial system and serious global imbalance often leads to the collapse of established international financial system. This means that global imbalances do not directly lead to power shifts in global order but it applies its influences by bring instabilities to the international financial order. In the next chapter, I will examine the contemporary global imbalance and the role of China in it, especially the interaction between its internal imbalances and external pressures in the post-crisis global rebalancing.

Chapter Four

Global Imbalances in the Post-Bretton Woods Era: the Global Financial Crisis and the Rise of China

4.1 Introduction

In the previous chapter, this thesis examined three key historical phases, or episodes, of global imbalances, which were the pre-1914, interwar and 1965-1971 periods. The purpose of this was to understand the relationship between leading powers, international financial regimes and changes in global order - especially the lessons drawn from the experiences of Britain and the US in managing global imbalances in the 19th and 20th centuries respectively. I argued that the interactions between leading powers, international financial regimes and global order, in the context of global imbalances, did not always follow the same path and there is no clear causal link between global imbalances and changes in global order. However, there is a strong historical link between global imbalance and changes in international financial regimes. Moreover, in the context of global imbalances, if leading powers can maintain or rebuild international financial regimes, it is possible to maintain a hegemonic role in the global order, such as was the case of the US following the collapse of Bretton Woods System in the 1970s as a consequence of the global imbalances in 1965-1971.

Following the historical analysis of global imbalance presented in the previous chapter, this chapter focus on the post-Bretton Woods period, leading up to and including the 2008 GFC and the rise of China. First, this chapter examines the 'Jamaica System which is the international financial system that succeeded and arguably the sources of global imbalances of the late 20th and early 21st centuries. The chapter then introduces and describes contemporary global imbalances and assessed the primary explanations for these. Finally, the chapter examines the global imbalance from China's perspective,

especially the interaction between the global imbalance and China's own internal imbalance, which I argue are directly related to one another and to the pattern of economic liberalisation that China has followed since 1978.

4.2 The Jamaica System and Global Imbalances in the Late 1970s and 1980s

After the collapse of the Bretton Woods system in 1971, the Jamaica System was established in the late 1970s. The Jamaica system was based on the Jamaica Agreement reached in 1976, in which four main changes to the international financial system compared with the Bretton Woods system were negotiated. First, 'floating exchange rates were legalized ... and the determination of the par value of a currency became the responsibility of the country itself' (Gilpin, 1987:141). But the exchange rate policies of member countries were still supervised by IMF to prevent 'beggar thy neighbor' exchange rate policies. Second, it abolished the official price of gold and allowed the central banks of member countries to trade gold on the open market, which reduced the reserve role of gold in the international financial system. Third, IMF quotas were increased by 33.6% from 29.2 billion SDRs to 39 billion SDRs, especially those of Organization of the Petroleum Exporting Countries (OPEC) countries, the purpose of which was to guarantee the solvency of the IMF (Li, 2016:40). Fourth, 'funding for the less developed countries was increased' (Gilpin, 1987:141).

Based on these changes, the international financial system was a regime defined by floating exchange rates compared with its two predecessors and was arguably both more volatile and less efficient as an adjustment mechanism. Under the Jamaica System, there were less tools available that could be used to coordinate adjustments between member countries as this now depended much more on their individual monetary policies. This was reflected in the global imbalances of the late 1970s and in the 1980s. Under the Jamaica system, prior to contemporary global imbalance of the late 1990s and 2000s, the world economy experienced two separate episodes of serious imbalance in the late 1970s and 1980s. It is important to recall the three major

global imbalances discussed in the last chapter were all finally rebalanced by an international adjustment mechanism of an established system or by building a new system. In contrast, the late 1970s and 1980s were addressed merely by manipulating the par values of major currencies but with very limited systemic adjustment. This set the stage for a new set of imbalances in the late 1990s.

The imbalance of 1977-1979 was much smaller than that in the 1980s, in that the ratio of the US current account deficits in its overall GDP was always less than 2% in the late 1970s. But the measure of rebalancing, which was a sharp depreciation of the US dollar, was a more serious problem than the imbalance itself. In the late 1970s, stagflation was the main concern for the world economy. In the mid-1970s, compared with the US running current account deficits, Germany and Japan enjoyed significant surpluses. According to Solomon (1977; 1999), the ballooning of the US balance-of payments deficits led to capital flight from the US that worsened the exchange-rate instability and the stagflation in the US in the 1970s. Then, in the face of declining output and unusually high rates of inflation and unemployment, the US government tried to gain competitive advantage by encouraging the depreciation of the US dollar, which led to price volatility and serious inflation (Solomon, 1999:3-6; Bordo, 2005:15). To respond to this, in 1978 President Carter proposed 'an anti-inflation package', with tighter monetary and fiscal policy, voluntary wage restraints, price controls and regulatory reform to improve competitiveness, to adjust the US internal and external imbalances (Bordo, 2005: 16-17). But the second oil price shock and the Iran hostage crisis put more pressure on the dollar and worsened the inflation and twin deficits of the US. In 1979, the so-called Volcker's 'shock' was introduced, 'involving a rise in the discount rate to 12%, an increase in reserve requirements, and a change in operating procedure away from targeting the federal funds rate towards a non borrowed reserve aggregate' to ease the pressure on the dollar (Bordo, 2005: 17). Scholars indicate that the imbalances of 1977-1979 was far smaller than today but the problem behind it was very serious. As they say, 'the adjustment well reflected the underlying fundamentals' so the depreciating dollar was just the external manifestation of US poor monetary

policies which created the Great Inflation and recession (Bordo. 2005: 17).

Then, in the 1980s, the US again ran large deficits on its current account. The direct reason for this was the substantial appreciation of the dollar from 1979 to 1985. The causes of this appreciation are contested. From the US, much of the blame was heaped on the surplus countries, Japan, Germany and other European countries, for allegedly manipulating the exchange rates of their currencies to improve exports and to support their less open domestic financial markets, thus leading to higher savings rates. But many scholars defend for these surpluses countries and argue that instead the US was to blame, because its huge fiscal expenditure was the root cause of growing imbalances in world economy (Ito, 2009). According to them, between 1980-1985, in order to fight against inflation and to support Reagan's revitalization plan, the Fed's high interest rate policy strongly contributed to the appreciation of the dollar and put pressure on the Japanese yen and deutschmark, which made governments of these surpluses countries defend their currencies. This argument supported by Martin Feldstein's study of the link between the US budget and trade deficits in the 1980s (1992: 1). Then, in 1985, when the trade and current account surpluses of Germany and Japan peaked, while the US ran large twin deficits, the Plaza Accord of 1985 and Louvre Accord of 1987 were concluded. The main aim of these two were to bring down the value of the dollar but this processes was backed up by foreign exchange intervention (Frankel, 2015). As Frankel indicates, in 1985-1987, the dollar depreciated by 40% which improved global trade rebalancing, especially between the US and its main trade partners (Frankel, 2015). Noteworthy here is that the side effects of these two accords directly led to Japan's Lost Decade¹³ and the US stock market crash in 1987. But this mitigation of imbalance in the late 1980s just by depreciating dollars did not fundamentally rebalance the global economy because it did not solve the systemic problem both in the international financial regime and, moreover, in the US domestic financial system, which set the stages for future, and more serious, imbalance.

¹³ Japan's Lost Decade references to two decades of stagnation of Japan's economy since mid-1990s.

It can be seen that the domestic monetary policies of member countries, especially the US, played more important roles in the imbalances, compared to under the Gold Standard and Bretton Woods system. The rebalancing processes of the two episodes of global imbalances in the 1970s and 1980s reflected three important features of the Jamaica System. Firstly, the US dollar was still the most important currency in the international financial system, even though continuously facing challenges from other currencies. In 1977-1984, the share of the US dollar in world official foreign exchange reserves declined from 78% to 65.1%, but the shares of the Japanese yen and deutschmark both increased sharply, from 2.4% to 5.2% and from 9.1% to 12 % respectively (IMF, 1985:54). But this did not fundamentally change the dominant role of the dollar. After the collapse of the Bretton Woods system, the US dollar was still the most important currency of official foreign exchange reserves (COFER), with two thirds of world trade still invoiced in dollars. Moreover, under the Jamaica System, even though the direct link between the dollar and gold was gone, the dollar found other anchor commodities - especially oil - to ensure the preservation its hegemonic role. According to David Spiro, petrodollar recycling should be seen as a 'hidden hand' of American Hegemony in that it underlined the role of the dollar as the anchor currency of the Jamaica system. Moreover, in 'the successful resolution of the disequilibrium in global balance of payments caused by the oil price revolution ... nearly 500 billion petrodollars were recycled from oil producers to countries with trade deficits' (1999:1-6). Based on petrodollar recycling, more commodities in international trade, such as primary products, raw materials and even gold, were dollar-denominated, which further ensured the hegemony of the dollar under the Jamaica system.

However, even though the dollar was still the dominant anchor currency under the Jamaica System, compared with the Bretton Woods system, the diversification of currency reserves constituted a second feature of this new system. As argued, in the 1980s the Japanese yen and deutschmark became more and more significant, not just

in COFER but also in SDRs. Further in the 2000s, the rise of the euro more seriously challenged the dominant role of the dollar. On the one hand, this diversification of currency reserves provided more choices for countries and also to some extent helped to solve the problem of international liquidity. However, it also contributed to instability. Under a diversified monetary system, in order to maintain the stability of the system, international cooperation becomes more important than under a fixed-exchange rate system, with the requirement that major powers need to coordinate fiscal and monetary policies, including exchange rates, supply of currencies, price stability and so on (Mckinnon, 1984). As Mckinnon says, 'the unique American role [under the Bretton Woods system] of providing a reserve currency for the rest of the world would now be shared with the EMS group and Japan [in the 1980s] ... Once America, Japan, and Europe negotiate such an agreement [on their fiscal and monetary policies] and their management of the joint monetary base is seen to be successful, most smaller countries ... would voluntarily decide to fix their own exchange rates to the dollar, mark, or yen' (Mckinnon, 1988: 102). But the rebalancing processes described here shows that when the world economic mood is generally positive and stable, it is far easier to maintain the basic coordination of economic policies than when the mood is negative and unstable, when countries naturally focus on domestic economic interests first and tend to abdicate their international responsibility to maintain the stability of the international financial system. This problem relates to the third significant feature of the Jamaica system - that of the floating exchange rates.

In contrast to the fixed-exchange rate under the Bretton Woods system, the floating exchange rate system defined the Jamaica System. As Mckinnon points out, achieving international agreements was more likely to be much easier under the Bretton Woods system based on its fixed exchange rates system than with floating rates where each central bank more easily acts unilaterally (1988:100-1). Under the floating rate system, the major countries focused on domestic economic development and preferred to take less international responsibility for maintaining the stability of international

financial system. This, in the short term, benefited the development of domestic economies because it freed governments from international responsibilities and they were able to dedicate more resources to improving domestic growth. Most countries considered that improving the domestic economy was the basis of stability of the international system. But as Gilpin argues, under the Jamaica System:

‘domestic autonomy had triumphed over international rules; national disengaged from the requirements of a fixed-exchange system in order to pursue one or another national objectives such as expanding exports, stimulating economic activities, or preventing the importation of inflationary pressures ... Jamaica was silent on such critical aspects of a stable international monetary order as adjustment and liquidity. In effect, each nation was free to determine monetary matters for itself rather than subordinate to international rules ... the dilemma of national autonomy vs. international norms appeared to have been resolved in favor of the former ... The abandonment of Bretton Woods and the system of fixed exchange rates meant the loss of international financial disciplines’ (1987:141-2).

For instance, the US adopted a high exchange rate policy to attract international capital in 1980-1985 but when this resulted in it becoming the world largest debtor in 1985, it allowed the dollar to continuously depreciate to reduce its dollar-denominated debts. In the early 1980s, in order to improve its export performance, the Japanese government kept the yen exchange rate at a low level and, during the 1997 Asian Financial Crisis, it allowed a sharp depreciation of the yen to reduce Japan’s pressures but totally ignored that this policy would deepen and also transmit the crisis to its trading partners. In summary, under the Jamaica system, compared with previous international financial regimes based on fixed exchange rates, the domestic policy choices of state actors became crucial, which is something that proved to be a significant factor in the global imbalances of the late 1990s and 2000s.

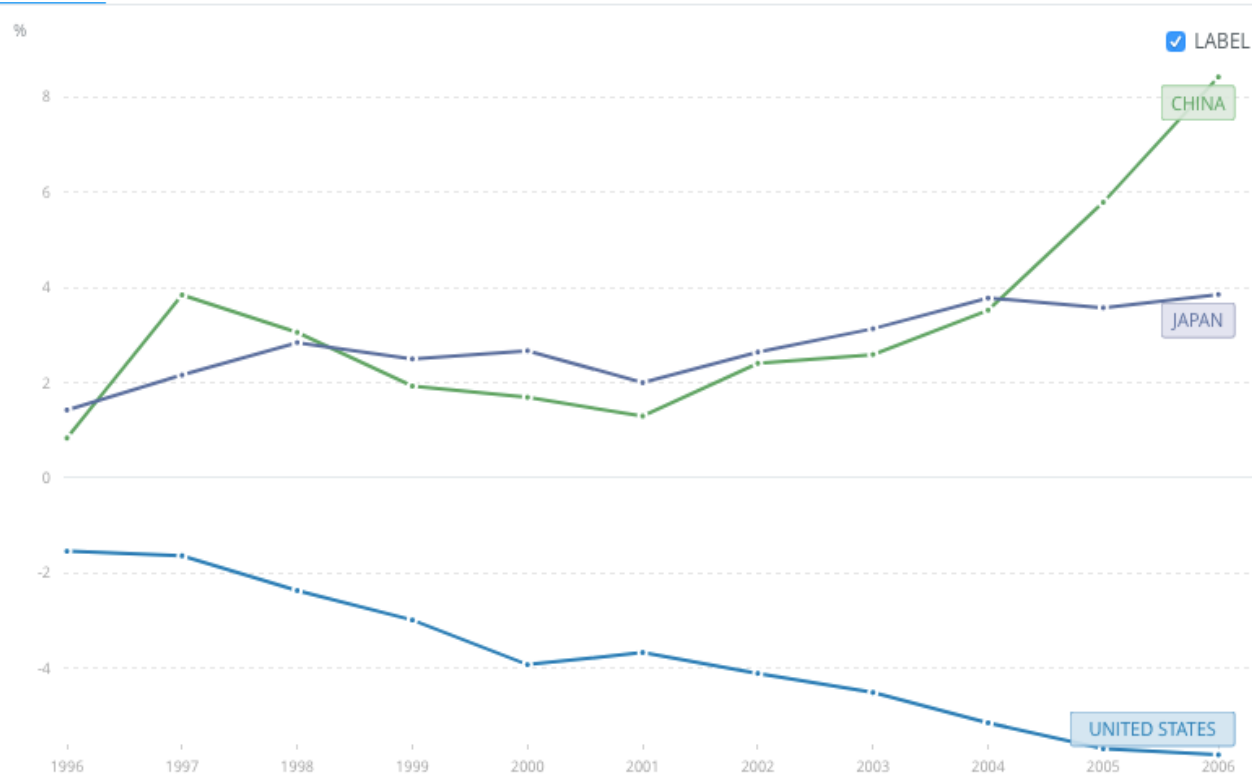
4.3 Contemporary Global Imbalances and 2008 Global Financial Crisis

As I have argued, the mitigation of imbalance in the late 1980s, principally depreciating dollars, did not fundamentally rebalance the world economy but set the stage for future, and more serious, imbalances. Current global imbalances can be traced back to the late 1990s and have worsened since. Very similar to the imbalances in pre-1914 period, the current period is characterized by its 'large size and greater persistence of current account imbalance' for both the principal capital exporters and recipients (Bordo, 2005: 8; Bordo, Eichengreen and Kim, 1998:14). In the 1980s, the ratio of stocks of foreign capital (including assets and liabilities) to GDP for selected countries experienced a sharp increase, which reached the prewar level in 1985 and then again in 1995, this number already went to 57%, surpassed the level of 1910s (Obstfeld and Taylor, 2004:51-56). The data of liabilities also shows a similar pattern, which was just 11% to global GDP in 1938 but peaked in the 1990s at approximately 50% (Obstfeld and Taylor, 2004: 50-52). In 2004, the ratio of the US current account balance in its overall GDP reached -5.145% and -5.8% in 2006. In contrast, China and Japan ran large surpluses on their current accounts, at 8.4% and 3.9% GDP respectively (see Figure 4.1).

Most scholars agree that contemporary global imbalance is very serious, but there are various explanations for the persistence and size of these imbalances. Some scholars try to understand the global imbalance from the perspective of the international monetary system, such as in the 21st century version of the 'Triffin Dilemma' (see Smaghi (2011), Campanella (2010), and Barredo-Zuriarrain (2016)). In other words, the imbalance is due to the contradiction between increasing currency demands in the context of growing world economy and domestic policy incentives of reserve issuing/holding countries. Some other factors need to be considered also, including demographics (see Higgins and Williamson (1997), Henriksen (2002) and Ferrero (2005)) the global division of labour (see Barattieri (2014), Bracke et. al. (2010), Legg et. al. (2007)) and the relationship between national productivity rates and current account imbalances (see Bussiere et al. 2005). However, these mainstream

explanations are all focused on the economic policies of major countries, especially the monetary policies of the US and rising Asia. Noteworthy here is that many factors considered as the causes of this imbalance are often strongly related with some other factors, such as the strong link between savings gluts and changes in demographics. In other words, monetary policy is the key for many of the prevailing theories of global imbalances. I examine some examples of these below.

Figure 4.1 Current Account Balance (% of GDP) in 1996-2006 of the US, China and Japan.



Data from: the World Bank database

First, the explanations from the perspective of exchange rate policy are one of the most widely used in Western academia, especially in the US. This perspective declares that the appreciation of the dollar against other currencies is the main cause of the global imbalance; and that, under the same growth rate, the dollar will continue to appreciate and the US current account deficits will continue to grow also. According to a simulation by Obstfeld and Rogoff, 'in which Asia's, Europe's, and the United

States' current accounts all go to zero ... implies that the dollar needs to depreciate in real effective terms by 33 percent ... [but compared] the real value of Asian currencies would need to rise by 35 percent and that of European currencies by 29 percent against the dollar.' (2005:73). Krugman argues the Chinese government pursued the 'most distortionary exchange rate policy' that damaged the rest of the world, especially the US (New York Times, March 14, 2010). Krugman goes on to suggest the renminbi is undervalued by '20-40%' and this should be taken more seriously by the US considering the lessons from foreign undervaluation in 1971 (New York Times, March 14, 2010). Obstfeld and Rogoff, meanwhile, suggest that 'China's ability to sterilize the immense reserve purchases it placed in US markets allowed it to maintain an undervalued currency and defer rebalancing its own economy ... Complementary policy distortions therefore kept China artificially far from its lower autarky interest rate', compared the US with a significantly higher one (2009:42).

This school further indicates that the large current account deficit of the US is unsustainable and rebalancing is necessary, not only for the US but the rest of the world also, especially rising Asia. According to Obstfeld and Rogoff, they argue that within the next 5-10 years, the US' current account deficit required a rapid turnaround, to avoid damage. They also reject the view of scholars who argue that large current account deficits are less problematic today because of the integration of global asset and goods markets. Here they point to evidence on prices, trade and macroeconomic data to show that the large US current accounts deficits 'have enormous nominal exchange rate effects' and thus the relative prices of the US and foreign goods in the short run (Obstfeld and Rogoff, 2000:2-3). Moreover, in the medium term, 'the inevitable of reversal of today's US current account deficit can potentially have a substantial real exchange rate impact', and if the US current account suddenly go into balance may lead to a short-run real exchange rate impact in excess of 24%, so a gradual rebalancing within 3-5 years will be a better choice, the effects on real exchange rate would be around only 12% (Obstfeld and Rogoff, 2000:3-4). But if the large current account of the US cannot be rebalanced in the medium term, it will lead

to a sharp depreciation of the US dollar in the long term, which will bring great risks to the world economy, which, they say, looks increasingly possible (Obstfeld and Rogoff, 2004).

Roubini and Sester also support the opinion of Obstfeld and Rogoff and as they say, current global imbalance has strongly threatened the stability of international financial system and growth of world economy and will finally lead to a destructive adjustment, which refers to a sharp depreciation of the US dollar, collapse of dollar assets and a greatly decline in capital inflow in the US (2004: 2-8). This kind of destructive adjustment will lead to the increase in interest rate of the US and decline in US's demand, which will cause the global slowdown or even recession of the US and world economy. So 'pulling off the adjustment needed to unwind the current US external deficit smoothly will be a major policy challenge, both for the US and the world' and moreover, if it starts to rebalance sooner, it will be easier for a more smooth adjustment (Roubini and Sester, 2004:6). In 2005 they forecasted that if does not take any policies to revise the US deficits, the US will need more and more financing to maintain its large deficit which will finally be beyond the abilities of foreign central banks and then trigger a hard landing within two years (which will be 2007 as they means) that has been proven by the 2008 GFC.

Second, some scholars consider the saving rate as the key factor in the global imbalances, the most prominent being the so-called 'savings glut' school. This school points to the savings glut, or excess savings, of emerging-market nations, especially China, as the main cause of global imbalances. As Bernanke (2005) points out, US current account deficits are strongly linked to its low saving rate compared to surplus countries. This savings imbalance, or glut, is a consequence of three factors: the aging population and dearth of domestic investment opportunities in high-income countries; the sharp rise in oil prices in the early 2000s; and, most importantly, the new strategies of emerging-market nations, especially China, shifting from importers of financial capital to net exporters through the accumulation of large foreign reserves.

Corden (2012) argues that the imbalance is related with the increasing savings all around the world, which should be seen as the main cause of the GFC. The growing domestic savings in these surplus countries, especially China, led to a decline in world interest rates, cheap money and excess borrowing and high risk taking by financial institutions in deficit countries, especially the US (2005: 431-2).

Caballero, Farhi, and Gourinchas (2008) indicate that the inability of saving glut countries to generate sufficient local store-of value instruments needs also to be considered. According to them, global equilibrium is strongly related with excess global liquidity. They point out that the major industrial countries, including the US, the UK, Japan and the EU, are the supplier of financial assets to savers countries, especially China, plus other emerging-market and oil-exporting countries, whose accumulation of reserves and high saving rates, with there is a fast growth in 'with their inability to generate sufficient local store-of-value instruments', increased their 'demand for saving instruments' from major industrial countries (Caballero et al, 2008: 358-362). This led to current account deficits in developed countries, especially in the US because of the sharp increase of US assets in global portfolios, which stood at 17% of total global wealth in 2004 (Caballero *et al.*, 2008:358-362). They conclude that the lower growth rates of Japan and the EU countries, and less ability to generate sufficient local instruments of saver countries, generated larger current account deficits in the US, higher percentages of the US assets in global portfolios and lower real interest rates (Caballero et al, 2008: 358-362).

Compared with the 'twin deficits' school that sees excess savings in surplus countries as less important than insufficient savings in deficit countries (see Chinn and Ito (2007), Ito (2009) and Mann (2002)), the 'savings glut' school more see the US current account deficit as a problem caused abroad. As Bernanke (2005) puts it, 'the key reasons for the large U.S. current account deficit are external to the United States, implying that purely inward-looking policies are unlikely to resolve this issue'. Compared with the 'exchange rates' school reviewed earlier, the saving gluts school considers that, even

though the large global imbalance are not sustainable at pre-crisis levels, it should expect a more gradual and longer process of rebalancing. Moreover, the efforts from the surplus countries to reduce their preferences for savings over consumption and/or investment, are said to require strongest domestic financial institutions (Bernanke, 2007: 6; 2005). Bernanke further indicates that, in order to reduce the excess savings of China especially needs to 'move away from export dependence toward greater reliance on domestic demand' (Bernanke, April 1st, 2015). This is not just important for global rebalancing but also for maintaining sustainable economic growth of the US in post-crisis era.

Finally, there is the so-called 'Bretton Woods II' of Dooley, Landau and Garber. In their article, 'An Essay on the Revived Bretton Woods System', Dooley, Folkerts-Landau and Garber claim that the current global system has a 'single dynamic structure' similar to the 1950s under Bretton Woods (2003:1). As they say, under Bretton Woods in the 1950s, the US was 'the center region with essentially uncontrolled capital and goods markets' that allowed it to lend long term to the periphery, including European industrial countries and Japan, generally through FDI. The EU and Japan, as the emerging periphery, embraced the policies of devaluation of currencies, controls on capital and trade, reserve accumulation to lend credibility to their own financial system (Dooley et al, 2003: 1). In today's global system, the US-Europe-Japan forms the center and rising Asian become the periphery countries in this structure, which are following similar policies to the European countries and Japan did in the 1950s. Dooley et al. declare that these Asian countries, including China and India, enjoy the benefits from the center countries with open trade and capital markets, but support their export-led economies by undervaluing the currencies, controlling reserves and trade, all of which contributed to sharp rise of global imbalance (Dooley et al, 2003:2-3). Based on these observations, Dooley et al (2003) then point out that rising savings in Asian countries should be taken seriously as another reason for the global imbalance, which is due to their export-led strategies and accumulation of foreign reserves. But noteworthy here is that, even though Dooley et al seem to share the assumptions of

the exchange rate school, Bretton Woods II disagree statement of exchange rate school that the policy choices of these periphery countries will damage the world economy, because Bretton Woods II consider that the US also benefits from the increasing reserves of emerging powers.

They indicate that, comparing rising Asia today with Europe in the 1960s and Japan in the 1980s, the periphery strategy is likely to be followed by emerging-market economies in the future. So growing US deficits should be seen as a key feature of this system but not a serious challenge to dollar hegemony. This new version of Bretton Woods system is, for them, both stable and sustainable (Dooley et al, 2003; 2004; 2009). According to them, if isolated, any assessment of policy of accumulating reserve in emerging Asian countries would conclude this is a damaging strategy. However, if seen from the point of view of internal development, the strategy can be seen to have merit (2004:1). Considering the abundant labor resources in these emerging Asian countries and increasing domestic demand for capital in the US, they see the current imbalances as sustainable (2004:1-9). Even after the 2008 GFC, Dooley et al still insist that this crisis did not prove the unsustainability of current imbalance as, for them, the net capital inflows to the United States did not cause the crisis (2009). Furthermore, if the GFC had heralded the collapse of the international monetary system under Bretton Woods II, it would have led to the crisis for the US dollar, with the rest of the world ceasing financing the US and the interest rates of all dollar asset. But none of this came to pass, instead, surplus countries continue to finance the US current account deficits, even after the crisis (Dooley et al , 2009).

As argued, the 2008 GFC was a turning point for contemporary global imbalances, after which the deficits of the US sharply reduced, even though most scholars saw global imbalance as a key driver of the GFC. Obstfeld and Rogoff maintain that the GFC and global imbalances are intimately connected, which, as they say, 'the global imbalances posed stress tests for weaknesses in the United States, British, and other advanced country financial and political systems – tests that those countries did not pass'

(2009:4). But they also argue that the global imbalance was not a direct cause of the 2008 GFC, but both originated primarily in flawed economic policies. According to them, both deficits and surplus countries face little pressure to adjust. According to Howard Davies, this is because the weaknesses in the international financial system, which allow 'a country that issue assets which have reserve status around the world [such as the US] can finance current account deficits for an extended period ... a country facing upward pressure on the value of its currency can manage its exchange rate to resist such pressure and delay adjustment in its balance of payments' (2010:18). As the largest deficits country, the ability of the US to 'finance macroeconomic imbalances through easy foreign borrowing allowed it to postpone tough policy choice' (Obstfeld and Rogoff, 2009:2). The big appetites of foreign banks for the dollar assets further provided an external source to support this postponement (Obstfeld and Rogoff, 2009:2-3). Also surplus countries feel less pressure to adjust, like China, its ability to 'sterilize the immense reserve purchases it placed in US markets allowed it to maintain an undervalued currency and defer rebalancing its own economy' (Obstfeld and Rogoff, 2009:2-3). Caballero and Krishnamurthy (2009) may disagree with this argument because they admit that global imbalance drove the US securitization boom and bust. Even though that there are different arguments about the relationship between global imbalance and the 2008 GFC, there is no doubt that this shone a light on the international financial order.

Since the 1990s, the rapid growth of world economy was fuelled by debt-financed consumption in the US. The large debt-financed consumption of the US furnished the export-led economies of emerging markets, generating surplus abroad and deficits at home. At the same time, these emerging countries accumulated dollar reserves, which are recycled through the US's deep financial markets and hence support and then invest these dollars in American capital debt-financed consumption. The persistence of this dynamic has several aspects to it. On the one hand, there is the dollar primacy in the current international financial system, which according to Bergsten allows 'Americans to live beyond their means, as exemplified by the cheap Chinese goods at

Walmart, affordable vacations on the French Riviera, and US budget deficits financed by Middle Eastern countries' (2009:23). On the other hand, the US' low interest rate policy helped encourage its debt-financed consumption. These aspects need, however, need to be considered in the wider systemic setting of the international financial system.

First, under the Jamaica System the diversification of currency reserves and floating exchange rates provided more opportunities for international capital speculation. The Jamaica System went hand in hand with financial liberalisation and innovation, which became central to economic growth, especially in the US. However, these innovations have also contributed to a serious disconnect between the real economy and the financial economy. As Strange indicates, with the rising of globalization, the phenomenon of 'finance calls the tune', as she called it, becomes more and more serious, which means that the real economy of manufacturing is more controlled by financial economy (1998:179-180). Then she further indicates that owners of international financial capital are taking over the control over economies and societies from governments of states (1998:180). Even worse is that the mergers and acquisitions driven by international financial capitals will cause the economic concentration and then widen income gaps between small and big business and also between states (1998:180-182). But governments have lost their way on this because policies making is controlled by international financial capital and this cause moral contamination of international system (1998: 181).

The rapid growth of the financial sector continued because of high yields. In the US, since 1985, the profits of the financial sector have consistently accounted for more than one third of US domestic corporate profits, percentage peaking in 2012 at 44% (Khatiwada, 2010:2). As Gourinchas and Rey (2005:1) put it, the high profits of the financial industry led 'the US transferred itself from the world banker to world venture capitalist, investing greater amounts in high yield assets such as equity and FDI'. This transformation helps to explain the eagerness of surplus countries like China investing

in US government bonds and private investment vehicles while attempting to lure American FDI. But the downside of this situation for the US has been the 'offshoring' of the American manufacturing, exacerbating its twin deficits and contributing to rising economic nationalism that lay the grounds for the election of Donald Trump as president.

Moreover, the Jamaica System has become synonymous with heightened capital mobility, financial innovation and financialisation of corporate debt, credit markets, pensions and welfare, among other sectors. As Susan Strange (1988a) pointed out in the 1980s, although financial innovation was largely driven by the rise of MNCs and technological change, it was also dependent on the decisions (and non-decisions) of sovereign nation-states. However, as she argued, because the US, as the global hegemon, was the principal beneficiary of financial liberalization because of the reserve status of the dollar alongside the depth and sophistication of its financial markets, it had little incentive to prevent it. But the system problems with financializing - the dependence of the US (and its trading partners) of American debt-financed consumption was vividly exposed by the GFC. In terms of its domestic economy, in the post-crisis period, the asset-liability structure of American households and financial institutions has felt greater pressure to adjust, with knock-on effects aggregate world demand producing a lasting global 'credit crunch'. Since the 1980s, household indebtedness in the US grew sharply with the ratio of private debts to GDP increasing from 123% in 1981 to its peak of - 295% in 2008; meanwhile, the percentage of household debts to GDP went from 48% in 1981 to 100% in 2008 (*Financial Times*, February 17, 2009). After the financial crisis, most American families were forced to increase their saving rate and reduce consumption. As Figure 4.2 shows, the US personal saving rate experienced a sharp increase in the post-crisis era, from 2.6% of *disposable personal income* (DPI) in 2005 to 7.6% in 2012, which was the highest level since 1992. Considering the US' status as the largest market and hitherto the engine of the world economy, and that the contribution of private consumption to American economic growth is around 60% to 70%, this domestic adjustment had a significant

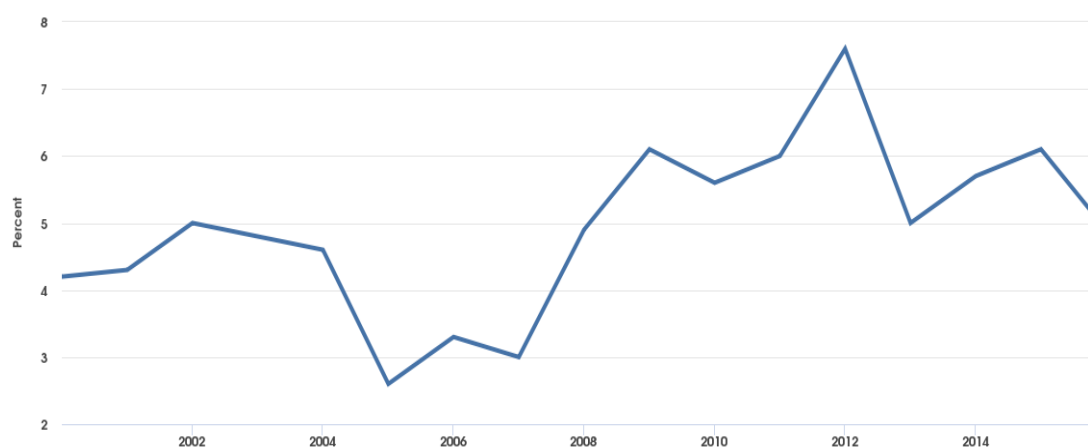
effect on aggregate world demand.

In the financial sector, it was a similar story. As the basis of American debt-financed consumption, the gross debt of the financial sector rose from 22% of GDP in 1981 to 117% in 2008, while the debt of non-financial corporations rose much more slowly from 53% to 76% (*Financial Times*, February 17, 2009). According to a IMF report in 2009:

‘credit write-downs on U.S.-originated assets by all holders since the start of the crisis will total \$2.7 trillion ... including assets originated in other mature market economies, total write-downs could reach \$4 trillion over the next two years, approximately two-thirds of which may be taken by banks. Overall credit to the private sector in the advanced economies is thus expected to decline during both 2009 and 2010. Because of the acute degree of stress in mature markets and its concentration in the banking system, capital flows to emerging economies will remain very low’ (2009: xi).

In sum, in the post-crisis period, continuous pressures on the balance sheet of financial institutions led naturally to a long lasting global credit crunch.

Figure 4.2 Personal Saving Rate of the US from 2000 to 2015 (percentage of DPI)



Source from: U.S. Bureau of Economic Analysis

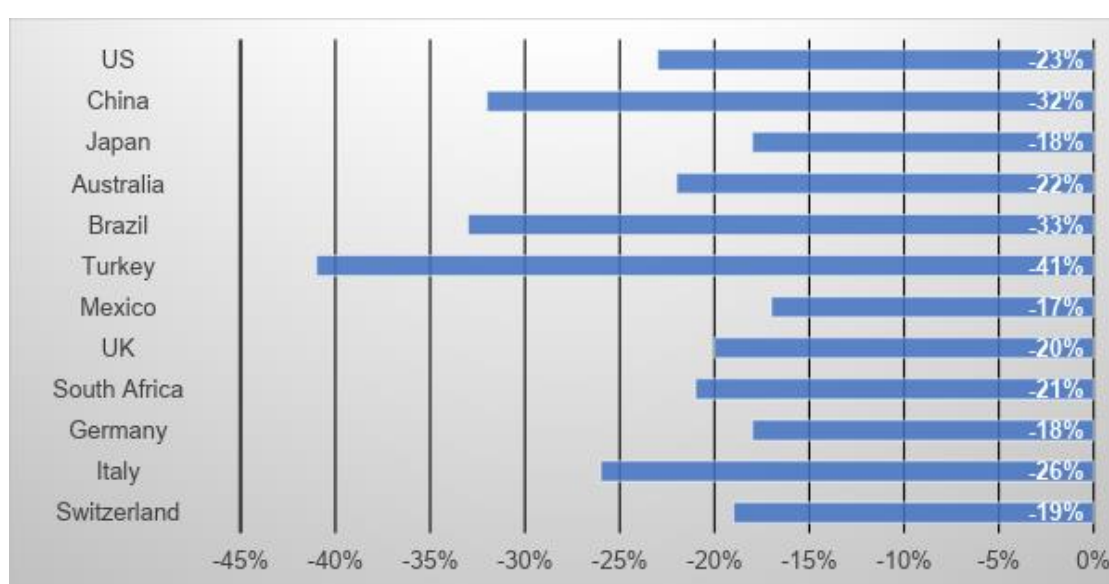
4.4 China's Internal Imbalances in Post-Crisis Era

As argued, scholars have not reached a consensus on the causes of contemporary global imbalances and the relationship between these imbalances and the 2008 GFC. However, most of them recognize that China is key actor in these imbalances. Mainstream scholars have considered the causes of global imbalances from various aspects, but the dominant view is that US deficits are not simply a domestically created problem but one which has systemic roots. China is often the centre of these systemic explanations and is typically viewed as a free-rider, or at least the principal beneficiary of the global imbalances. The politically corollaries of this is the charge that China is pursuing policies of trade mercantilism and currency manipulation, with international pressure designed to force it to open up and reform its trade and monetary policies reminiscent of the charges laid against Germany and Japan in the 1970s and 1980s. Yet China's own internal imbalances are rarely considered in narratives - nor the fact that China possesses independent motives for correcting these external and internal imbalances.

Since the reform and opening-up process began in 1978, China has achieved significant economic development but, with this, the 'model' of China's political economy has attracted more and more international attention. China's model of economic development is recognized as a government-led market economy characterized by its foreign investment- and external trade-orientation. With 40 years of development, leading to a substantial increase in investment and savings rates, growing proportion of trade in GDP, China now is facing several imbalances in its political economy. As Thomas Palley concludes, there are two schools of China's imbalance. One he calls the 'internal contradictions' school, which points out that China's over-investment and fixed exchange rates are leading to domestic financial instability and inflation (2006:70). The other he calls the 'external contradictions' school, which indicates that China's export-oriented economy will lead to deflationary consequences (2006:71).

Even though the two schools have different ideas of what triggered the crisis, both agree that without a rebalancing, China will face a high risk of a very hard economic landing. In other words, the imbalanced Chinese economy is a big challenge to the sustainable development of China - which may ultimately threaten the stability of China's political economy, especially its top-down design system and one party political system.

Figure 4.3 Collapse in World Trade (Change in Monthly Trade Flows Between October and December 2008)



Source from: Baldwin and Evenett, (2009)

Especially in the post-crisis era, with the slowing down of the world economy and the reduction of world demand and a global credit crunch caused by the adjustment of the American economy, China's trade-oriented and investment-oriented model has faced more challenges. Moreover, the anti-globalization/anti-deregulation/economic populist movement has triggered the rise of protectionism in world trade and international finance, which may further expose China's internal imbalances. According to Baldwin and Evenett, the G20 Summit in November 2008 'pledged to refrain from raising new barriers to investment or to trade in goods and services, imposing new export restrictions, or implementing World Trade Organization (WTO) inconsistent measures to stimulate exports and agreed to strive to reach agreement

this year on modalities that leads to a successful conclusion to the WTO's Doha Development Agenda' (2009:1). But it did not contain rising protectionism (see Figure 4.3) and, even worse, with continuous recession or weak recovery this trend in trade and finance, if anything, strengthened.

Baldwin and Evenett point out that 'governments' crisis fighting measures have spawned new, murkier forms of protection which discriminate against foreign firms, workers and investors – often in subtle ways' (2009:2). For example, in 2009, America's 787-billion-dollar economic stimulus package was put in place but the proposed 'Buy American' provision in this package, which breaches the principles of the WTO, triggered an escalation of international opposition to US plans. In 2016, the protectionist Donald Trump became the US president and strongly blames China for its large trade surpluses with the US, increases the risk of trade war between the US and China. EU Commission's report (2016:2) also shows that 'the stockpile of trade restrictive measures adopted [in 31 EU trade partners] since 2008 continues to increase, although at slightly slower pace than in previous years'. Noteworthy here is financial as well as trade protectionism. Financial protectionism is not just driven by the logic of the market that 'banks that have lost confidence and capital in the credit crunch are retreating to the home markets they know best' (FT, February 2, 2009). But also, political pressure in the post-crisis period has meant financial institutions seriously hit by the financial crisis and 'bailed out by national taxpayer', came 'under political pressure to lend at home rather than abroad' (FT, February 2, 2009). As the FT puts it, state aid is a form of protectionism.

In short the rise of protectionism in trade and finance constitutes a threat to China's trade-oriented and investment-oriented economy - creating a further push for China to address its external and internal imbalances. In the next chapter, I examine this imbalance as a function of challenges to China's political economy¹⁴. These are:

¹⁴ The section of China's four internal imbalances draws on a paper written by me and presented at the Hallsworth Conference: China and the Changing Global Order in 23-24 March 2017, Manchester.

1) External versus domestic demand and investment versus consumption

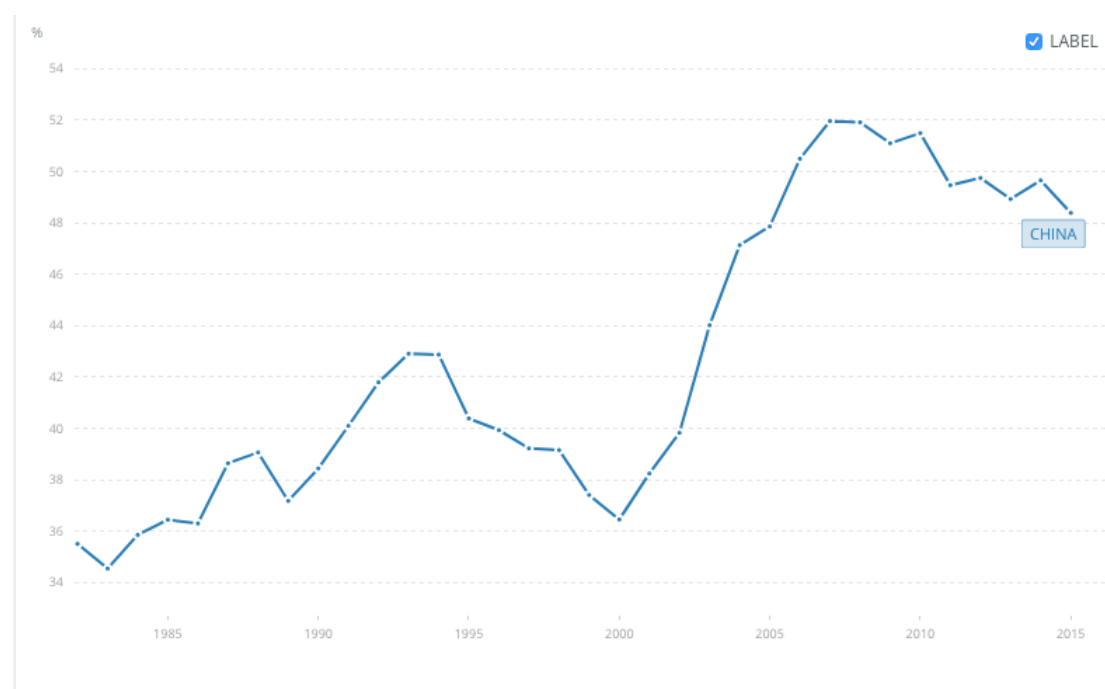
As argued, external trade-orientation is one of the main characteristics of China's economic model. According to data from 1985 to 2015, China's export rises from 80.89 billion to 14120 billion RMB - an average annual growth rate of China's export of goods of about 25%, that is, about 8% higher than that of GDP¹⁵. Trade plays a significant role in China's economic development. From 1986 to 2008, the average annual contribution of net exports to GDP was about 15%, and it reached a peak in 2007 of 29.6%. Even though after the 2008 GFC, due to weak global demand and China's economic restructuring, this number is decreasing, the imbalance between external and domestic demands is still serious. According to Thomas Palley, China's economy is a clear export-led growth that can be seen in its statistics, which is, in 2000-2003 the average annual growth rate of exports was 22.9% but that of GDP was just 9.2%. This difference even bigger in 2004 - 9.5% of GDP but 35.4% for exports (2006:79). Palley further points out that Chinese export-led growth 'is reliance on exports as a source of final demand', which makes China's economic growth principally dependent on the demand of the US market. In these circumstances, China's imbalanced model represents a source of financial instability (2006: 77-8). Scholars, such as Dooley et al (2003) criticise China and other emerging Asian countries for their use of policies including undervaluing their currencies, controlling reserves and trade to improve their export-led economies. Just as Palley indicates, China's trade surplus is a vulnerability because it rests heavily on US consumption (2006:80).

Facing increasing levels of interdependence of external markets, since 2000 China has committed itself to expanding its domestic demand, but the outcome of this effort is mainly the expansion of investment demand, which has worsened the imbalance

¹⁵ All data of China in this paragraph is from National Bureau of Statistic of China online data base. Available from: <http://data.stats.gov.cn/english/>. Access in: December 2016.

between investment and consumption. In China, the high investment rate is related with its high saving rate. Many western scholars, such as Bernanke (2005) and W. Max Corden (2012), sharply criticise China's high saving rates and even indicate that the saving glut between China and advanced economies are the keys to understanding China's surpluses and one main cause of global imbalance, which will seriously challenge the global recovery in the post- crisis era. It is true that the savings rate in China (<20%) is much higher than that in advanced economies¹⁶. As Figure 4.4 shows, in China saving rates have increased rapidly from 35.5% in 1982 to 48.6% in 2015. In 2007, this number reached peaked at 51.9%.

Figure 4.4 Gross Savings of China From 1982 to 2015 (% of GDP)



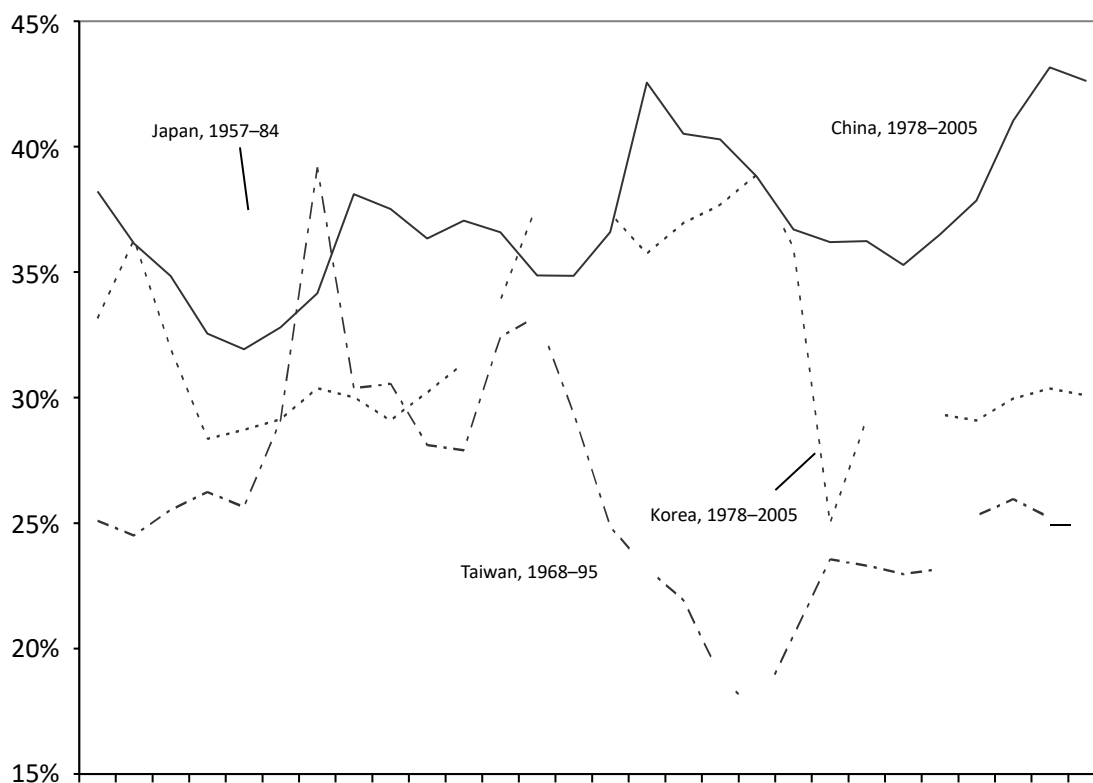
Source from: The World Bank database

According to Nicholas Lardy, the high national saving rate in China has fuelled the rapid growth of investment. While China's East Asian Neighbors also experienced high investment rates in their development period, in 2004 and 2005 China's investment rate accounted for 42 percent of GDP - 'a level well above the historic experience of

¹⁶ Data about saving rates are from the World Bank online databases.

China's East Asian neighbors in their high growth periods' (see Figure 4.5) (2006:2-3). Martin Wolf, the chief economics commentator for the Financial Times, also indicates 'this extraordinarily high level [of investment rate] is hard to justify as growth slows ... is [also] associated with explosively rising debt and falling growth in total factor productivity, a measure of technical progress. Such a path is unsustainable' (see Figure 4.6) (Financial Times, March 22, 2016). The worse is that the debts of non-finance corporates, especially of manufacturing industries – the central pillar of the trade-oriented Chinese economy - increased most rapidly. This seriously challenges the stability and sustainable development of the Chinese economy and even the legitimacy of China's political authorities.

Figure 4.5 Capital Formation as Percent of GDP

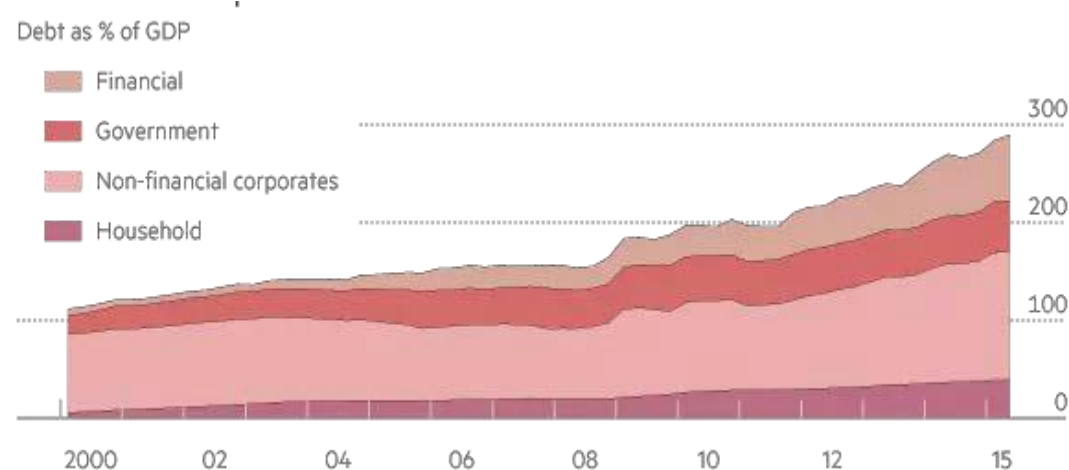


Source From: Lardy (2006)

Compared with China's high saving rate and investment rate, its consumption rate is

quite low, just 62% of GDP and much lower than world average 78% in 2000¹⁷. Even worse is that this rate kept decreased to just 48% in 2007. The main reason for this is the rapid decline of resident consumption, especially the rural resident consumption that fell from 30.3% to 9.1%. Even though this may be related to China's urbanisation, the decreasing of rural resident consumption is much faster than the pace in urban areas. The imbalance between investment and consumption has restricted the sustainable economic growth of China. Actually, the Chinese government also realizes the seriousness of the imbalance of China's economy. As Lardy indicates, there are four motivations for Beijing to make a transition toward more consumption-driven growth: 1) the threat posed to China's reform of developing a commercially oriented banking system in recent years; 2) the problem of excess capacity and falling prices of state-owned banks; 3) the trend to commercial banks insolvency; 4) trade and investment oriented growth lead to large trade surplus that 'raises the prospect of a protectionist backlash in the United States and other important markets for Chinese exports' (2006:5).

Figure 4.6 Debt As % of GDP



Source from: Financial Times, March 22, 2016

¹⁷ Data of consumptions of China are from National Bureau of Statistic of China online data base (see note 14).

Date of world consumptions are from World Bank global consumption data. Available from: <http://datatopics.worldbank.org/consumption/>.

2) China's 'twin surpluses' and excessive growth of foreign exchange reserves

The 'twin surpluses' refers to trade and capital account surpluses, the latter due to a net inflow of FDI. China's twin surpluses can be seen as an inevitable outcome of its trade and investment oriented model of development. As Palley concludes, China's market reform amounts to a capital accumulation strategy by attracting FDI and promoting exports (2006:71). Morris Goldstein and Nicholas Lardy agree on this point. They indicate that Beijing indeed tries hard to solve the 'overheating' problem - caused by overlending and overcapacity - mainly by using administrative controls. However, they point out that administrative control is not a wise choice to rebalance China's external imbalance because reducing overheating will lead to slowing down of growth of imports thus increasing the current account surplus (2004:8). According to them, China's low interest rates and undervalued currency are responsible for the overheating, which is Beijing's strategy to improve China's export-oriented economic growth (2004: 8-10). Actually many western scholars indicate that because of 'twin surpluses', compared with advanced economies, especially the US, China has benefited most from global imbalances. As Krugman indicates, 'China, by engineering an unwarranted trade surplus, is in effect imposing an anti-stimulus on ... [other world's largest economies], which they can't offset ... Chinese currency policy is adding materially to the world's economic problems at a time when those problems are already very severe. It's time to take a stand' (New York Times, March 14, 2010).

China's twin surpluses necessarily lead to the growth of foreign exchange reserves (FER). In November 2016, China's FER was 3.0105 trillion dollars, accounting for about 30% of China's GDP. Even though it was much less than that in 2014 (3.99 trillion dollars), it still was the highest in the world and about three times the FER of second-placed country: Japan¹⁸. In Jan 2017, about 65% of China's FER was believed to the US

¹⁸ Data of China FER from the State Administration of Foreign Exchange of China, available from:

dollars and 35.06% of China's FER was US Treasuries¹⁹. In other words, China's FER is very sensitive to the volatility of the value of the dollar and price of US treasuries, which seriously challenge the hedging of China's FER. It can also show that at least one-third of China's FER is recycled back to the US to provide sustainable boosts to US consumption. Moreover, the US dollar market is the only one that can accommodate China's huge FER so it may be said that China's FER is 'kidnapped' by the US dollar. The essential reasons for this situation: one is the dominance of the US dollar in international financial and trade system, and another is the low level of internationalization of RMB. So a lack of influences in the global financial system, combined with large FER, threatens China's financial stability and independence.

3) The imbalanced industrial structure

In China, the imbalance of the industrial structure may be seen as a necessary outcome of its trade and investment-oriented development model. This imbalance can be seen in two aspects. One is that, for a long time, manufacturing has played the dominant role in China's economic growth. For example, in 2009, the contribution rate of manufacturing to economic growth was about 55%, and about 50% of GDP²⁰. Even though that it may show the successes of China's industrialization, it cannot be ignored that China is facing the economic structure characterized as weak agriculture, low added value manufacturing and underdeveloped service industries. Even though, with the economic restructuring since 2013, service industries in total GDP is increasing and superseded manufacturing for the first time in 50% in 2015. But the quality of service industries needs to be much further developed. Moreover, emphasis on the development of service industries does not mean the less importance for

<http://www.safe.gov.cn/wps/portal/english/Data>. Data of Japan FER from IMF online database.

¹⁹ Data of the US treasuries from the US Department of the Treasury publish: <http://ticdata.treasury.gov/Publish/mfh.txt>. Calculated by author.

²⁰ Data of China from the National Bureau of Statistic of China online data base (see note 14).

manufacturing in the Chinese economy. Particularly in the post-crisis era, the revival of manufactories is also to be seen as the key to economic recovery and re-stimulating economic vitality.

In China, the rapid growth of manufacturing can be characterized as 'three highs' (high input, high consumption, high pollution) but with 'two lows' (low efficiency, low value added). However, this model now faces several challenges. For the 'three highs', the first problem comes from the supply of land and labor. Facing rapidly rising land prices and short supplies of cheap labor, especially in the most developed south-east areas of China, such as Guangdong and Jiangsu, the firms are experiencing a rapid growth in costs. The shortage of resources is another challenge. Calculated by total reserves, China is a resource rich country, but it suffers a per-capita lack of resources. This shortage is further worsened by the high consumption mode of development and increases the conflicts between industrialization and urbanization. Moreover, with economic development and urbanization, severe environmental pollution has caused great economic losses, endangering the health of publics and even threatened social stability. For example, China's central and local governments all face big pressures to solve the problem of haze, which has become a pressing need for the majority of Chinese people.

The 'two lows' may be a more serious and intractable challenge. In China, the low efficiency of China's economy is often linked with China's state owned enterprises (SOEs). As some scholars point out, in China compared with the non-state sector, the productive efficiency of SOEs is on average lower level. Even though the efficiency gains of SOEs in recent years show limited success of the partial and gradual industrial reform policy, a more fundamental change in ownership structure is still necessary (Zhang, Zhang and Zhao, 2001). Some other scholars mention that, besides the task of efficient production, China's SOEs often also face the task of social welfare provision, such as providing a social safety net against unemployment. But the weak economic performance of the SOEs cannot match its social welfare task (Bai, Li, Tao and Wang,

2000). But in China, the reform of SOEs often faces more internal pressures and opposition because it will seriously threaten the vested interests and then bring instability to China's political system. So now Beijing is facing a dilemma: reforming SOEs will bring instability to China's political and economic system in the short term but without reform will seriously threaten the sustainable economic growth of China that in medium and long term may cause bigger challenges to China's political stability. The problem of low value added production is also intractable. The low value added industries can be rapidly developed in China based on its 'three highs' but this way is proved to be unsustainable. So transformation is necessary but industrial upgrading faces many challenges, such as low contribution rate of technical advance requiring more investments in research and development (R&D) from government and enterprises and pressures of GDP growth for local governments asking for new evaluation system of development. But more serious is that if without supporting policies, transformation may bring potential threats to social stability because it will strongly influence one big group: migrant workers (农民工). In China there are more than 240 million migrant workers, who leave rural areas and go to work in cities. Most of them do factory jobs and most of these factories are labor-intensive, low-value-added industries. As some scholars mentioned, these migrant workers are becoming the new poor and vulnerable members of cities that need more support from government (Ding 丁, 2011:285). So in accomplishing industrial upgrading, helping these migrant workers with skills upgrading is also significant to social stability to ensure sufficient labor for the upgraded industry.

4) Regional disparities and urban-rural disparities in China

In China, the imbalance of regional development is mainly between west inland and east coastal regions. In 2015, GDP per capita of coastal Jiangsu Province, which was

RMB 88085 and ranked first in China²¹, was 3.36 times of that of inland Gansu Province in the last place. As figure 4.7 shows, in China 'gleaming coastal skylines obscure lagging development inland ... provincial economies reliant on cheap labour and low-value-added manufactures are being left behind a China's east transitions toward an e-commerce and services-centric model' (Lockett, 2015). Then Lockett (2015) points out that this disparity is caused by Deng Xiaoping's 'decision to let some get rich first begs the question of whether the rest ever will'. As scholars point out, 'China's spectacular growth and poverty reduction has been accompanied by growing inequality which threatens the social compact and thus the political basis for economic growth' (Fan, Kanbur and Zhang, 2009:1). It is true that, in the first two decades of opening up, the eastern coastal provinces enjoyed more preferential policies and facilitation measures for attracting investment, especially FDI, contributing significantly to their trade-oriented development. Since 2000, the Chinese government has tried to narrow the gap between inland and coastal areas by putting forward a series of policies, even some national strategies, such as Western Development Strategy and Northeast Old Industrial Based Revitalization, which grant more favorable policies to inland provinces. But these policies and strategies have not significantly rebalance China's regional disparities.

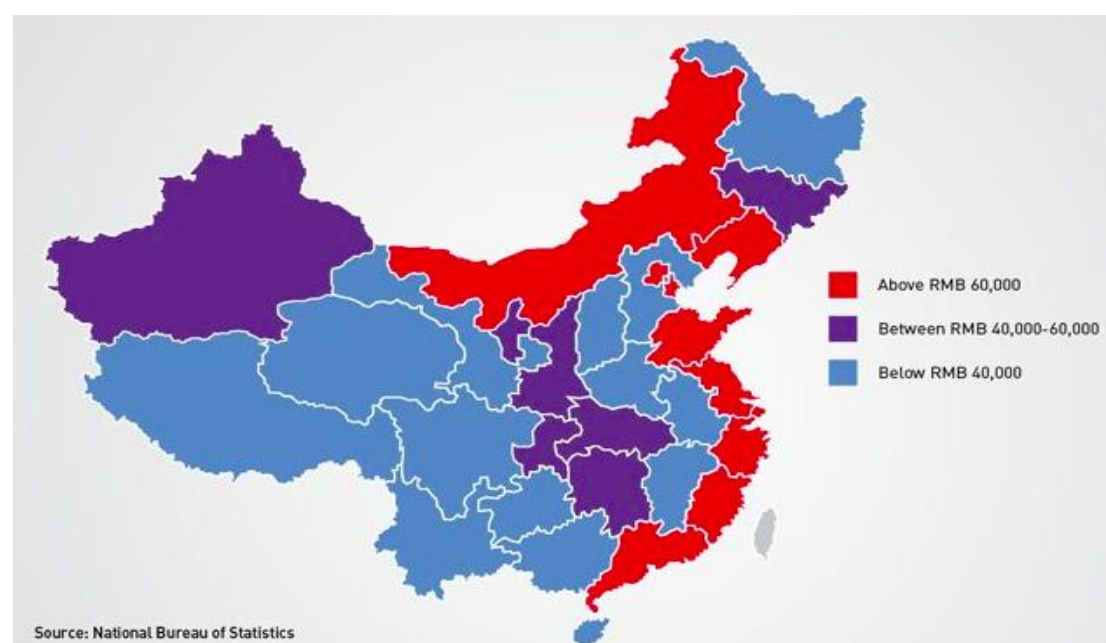
The geographic position of eastern areas may better explain its much more rapid economic development and China's regional disparities. The differences between inland and coastal regions are not unique to China and many advanced economies, such as the US and Italy, have also experienced this type of imbalance. Since the Age of Sail, when power shifted from land to sea, the modern world economic and international trade system have been based on this. Today, according to the International Maritime Organization (IMO), about 90% of world's trade is carried by sea and as the report of United Nations Conference on Trade and Development

²¹ Except for Municipals and Hong Kong, Macao and Taiwan.

Data from the National Bureau of Statistics of China online data based (see note 14).

(UNCTAD) indicates, 'maritime transport is the backbone of globalization and lies at the heart of cross-border transport networks that support supply chains and enable international trade' (2016:5). In China, considering China's trade-oriented development model, for Chinese west inland, far from the seaports, impedes their participation in the world trade. In short, the reconstruction of the inland infrastructure and market is fundamental to solving China's regional disparities.

Figure 4.7 Lagging Behind: China's GDP Per Capita by Province Shows the Disparities Between Inland and Coastal Regions



Source from: Lockett (2015)

The urban-rural disparity is another aspect of China's internal imbalance. Since the reform and opening up, the Gini index of China has increased from 0.31 in 1981 to 0.38 in 2007, which represents an unprecedented increase in the history of development (Molero-Simarro, 2017:101). According to the National Bureau of Statistics of China, per capita annual urban-rural households income gap ratio has sharply risen from 2.57:1 in 1978 to 3.23: 1 in 2010. Moreover, this gap is still growing. In the economy, as mentioned before, the sharp decline of rural resident consumption, from about 30.3% of GDP in 1978 to just about 9%-10% in recent decades, is one important reason

for China's low ratio of consumption. As Ricardo Molero-Simarro indicates, the decline of the relative wage is one important reason for this sharp increase in the Gini index, because it has led to less share of medium and low households in available income. In contrast, 'rising profit share has enabled the richest sectors of the urban population to hoard a higher proportion of disposable income' (2017:115; 2015). He suggests that the Chinese government needs to launch a mixture of redistributive policies especially focusing on pushing up the share of wages on GDP (2017:116). Some Chinese scholars point out that urbanization is a way to narrow the urban-rural income gap because urbanization improves the labor migration from rural areas to urban areas that help to 'transfer rural surplus labor force, increase the rural per capita resources endowment and improve the rural income' (Su, Liu, Chang and Jiang, 2015: 85). But they also mention that, in some provinces, such as Anhui and Fujian, urbanization has not helped to narrow the urban-rural gap because of excessive development of big cities without the coordinated development of small and medium cities, which should be noted in future policy making (2015: 85). Compared with the negative impact of growing rural-urban disparities in China's economic development, its challenges to Chinese social and political stability may be a more serious problem. Chinese scholars, Li Changan (李) and Lai Desheng (赖), have created a model to verify the relationship between urban-rural income gap and stability of society²², and conclude that the growing urban-rural income gap does not obviously affect China's economic growth but its negative impact on social and home stability is very clear, especially to social security (2013:49-53).

4.5 Conclusion

In this chapter, I have examined the contours of contemporary global imbalance in

²² According to them, social stability is including three aspects: social, economic and home. Social stability refers to four index, including the number of cases in labor disputes (LD), the number of criminal cases (LC), the number of civil disputes (PD) and the number of public security cases (SC). Economy stability refers to two index: growth rate of GDP and final consumption rate. Home stability refers to gross divorce rate.

three distinct ways. First, I analyze the post-Bretton Woods 'Jamaica System', including two episodes, in the late 1970s and 1980s respectively, of severe imbalance and their correction. This chapter indicated that the adjustment mechanism of the Jamaica system has been much weaker than former, fixed-exchange systems, discussed in previous chapter, with rebalancing depending on the 'managed' depreciation of the US dollar. This set the stage for further imbalances since the late 1990s. Then I examine the contemporary global imbalances, characterized by their large size and greater persistence since the late 1990s. The causes of these imbalances are still very controversial with three competing explanations, or schools, offering different accounts. Even though these schools hold different opinions on most topics of contemporary imbalances, including key causes, its sustainability and ways of rebalancing, they mainly converge on the grounds that the global imbalances, especially US deficits, are a systemic rather than a domestically produced problem, in which China is a key part.

However, the chapter pointed out that after the 2008 GFC, which was strongly related with the imbalances, the global order is facing many changes both in economics and politics. In economics, a world economy heavily dependent on the debt-financed consumption of the US since the 1990s was left exposed by the GFC. In politics, post-crisis adjustment has produced a new political movement, characterised by the end of laissez-faire and rise of anti-globalization and populist-nationalism. In the context of this changing post-crisis global order, especially with the dramatic rise of economic nationalism in recent years, China faces more external pressures to rebalance. Moreover, as the final part of the chapter showed, these increasing external pressures highlight China's serious internal imbalance - including imbalances between external and domestic demand; imbalances between investment and consumption; imbalances between excessive growth of FER and low level of internationalization of RMB; imbalances in the industrial structure of China; and imbalances in terms of regional and urban-rural disparities. The fact that external pressures and internal imbalances have interacted with each other to push Beijing to do more towards

internal restructuring and economic rebalancing is the focus of the two remaining chapters.

Chapter Five

China's 'Model' of Development and the Political Economy of China's Rebalancing

5.1 Introduction

In chapter four, I examined the contemporary global imbalance and drew three main findings. First, the rebalancing processes of the late 1970s and 1980s, under the Jamaica System characterised by weaker adjustment mechanisms, set the stage for the contemporary global imbalance since the late 1990s. Here Chapter Four established three mainstream explanations of the current imbalance and found that, even though they explain the rise of global imbalance from different perspectives, they tend to see the US deficits and global imbalance as a systemic problem that points to China as the key to global rebalancing. However, I argued that China faces other external pressures on rebalancing because of the dramatic changes in the post-crisis global order, including the difficulties of a world economy - including China - dependent on debt-fueled consumption in the US since the 1990s, and the rise of anti-globalization and economic nationalism and protectionism. Moreover, these increasing external pressures go alongside China's serious - though less remarked upon - internal imbalances, namely, overdependence on trade and investment, excessive growth of FER, an imbalanced industrial structure, and regional and urban-rural disparities. Chapter Four concluded by arguing that these external pressures and internal imbalances, combined, are pushing Beijing to accelerate its rebalancing processes.

As discussed in the last chapter, China is now playing an increasingly prominent role in the economic recovery and rebalancing that has been taking place, albeit slowly and unevenly, since the financial crisis. I argued that for global rebalancing, China's internal

rebalancing, especially the restructuring reform in China, is very important. The reason to say this is that the preoccupation of Western scholars with China's role as a 'surplus' country underplays significantly China's internal imbalances and the domestic origins of these imbalances. I argue that there are three related aspects to this. First, the notion of China as an unqualified beneficiary of global imbalances belies the extent to which there are independent pressures for domestic structural reform. Second, because of this, China is unlikely to follow the precedents set in the 1980s regarding the Plaza Accord and Louvre Accords, when Germany and Japan bore the brunt of the managed devaluation of the dollar (see Chapter Four). As Martin Jacques shows, China is proving to be far more independent in economic policy-making than Japan was at a comparable stage of the monetary imbalances of the 1980s (2012:467). Third, to the extent that China is and in future years will be susceptible to external pressure, such as calls for greater exchange rate flexibility or offering improved market access, I argue, the effects are likely to be temporary, given China's independent interests and domestic priorities. In the post-crisis period, then, the challenge of global rebalancing presents both challenges and opportunities for China. The transformations in the global political economy described in the previous chapter point to China's need to transform from a trade- and investment-oriented economic model to a more domestic- and consumption-oriented one. There are thus internal as well as external aspects to the political economy of China's imbalances. In the rest of the chapter, I consider the rebalancing processes of China, especially the economic restructuring under the new normal of China in the post-crisis era-and how they relate to China's model of capitalist development - in more detail.

5.2 The Chinese Model

With the rise of China, especially in the post-crisis era, the Chinese model has attracted more and more attention. As Keohane (2009: 40-42) indicated, rise of China and its influence to existing global system is one of five biggest changes in today's IPE. He also further criticizes that the new mainstream of western IPE studies, especially Open

Economic Politics (OEP) – essence of the new IPE in the American School, is too ‘egoism’ to ignore this important change in real world (2009: 34;38). David Lake, a staunch advocate of OEP, also admits that rise of China does highlight several analytic limitation of OEP (2008: 22; 30-31). As argued before, the wester-centric character of IPE studies highlight China’s particularity and there is a phenomenon of the ‘absence of China’ in current IPE studies. So this chapter will first study the Chinese model of development. The primary aim to examine the features of Chinese model is to show the political prerequisites embedded in China’s economic reforms or, in other words, what will not change in China’s processes of rebalancing after the 2008 GFC following a different approach to reform.

According to Joshua Cooper Ramo (2004), who first proposed the concept of the ‘Beijing Consensus’, the success of China’s development in recent decades is demonstrable and will eventually compete with and displace the US-led Washington Consensus. Other scholars, however, have questioned this and the supposed distinctiveness of the Beijing Consensus. In particular, they point out that, since 1978, China has embraced key aspects of the Washington Consensus, including the creation of a market economy, protecting property rights, maintaining macroeconomic stability and implementing a prudent fiscal policy (Naughton, 2010; Kennedy, 2010). At the same time, others point out that it is too early to talk about a distinctive model, given that China is still experiencing great socioeconomic and political changes (Williamson, 2012:2; Haberer 海贝勒, 2005:9). Despite this, it is possible to discern aspects of China’s evolving model of capitalist development that are quite distinctive and, in some cases, arguably unique. In other words, even though China has assimilated many aspects of Western economic liberalism it has done so against the backdrop of a specific set of historical and cultural circumstances. In what follows, I argue that it is indeed possible to describe China in terms of a discrete model of capitalist development, shaped by both endogenous and exogenous influences. Specifically, I identify four core features of this model, namely: the one-party system; the role of the

state/government in the economy; gradualism and incrementalism with respect to policy innovation and reform; and the assimilation and adoption of foreign practices but only according to local circumstances and customs. In the next section, I outline each of these features in turn.

1. The one-party system

In studies of China, Western scholars typically see China's economic system and its political system separately, or criticize China's one party system for hindering its economic development (see Shirk 1993; Oksenberg, 2001; Lardy, 2014; Shambaugh 2014; 2016). In this chapter, my intention is not to assess the rights and wrongs of China's political system, but rather to underline the fact that, in China, political and economic power is inextricably linked. Specifically, in China, the guiding principle of policy making is maintaining the legitimacy of Communist Party of China (CPC), principally through ensuring sustained economic growth. In short, in China the economy is in service to the political system, rather than the other way around. No reform, neither in the realm of politics nor in the realm of economics, can go against this principle. The fluctuations in the CPC that have occurred in the thirty years do not indicate (as some scholars have mistakenly thought) the growing permeability of the Chinese state to democratic impulses, but the mere strengthening and consolidation of its grip on power. According to David Shambaugh, in 1985-2015 the CPC experienced five occasions of political re-orientation, from liberal neo-authoritarianism to neo-totalitarianism then shifting between hard and soft authoritarianism (2016:99). This suggests that China's political system is not static, but nor is it destined towards a teleological end point of Westernisation, liberalization and democratisation.

This is why, since the 1990s, the paradox that has perplexed Western scholars is why political reform has not gone hand-in-hand with economic reform (Shirk, 1993:3-18). Furthermore, this explains why Western scholars more tend to analyse China's

economic and political system as following different logics, wherein the political system will eventually need to catch up with the economic system. David Shambaugh, for example, in his book *China's Future* (2016) argues that without political liberalization it will be hard for China to achieve sustainable economic growth. Shambaugh goes on to list several social and economic problems of China - most of which are correct, which he concludes can be best addressed through political reform. This diagnosis, however, fails to consider the importance of social stability and other factors, such as nationalism, cultural traditions and tribalism, which may point in the opposite direction to the one pointed to by Shambaugh.

Generally speaking, these Western commentaries on the nature of China's political system rest on one clear presumption. It is assumed that the direction of travel of political reform is towards political liberalism and the adoption of Western style democratic institutions. This, however, is a misreading of the situation, which is rooted in the conflation of modernization with westernization. As Susan Shirk concedes, the 'communist political systems also have elements of flexibility and authority ... in some forms of communism economic transformation can be achieved without changing the political rules of the game' (1993:6). More specifically, according to Martin Jacques, 'the Western consensus still sees history as a one-way ticket to Westernization'. In reality, Jacques argues, 'China will be one of the great challenges of the twenty-first century', because it will not follow the traditional road of westernization to chase development as most countries did in past two even three hundred years (2012:564). This will mean that China's modernization will be very different to traditional Western path to capitalist development. In other words, China's one party system is likely to be an integral rather than transitory aspect of its future political economy.

In China, the main political imperative is to build efficient and responsive state institutions to enhance the capacity to meet the demands of economic and social development. According to Song Luzheng (宋鲁郑) (2010), the one-party system is a

defining characteristic of China's model and key to its success – an interpretation somewhat different to the Western scholars discussed above, who generally consider China's political system as an impediment to development and reform. Song indicates that one party politics ensures that the government can follow long-term national development plans (such as Made in China 2025 and One Belt One Road) and can maintain the stability and consistency of policies. The one-party system derives its legitimacy from the performance of the economy rather than through electoral competition. Tony Karon points out that the strong government, to some extent, leads to more rational and efficient decision making that 'unlikely to give corporations the power to veto or shape government decision making to suit their bottom lines at the expense of the needs of the system as a whole in the way' (Time, January 20, 2011). Also, under Confucianism, in China government usually more plays the role as 'big brother' of society and people consider the state as necessary virtue but not necessary evil as in western societies, which makes the Chinese government often can enjoy much more authority than in western countries. The political traditions of China, the core value of which are 'sincerity, loyalty, reliability and steadfastness', are neither favorable nor orientated towards democracy and moreover for thousands of years, a centralized and unitary status is always a pride of China (Jacques, 2012:270-1). In the medium term, then, continued economic development will be the main source of legitimacy for the CPC; and to the extent that political reforms are being undertaken, these are designed to strengthen the capacity and efficiency of the state as an economic agent rather than, say, meeting societal demands for multi-party democracy. It is worth noting, also, that outside calls for political reform in China have lost some of their moral authority since the financial crisis and the subsequent rise of electoral populism, exemplified by the election of Donald Trump and the UK's decision to leave the EU, both in 2016. As Gideon Rachman of the Financial Times has noted, while Chinese elites still look to the West as the model of political reform, for Chinese citizens and the elite itself, 'the west is looking so weak' (FT, October 23, 2017). In other words, whatever appeal Western democracy once had in China appears to be diminishing as China redoubles its focus on institutional and structural economic reform.

2. The role of the state as an economic agent

Since 1978, economic reform and external liberalization has enabled China to create the conditions for a successful state-led market economy. According to Thomas Haberer, there are five elements of China's distinctive and strong government: 1) the legitimacy of the political system is accepted by its citizens; 2) the ability to regulate and control the society; 3) control of resources and ability to apply mandatory measures across the economy and society; 4) the ability to negotiate that can find balance in different conflicting interests; 5) learning ability that can learn from mistakes and failures (2005: 10). As I have argued, China's modernization has followed a different path to the traditional Western one. Some western scholars, however, consider China's model as just a variant of Western models. Jonathan Anderson (2005), David Harvey (2005) and Giovanni Arrighi (2009) have all argued that China's model is a variant of neoliberalism but with 'Chinese characteristics'. They believe that China is highly privatized, market-oriented and liberalized, which combined make China's model not just capitalist but neoliberal, also. In *'The Retreat of the State'*, Susan Strange also indicates that even though some Asian states, including China, still against her basic argument of weakening of state authority and rise of market with the development of globalization, 'under increasing pressure from Washington to adopt more liberal policies on trade and investment', these Asian states will become more and more liberal in economy and finally support her arguments about the retreat of state (1996: 6-7).

However, theses interpretation underestimates the role of government in China's economic governance, which can be seen especially in two aspects – the guidance function of the CPC's economic plans and the strategic role of SOEs. According to Tony Andréani, China's economic model has six characteristics and three of which concern the role of government in economic governance, namely, the size and significance of the state-owned sector; the government's control of SOEs; and the monopoly role of

the government in economic planning (2008: 67-75). Of these three characteristics, the unique but changing role of the SOEs is especially worth noting. In recent years, SOEs in China's economy have declined and SOEs now face more competition challenged from the private sector and MNEs. In 2015, for example, the number of SOEs in China accounted for just 5.02% in all industrial enterprises when the respective figure was 39.2% in 1998. Similarly, the proportion of SOEs in total industry assets decreased from 68.8% in 1998 to just 38.83% in 2015. In the past, the SOEs played a dominant role in both manufacturing and services: in 2000, SOEs accounted for 42.6% of China's tax income compared with 17.5% for foreign corporations and 23.8% for private corporations. By 2010, however, the number of SOEs had declined rapidly to just 15.5% while the number of private corporations increased to 54.6%. This does not mean, however, that importance of SOEs in China's economy is declining; rather, their role is changing as a reflection of structural and economic reform in China.

The functions of SOEs has shifted from mainly about improving the economic growth to more playing strategic roles in China's domestic and foreign economic policies (国计) and taking more responsibilities in people's livelihood (民生), such as improving elderly care services and reducing poverty. Especially since the 2008 GFC, the Chinese government has come to see SOEs as an instrument of macroeconomic policy that caused debt and excess capacity problem for SOEs. At the same time, SOEs are now recognized as a key vehicle in the structural reform of the economy. For example, as SOEs have been gradually withdrawn from sectors with high level of marketization, such as internet industries and most service industries, their role in strategic sectors, such as electricity industry, energy and heavy industries, is still important. The strategy behind this shift is to strengthen the national economic security of China while at the same time addressing problems of uneven economic development, such as through investment in the poor western provinces and regions, better welfare regimes and higher wages. The SOEs are also playing an increased role in China's foreign economic and security policies. In Africa, for instance, the SOEs have played a prominent role in

China's natural resource diplomacy on the continent (see Brautigam, 2011). On the domestic front, the strategic role of SOEs in China's economic governance does not mean that the economic performance of SOEs stand out. Indeed as the SOEs have moved out of the manufacturing and services and into strategic sectors as economic stabilizers after the 2008 GFC, they have suffered a dramatic decline in earnings (Batson, 2016:7-14). In August 2017, Beijing announced that China Unicom, one of the country's three telecommunications SOEs, will be opened up to mixed ownership and partial privatization.

The relationship between market and government in China's model reflects a deep but residual suspicion of capitalism and fear of market omnipotence. Accordingly, the government 'manages' the market in many different ways and at various levels, such as through economic planning (e.g. five-year plans) and control of SOEs. State intervention in the economy is an important characteristic of China's economic governance but noteworthy here is that it does not mean that China is a planned economy. As Gregory Chow (2011:1) says, the nature of China's economic planning changed rather than reduced since 1978: 'market reform reduced the importance of central planning but more recently the global economic recession and China's active macro-economic policy interventions have increased the importance of economic planning'. The main purpose of economic planning now is to give strategic guidance to China's economic development in five year stages, but this does not entail giving detailed plans for all economic sectors as the planned economy did. The interaction between government and market in economic planning also shows market-state relationship in China. In some cases, Beijing is 'educated' by market power, such as in internet industries. In the early 2000s with the rise of internet enterprises in China, such as BATJ (Baidu, Alibaba, Tencent and JD.com), the government realized the huge potential of China's internet industries but Beijing did not clearly figure out a blue print of future China's internet industries so decided to rely more on the free market to

improve its development²³. After 15 years of development, these internet industries have developed rapidly and many new internet technologies, such as mobile payment and the sharing economy, have fundamentally changed the lifestyles of Chinese people and have become key aspects of China's modernity. Based on this, in 2015, the Chinese government first mentioned the strategy of 'internet+' (互联网+) in its government work report that gave a clear future strategy of development of China's internet industries in next decades a try to solve some moral and social problems caused by the internet business booming, such as data collection and management, network security and internet addiction of teenagers.

But the development of China's high-speed rail tells another story, which is totally government-lead. In the mid-1990s, China's government firstly mentioned the plan for building high-speed rail lines and, to 2004, China had its first high-speed rail line and then, to 2016, China already had the longest high-speed rail network in the world, most of which depended on government investment and research and development (R&D) by SOEs represented by CRRC (中国中车) and CREC (中国中铁). As a large infrastructure project with potentially large economic and social benefits in the long term, the early phase of China's high-speed rail construction also faced the problem of over-indebtedness and low economic returns. So the government played a leading role in this phase but, with 20 years of development, the high-speed rail industry has shown huge potential economic profits. In 2017, one private enterprise consortium led by Fosun International Limited (复星集团) decided to invest 44.89 billion renminbi (RMB) to build China's first PPP mode high-speed rail line from Hangzhou to Taizhou in Zhejiang Province. As a socialist nation, a strong government is a key character of China's economic model and the government plays a significant role in China's economic governance, which makes it very different from the Anglo-Saxon liberal model while its mixed character makes it also very different from the Soviet model.

²³ Interview 30

3. Gradualism

Gradualism is another significant characteristic of China's model. Here China's approach stands in marked contrast to Russia, whose 'shock therapy' was a 'revolutionary strategy for the complete reconstruction of the economic arrangements of a country' (Murrell, 1993: 115) but also a fundamental change its political, social and culture circumstances in a short time. As Zhang Weiwei (张维为) points out, China's gradual reform process has gone through three incremental stages: from rural to urban, from coast to inland, and from economic reform to political reform (2017). Similarly, Zheng Yongnian (郑永年) suggests that there are three steps to China's reform, which is from economic reform to social reform then finally to political reform (2011). Zheng argues that China has chosen gradual reform but not a revolutionary change based on the lessons learnt from Russia's 'shock therapy' and the different experiences of economic reforms and development of the four Asian Tigers (Hong Kong, Taiwan, Singapore and South Korea). Some other scholars have pointed out that gradual reform has many negative influences in China's development. As Anthony Saich (2001; 2011) points out, the dual system caused by gradual reform makes China pay high social cost in the process of transition that may well outweigh the economic benefits of vested interests so even in the early reform, gradual reform plays a positive role but now it is time to adjust. Some scholars also mention that 'shock therapy', even with serious consequences, it has laid down the institutional foundation for future reforms (Sachs, Woo and Yang, 2000; Kornai, 1994). In contrast, they argue, China's gradual approach to reform has failed to establish an institutional framework but just perpetuates the very problem that it sets out to cure and makes next step of reforms more and more difficult. Gradualism is still controversial but there is no doubt that it is one key character of China's model. So it is important to understand the reasons of China's choice of gradualism instead of a radical reform as Russia did.

Gradual reform, to some extent, ensures the stability of China. In China's reform, political stability is the priority. As Deng Xiaoping said, in China the overriding need is for stability and, as primary architect of China's reforms and opening up, in his talk with American President George Bush in 1989, Deng indicated that without a stable political environment it would be impossible to carry out reform in China. The pursuit of Western-style democracy, he suggested, will achieve neither substance nor economic development but throw the country into turmoil and undermine the people's unity (Jiang, 2017:182). Even though the world and China have both experienced dramatical changes since 1989, prioritizing stability is still the guiding principle of the policy making and reforms guided by the CPC. This is not just related with strong requests of stability in China's development, but also China's culture and traditional political philosophy. If reviewing 150 years turbulent history of China before reform and opening up (from Opium war in 1840 to 1978), it can be understood why the Chinese government and people place emphasis on the importance of stability facing reforms. Chinese attitude surveys also supports this to show that Chinese citizens rank stability the second most important social value, which is compared with average ranking of 23rd among other nations' citizens (Ramo, 2004:23). Moreover, different with western culture, Chinese traditional culture is strongly associated with the character of unification (大一统); and to achieve and maintenance the country's unity is an important source of legitimacy for the government - both in ancient and modern China. Under Confucianism, Chinese people are proud of the unity of China and see unification as one important indicator of prosperity. Conversely, they see losing territory as a great humiliation, not only to the authorities but also to themselves. China's history from mid-1800s to mid-1900s tells that the instability of the country strongly breeds separatism, such as carving up of China by warlords and imperialist colonial rule. The experiences of Russia in the mid-1990s also shows, at least for China, that chaos in the economy and society caused by radical reform enhanced separatism, regionalism and religious extremism in Russia, such as crisis in Chechnya, which strongly threatened the unity of country. In China, the desire for

national unity is one significant reasons for the stability priority principle.

More important is that gradualism ensures the flexibility and sustainability of China's reforms, thus helping to reduce resistance to reform. According to Shaun Breslin, 'as reforms were not packaged together, it was relatively easy to back-track on individual changes that proved unpopular (or generated unexpected consequences) without having to back-track on the entire reform package in total', which also ensured a certain stability and continuity of reform (2004:5). Gradualism can be seen as a natural choice of China's model, based on its practice-based governance philosophy. As Zhang Weiwei indicates, compared with western philosophy that focuses on the question of 'to be' or 'ought to be', Chinese people place more emphasis on 'to be is to do' or 'to do thus to be' (Zhang, 2012:90). This makes practice become more important than theory and in China practice often goes before theory. Just as in the Chinese traditional saying, genuine knowledge comes from practice. But as argued before, stability is one important principle of China's reform, so the problem here is how to make sure that stability does not produce inertia. So gradual reforms offers an answer to this question. For instance, Beijing's approach to reform is both bold in policy innovation but prudent and gradualist in the scale and implementation of these innovations, such as establishing special economic zones and a regional pilot of public policy reforms. These policy experiments in specified regions first helps to prevent the potential risks to China's stability if these policy experiments fail, as only a limited population or region will be affected. Also, the experiment regions often enjoy some special policies such as incentive measures to reduce resistance of reform. Noteworthy here is that for more difficult and complicated reforms, China's government tends to make experiments in smaller regions and scales and experiment before nationwide expansion. So considering the principles of prioritizing stability and practice-based governance philosophy, China's choice of gradual reform becomes easier to understand.

4. The assimilation and adoption of foreign practices but only according to local

circumstances and customs

As argued, in studying China's model many scholars indicate that China's real development model still follows the Washington Consensus and the only unique thing of China's model is that China applies the Washington Consensus in a gradual fashion (see Naughton, 2010; Kennedy, 2010; Lardy 2014). According to this interpretation, China is the world's second largest receiver of FDI and after entering the WTO, China has step by step opened its domestic market to the rest of the world. From this point of view, China's long-term balanced budget and fiscal surplus shows the cautious nature of China's government in managing its finances. Interestingly, some Chinese scholars argue if the CPC wants to keep promoting economic development and maintain social stability, a more open government and greater democratization may be the CPC's only choice (Foreign Affairs, February 2, 2010). No matter the rights and wrongs of these studies, there is no doubt that since reform and opening up in 1978, the Chinese government has endeavored to learn from the experiences of other countries and to adopt many policies from other models from advanced western economies but also from former socialist countries in East Europe and more developed Asian countries or regions.

Strong learning ability is one feature of China's government and China as it tries to learn from others' mistakes and failures, such as the collapse of Soviet Union, the chaos caused by Russia's Shock Therapy and the lost decades after Japan's bubble economy. But China has also looked to the successful experiences of other countries. For example, since 1978, the early learning examples for China were the East European socialist countries, which have reformed before China, such as Yugoslavia and Hungary.. To the mid-1980s, many Chinese officers went to more advanced economies, such as Europe, the US, Japan and South Korea, to learn from their experiences about the functioning of market economies. The best case of this is Singapore. In the interviews with commercial officials from Fujian government, one of the earliest areas to open up in China, informants mentioned that China, especially local government officials,

often looked to Singapore as one of the best cases to study because of its high quality of governance, efficient institutions, relatively similar culture environment and its successful combination of a market economy with semi-democratic political system. Many policy innovations in China especially in local government, were inspired by Singapore's approach. For instance, car license auction system and the provident fund system in Shanghai was based on Singapore (Tan and Wei, 2017). Selective learning and adaptation is one important principle of China's reform but some may ask how can a socialist country be open and inclusive in policy making while maintaining the one party system. So it needs to be clarified that, in China, the sources of legitimacy of the CPC regime have changed since reform and opening up in 1978. Now the legitimacy of CPC regime is less from the function of ideology and more from its capability to delivery economic growth with the quality of its governance (Jacques, 2012: 277).

But assimilation and adoption of foreign practices is not enough; these practices also need to be translated into local customs and traditions. Actually learning from developed countries is not new for China. After the mid-19th-century, China experienced several times movements of westernization to improve modernization, but all totally or partially failed. For example, the Westernization Movement (洋务运动) from 1861-1895 under the rule of the Qing Dynasty failed and was ended by China's defeat in the Jiawu Sino-Japanese War. The Revolution of 1911 (辛亥革命), led by China's western-learning elites represented by Sun Yet-sen indeed overthrew the monarchy but did not change China's backward economic structure that finally ended with several warlord regimes in the late 1910s. Even after 1949, in 1958-1962, the CPC's Great Leap Forward copied from policies of the Soviet Union but these failed and turned out to be totally wrong by the severe famine in the early 1960s they precipitated. After studying four aspects of China's westernization including language, food, the body and politics and power, Martin Jacques (2012) concludes that the impact of westernization in China is quite limited and, even as the pioneer of

westernization in Asia, Japan, in its process of modernization also tried hard to make a balance between westernization and Japanization. As he says, considering its long history and extraordinary distinctiveness, 'if the process of [China's] modernization is simply a transplant then it cannot succeed ... the modernity [should be] theirs in order for it to take root and flourish' (2012: 65; 159). History tells that just copying from others without localization, will not allow China to modernize. In march 1979, Deng Xiaoping firstly mentioned the 'Chinese mode modernization' (中国式的现代化道路) and to 1982 he mentioned the concept of 'socialism with Chinese characteristics' (中国特色社会主义), that China's reform is about self-improvement and development of socialism with Chinese characteristic and reform and opening up are crucial to adhering to this. Wang Huning (王沪宁), the most famous political science scholar who became one of seven members of the top leadership group of CPC -Politburo Standing Committee in Oct 2017, indicate that China's reform faces many distinctive problems that cannot find answers from others experiences. For example, in China's political reform, four relationships need to be concerned, which are: relationships between its super large society and political regulation; between one party system and political democracy; between public ownership and the political system; and between ethical democracy and legal democracy. To solve these problems, Wang argues, China needs to depend on its own practices (Wang 王, 1994:31).

In summary, then, even though the idea of a Chinese 'model' of development is contested, I have shown here the presence of several distinctive characteristics. China's modernization has followed a unique path, spearheaded by the one party system with a strong state; preferring gradual reform because of the principle of stability prioritization and practice-based reasoning; and being open to learning from others while emphasizing local customs and traditions. Recognising these features is the key to understanding China's imbalances and the related reform process. These are persistent and embedded features of China's development model, which are, to

some extent, hard to challenge. Noteworthy here is that China's rapid development depending on China's distinctive model does not mean that China's model is 'better' than others. Actually, China's model of development is facing many serious problems especially its serious imbalances, as argued in the last chapter. China's imbalanced development has become the key concern for CPC authorities. The next section of this chapter will examine the response to China's imbalances under the so-called 'new normal' in the post-crisis era.

5.3 China's New Normal and Rebalancing²⁴

With four main structural imbalances outlined in chapter four, China's model of economic development was severely tested, especially during and after the 2008 GFC. China's economic growth rate has decreased from double-digits to in the range of 6.5-7.5% since 2014. The phrase 'new normal' was first used by Xi Jinping in May 2014 to describe China's next period of economic growth (China Daily, October 5, 2017). As scholars point out, the 'Chinese government has attempted to rebalance its economy ... from largely relying on low-cost investment, cheap and abundant labour and use of natural resources to support growth ... to achieve a "new normal" of slower but more sustainable economic development' (Zhang and Chen, 2017:1). When talking about the new normal of the Chinese economy, the most distinctive feature is an economic slowdown (see BBC, September 24, 2015; FT, March 22, 2016 and January 14, 2018). But the slower growth rate is just one element of China's new normal, alongside environmental sustainability, economic restructuring, fairer distribution of income, reducing poverty, innovation, promoting services and so on. According to China's 13th Five Year Plan Beijing, reaching a more sustainable and higher quality pattern of economic growth while avoiding a 'hard landing' is the main goal in the next decade. As Fergus Green and Nicholas Stern conclude, to China's leadership 'new normal' means 'having better quality growth as its core' that can be understood

²⁴ The part of this section draws on a paper written by me and presented at the Hallsworth Conference: China and the Changing Global Order in 23-24 March 2017, Manchester.

according to the four following elements: 'growth rate; composition; energy intensity; and carbon intensity' (2015:10). As some government policy think tanks point out, China's new normal is a process of restructuring away from the 'old normal' of rapid but extensive economic growth, a government-led economic system and a manufacturing-dominated industrial structure (Li 李, 2015:21-2).

As China's new process of economic restructuring, the new normal is strongly related with the changing global order in the post-crisis era. According to Cox, the structural changes in production will stimulate the contradictions between social force, which will finally cause the elimination of old form of state and world order and the rise of a new one (1987:7-8). As Cox says, 'change can occur at all levels –in production relations, in class relations, in the emergence of new historic blocs and of alternative forms of state, and in the structure of world order... Where change does occur, it will be through mutually sustaining relationships at all of these levels' (1987:8).

Moreover, China's new normal is also not an independent phenomenon but reflects the trend in the world economic recovery in the post-crisis era. There are two related aspects to this. First, China's economic slowdown reflects the world economy in the post-crisis era, which IMF President Christine Lagarde characterized as 'relatively low growth and high unemployment (FT, October 2, 2014). Lawrence Summers also agreed with this assessment, referring to the post-crisis era of 'secular stagnation' (FT, December 15, 2013). According to him, there are four reasons for this: 1) the economic recovery of the US only kept up with population growth and normal productivity growth but the performances of other industrial economies are even worse; 2) in the past decade, before the crisis, bubbles and loose monetary policy were only sufficient to drive moderate growth; 3) in the short-term, because of constraints by the zero lower bound, real interest rates cannot fall enough to spur enough investment to stimulate employment; 4) falling wages and prices will lead to delayed spending (FT, December 15, 2013).

Moreover, the structural economic problems are not just the concerns of China's economic development but also to world economic recovery in the post-crisis era. The global economic system also faces many structural problems, such as a lasting decline in total factor productivity (TFP) since the late 1990s (see Eichengreen 2015; FT, January 15, 2014), decreasing labor supply because of world population ageing (see Bloom, et al, 2010; Basso, 2015), and growing income disparities (see Richardson, 1995; 2017 Global Risks Report (World Economic Forum)), especially with the development of globalization since the 1990s. As Jeffrey Sachs says, 'the new globalization ... with a combination of breakthrough technologies [including technologies of information, communication and transportation] and changes in geopolitics has created a far more intensive set of economic interconnections ... has been the unmet economic challenge of the past forty years' (2011:85-7). So China's new normal should be examined in the context of the world economy and geopolitics in post-crisis era. However, this adjustment is more than merely avoiding a hard landing of China's economy, as some western scholars assumed. The new normal of the Chinese economy should be understood from two aspects - slower growth rates and the restructuring of the Chinese economy. Next, the chapter examines three key themes of these reforms and three leading reforms, or strategies, in China's restructuring and rebalancing.

Some scholars indicate that China's growth decline can be seen as an expected result of the side-effect of four-trillion-yuan economic stimulus program in 2009, introduced immediately after the 2008 financial crisis, which deepened China's economic imbalance and also caused overcapacity, rising public debts and asset bubbles (Amighini, 2015: 51; Zhao, 2015: 43). The stimulus program in 2009 may be seen as the trigger of the Chinese slowdown, but the root cause was China's imbalanced economic model. Chinese trade-oriented economy is very sensitive to external demands, and in the post-crisis era, the slowdown of world demand needs to be considered in the context of the slowdown of the Chinese economy (Yao, 2014). As argued, China's imbalanced model of economic development is also very investment-

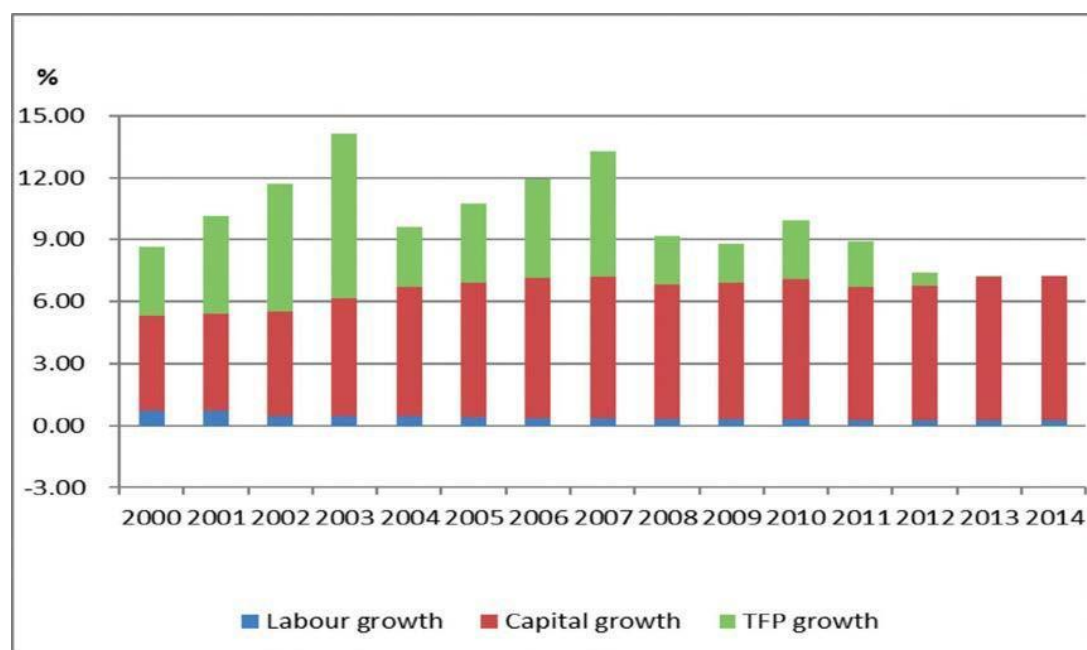
oriented, and this was much worsened by the enormous stimulus program in 2009. Overcapacity caused by this program led to the decline in investment and ‘dragged the whole economy into a substantial slowdown’ (Amighini, 2015: 52). Moreover, the debt burdens of local government and private sector also increased more quickly after 2008, which became a burden for China’s economy and threatened the stability of the Chinese political economy (see Figure 5.1). High investment levels and rapid rising debts are associated with the falling growth in TFP. According to Ross Garnaut, as Figure 5.1 shows, in 2013 and 2014, China’s GDP growth came almost solely from increases in capital stock while TFP growth did not increase at all, which is a measure of technical progress (2016:32-3). In these circumstances, ‘the implementation of the new normal would have massive effects on the industrial structure of demand ... so that sharply lower investment means a slump in demand for the products of heavy industry that had central roles in the old model of growth’ (Garnaut, 2016: 33-4). The demographic transition worsens this because population ageing in China is leading to working-age population declines since 2012, with the slowdown of migration of labor from rural areas to the cities (Yao, 2014:71).

Facing economic slowdown, in contrast to the quickly introduced stimulus program in 2009, under the new normal Beijing emphasizes that economic restructuring cannot depend just on fiscal and monetary policy tools. Beijing’s tolerance of lower growth, to some extent, also shows China’s greater determination to shifting away from the old model focusing on the quantity of growth to new one focusing on its quality. For Chinese policy elites, economic growth with high quality may be more important than high rate of GDP growth under the new normal. Beijing has very clearly indicated that Chinese economic trend shifts into an L-shaped growth pattern and Beijing will not chase a V-shaped economic recovery under the new normal (see the People’s Daily interview with ‘authoritative insider’ on May 9, 2016²⁵). The official notes that considering weak demand and overcapacity, instead of V-shaped, L-shaped pattern

²⁵ See from: <http://en.people.cn/n3/2016/0509/c98649-9055137.html>.

characterizing as a very slow recovery after economic bottoms out can be better used to understand the Chinese economy in next several years. From the optimistic view to 2020-2030, with successful economic restructuring, the average growth rate of Chinese GDP will be in the range of 4-6%. Hence ‘a gradually slowing rate of Chinese growth toward developed country norms is a consequence of economic maturation’ (Green and Stern, 2015: 10). In this context, economic restructuring is the core of China’s rebalancing under the new normal. Under the new normal, economic restructuring is mainly related with three key pillars - new economic driver, new composition of growth and environmentally sustainable development.

Figure 5.1 Contributions of components of GDP growth



Source from: Garnaut (2016:33)

1. New Economic Driver

Compared with capital investment and production factors as main driving powers in China’s old model, China is counting innovation as the pillar of economic development under the new normal. Improving innovation is most important but also very difficult part of China’s economic restructuring, especially in the context of China’s ‘big

government-small market'. I argue that under the new normal, innovation is related with two aspects – promoting enterprise innovation and institutional innovation of government. As Yasushi Suzuki and Mohammad Dulal Miah argue, as a frontier economy, the key to successful transition to a more mature economy are: 1) to develop a free and open market for ideas and 2) to implement further deregulation encouraging people's creativity, aiming to increase economic output and efficiency (2017:35). Promoting innovation of enterprises is strongly linked with industrial upgrading. In China, industrial upgrading is often hampered by lack of technologies and inefficient innovation. According to Suzuki and Miah, there are four types of industrial innovations: customer-focused innovation; efficiency-driven innovation; engineering-based innovation; and science-based innovation (2017:37). China does better in the first two areas but much worse in the latter two. Backed by its massive consumer market, performances of China in customer-focused innovation is the best of the four, such as in the industries of e-commerce, mobile payment, share-economies and smartphones. The efficiency-driven innovation is more prominent in China's traditional industries, such as steel, cement, textiles, solar panels and, in recent years, facing the challenges from the demographic structure and weak market demands, their pressures of reducing cost are increasingly pushing them to make more innovations to shorten production time and to enhance product quality.

In the engineering-based and science-based innovations, China is relatively weaker, but these two are much more important in high value-added industries, such as biotechnology, aerospace, and semiconductor design. In China, the total spending on R&D reached 1.76 trillion RMB in 2017, as CNBC reported, a year-on-year increase of 14% and a rise of 70.9% from 2012 (February 26, 2018). China has launched a target, as minister Wan Gang explained, by 2050, 'China needs to enter the ranks of innovation countries and become a big technological innovation power' (South China Morning Post, February 27, 2018). China has established various new high-tech industrial parks and incubators to improve industrial innovation and plans to reduce China's dependence on imported technologies to 30 percent by 2020 (Linton, 2008).

But Beijing also indicates that key and core technologies are still controlled by others and 'many industries are still at the lower-to medium end of the global value' (SCIO²⁶, May 25, 2016). In recent years, Chinese enterprises still tend towards overseas mergers and acquisitions (M&A) to solve the shortage in technology, such as Shanghai Fosun Pharmaceutical's purchase of French drug distributor Tridem and ChemChina buying Swiss seeds and agrochemical group Syngenta. But for a sustainable improvement of innovation, more important is that China needs to have their own strategy of innovation especially for private sector-led innovation by 'reducing its reliance on budgetary and foreign-funded innovation' (Suzuki and Miah, 2017: 38). Some scholars also mention that in order to further improve Chinese-origin innovation, enterprises rather than government should have the central role in innovation (Linton, 2008; Sun and Cao, 2014). [and] deepen the reform of the management system for science and technology'.

Institutional innovation of government is one important theme of China's rebalancing and restructuring. Under the new normal, this is mainly about streamlining government and delegating authorities. The transformation of government functions lies at the core of administrative reform in this government and streamlining government and delegating authorities is the crucial step to do this²⁷. As Premier Li Keqiang said in the speech on May 12, 2015, 'Economic reform is essentially about striking a balance between the government and the market by enabling the market to play a decisive role in resources allocation and the government to function better ... to streamline administration, delegate power and strengthen regulation is a crucial step to address these acute problems [of economic reform]'²⁸. Institutional innovation of government by streamlining administration, delegating more powers, improving quality of regulation and providing better services shows the different approach to

²⁶ SCIO-State Council Information office of China.

²⁷ Source from: full version of speech on official website of State Council of China: http://english.gov.cn/premier/speeches/2015/05/23/content_281475113213526.htm

²⁸ See above.

reform to improve economic development compared with adopting strong stimulus policies as in 2009.

In 2013-2017, the State Council abolished 491 items that previously required administrative approval and delegated 127 items of approval to lower levels²⁹. Also, there were 420 administrative fee and government-managed funds, worth about \$16 billion per year, which have been abolished³⁰. Beijing promises that by 2022, they will cut at least one third of the existing 1700 administrative approval items³¹. The aim of streamlining administration is to ‘sustain healthy economic growth, by increasing the market’s role in efficient allocation of resources and encouraging firm-level innovation and investment, while decreasing direct government involvement’ (Alkon and Wong, 2017) Beijing admits that the administrative reforms are painful because it curbs government that required real sacrifice but it will not change their determination of reform (China Daily, January 05, 2017). Under the new normal, the institutional innovation of government will be embedded in various reforms of China. For example, the Shanghai Pilot Free Trade Zones (PFTZs) established in 2013, first introduced the ‘negative list’ in investment approval system and because of this institutional innovation, 95 percent of procedures in former investment approval system were cut³². As some scholars indicate, this institutional innovation is also related with building trust in government that Chinese authorities have launched a series of reforms to ‘increase the efficiency and responsiveness of the bureaucracy, to enhance the professionalism [of government]’. Even though that many of them still have a long way to go, these reforms have had positive impact on promoting people’s trust in government (Lai, 2007).

²⁹ Source from: official website of State Council of China:

http://english.gov.cn/premier/news/2017/03/08/content_281475588613516.htm

³⁰ See above

³¹ See above

³² Source from: official website of State Council Information Office of China:
<http://www.scio.gov.cn/32618/Document/1493121/1493121.htm>

2. New Composition of Growth

The restructuring of composition of growth is another key word in China's economic rebalancing under the new normal. First, as argued in the last chapter, old China's economic model is investment-oriented and export-oriented. Under the new normal, boosting consumption is important. As the report from World Economic Forum (September 08, 2015), China's strategy of boosting domestic consumption to rebalance its investment and export-driven growth are supported by three key drivers: namely, the emerging middle class, which is set to double between 2015-2025; accelerated urbanization; and a thriving e-commerce ecosystem in China. Narrowing the gap between urban and rural areas is also related to boosting consumption and stimulating domestic demands. In China, the consumption market of 900 million rural households are still underdeveloped, especially in the middle and west areas of China. But some observers also indicate that hefty mortgages to buy property amid surging prices make many Chinese middle class families reluctant or unable to spend more, which threatens the sustainable growth of consumption (Nikkei Asian Reviews, December 26, 2017). As Lardy (2006:6-8) suggests, promoting consumption-driven growth in China requires that 'the growth of household and government consumption increase relative to that of investment and net exports ... policies to promote consumption can be based on cutting personal income taxes or increasing government consumption expenditure'. This requires a more flexible exchange rate regime to increase the flexibility of the government to raise interest rates. In 2016, consumption contributed 64.4% to GDP growth, compared with 42.2% of investment and -6.8% of net exports (Market Watch, January 20, 2017). Moreover, in 2015, retail sales grew 10.7% from a year earlier and online sale jumped 33.3% year on year to 3.88 trillion RMB (China Daily, January 19, 2016). This is a good start to China's shift from investment and export-driven to consumption-oriented model but it needs to be further improved. As the China Report on the Work of Government 2016 aims to:

'tap the potential of domestic demand to increase the space for development...we

will work to achieve a moderate expansion of aggregate demand, adjust and reform the composition of demand, strive for better alignment between supply and demand and between investment and consumption, and work to achieve greater balance in the development of urban and rural areas and of different regions. This will create steady and long-term domestic demand to sustain economic development’.

As argued in the previous chapter, manufacturing plays the most significant role in China’s economic growth but in the new normal, service industries will become as important. Some scholars point out that in the new normal, ‘a shift in capital allocation away from heavy-industrial sectors (especially in low value-added products such as steel and cement) and toward service sectors and higher value-added manufacturing, as has been gradually occurring, will raise productivity as traditional industries decline’ (Green and Stern, 2015:10). This also related with opening up more services industries to foreign and private investors, especially the former highly state controlled services industries, such as health care, education, telecom and, most important, financial services. Beijing has launched ‘a new round of national pilot projects for all-round service sector reform as well as projects to promote innovation in high-tech services ... relax restrictions on market access to the service sector, and ensure greater specialization in producer services and higher refinement in consumer services’ (Report on the Work of Government, 2016). Further, the service industries also face restructuring, shifting from ‘food, clothes, house, transportation’ (衣食住行) to ‘knowledge, entertainment, health, security, beauty’ (学乐康安美) (Li 李, 2015: 23; Jin 金, 2015).

3. Environmental Sustainability

Environmental sustainability is another important element of the new normal, which includes two parts: one is environmental sustainability, including reducing air pollution

and improving energy efficiency; the other is economic sustainability. Energy efficiency in China is not just an economic issue related to economic growth by enhancing productivity, but also leads to reducing air pollution by reducing overall energy demand (Green and Stern, 2015: 11). According to them, energy efficiency is the key to environmental sustainability but also benefits development of innovative growth industries to improve weak link of the Chinese economy. This will further benefit industrial upgrading in China. Industrial upgrading under the new normal is related with promoting enterprise innovation and which is one key to maintaining sustainable growth of China's economy.

In China, environmental pollution caused by imbalanced industrial structure is not only an economic problems but now more a political challenge to CPC authorities. According to a Pew Poll³³ in 2015, 76% and 75% (including considering them as 'big' or 'moderately big' problem) of the Chinese public considered that air pollution and water pollution as concerns, which ranked second and the third in this list. The worse is that, even though corruption was still the first concern, in this poll, 63% of Chinese public think that corruption problem will get better in next 5 years. But just 37% and 36% of Chinese believe the water pollution and air pollution will be reduced; and 34% of the public even consider these two problems will be worse in the next 5 years. This shows that pollution is one key concern of Chinese people, but moreover the Chinese public seems to be losing confidence in the government to solve pollution problems. Beijing also realizes this. As some scholars shows, there is clearly a sharp increase in the consumption of gas, nuclear and renewables in China in 2005-2015. They forecast that even though carbon energy types (coal and oil) will still be dominant in China's energy consumption to 2040, their shares will strongly decrease and clean fuels will offer more development potential (Dong, et. al., 2017: 214-227). China is trying to shift from more using coal as an energy source to lower-pollution sources, such as natural gas, which also can be shown by China's more positive attitude in the multilateral

³³ See from: <http://www.pewglobal.org/2015/09/24/corruption-pollution-inequality-are-top-concerns-in-china/>.

negotiations of global climate change (Green and Stern, 2015:11).

4. Three Core Reforms

Under the new normal, Beijing has launched a series of new rebalancing policies and reforms but there are three core reforms in China's rebalancing and restructuring. These are supply-side structural reform in the short term; deepening market reform in the medium term, and One Belt One Road (OBOR) in long term.

Supply-side structural reform. In China's Report on the Work of the Government (2016), Beijing very clearly indicates that supply-side structural reform is the one key to maintain the sustainable growth and is an inevitable choice reflecting China's imbalances and the need for rebalancing. According to this report, 'to solve acute problems in key areas, ... [China] must work faster to remove institutional obstacles and carry out supply-side structural reform to improve the quality and efficiency of the supply system, and further stimulate market vitality and the creativity of society'. The Reform is characterized as 'three cuts, one reduction, one strengthening (三去一降一补)' (cut overcapacity, excess inventory and deleverage, reduce costs and strengthen points of weakness). Cutting overcapacity and excess inventory are two keys of the supply-side structural reform and the reform tries to address these problems mainly in two ways³⁴. The first is to eliminate backward production facilities in the industries suffering overcapacity and excess inventory. This will cooperate with improving the withdraw mechanism of 'zombie enterprises' proactively yet prudently by using measures of merger, reorganization, debt restructuring and bankruptcy liquidation. The aim of these is to increase the efficiency of resource and capital usage, and then to improve the level of competitiveness of whole industry. Secondly, Beijing also plans to promote the merger and reorganization of SOEs to increase the profitability of SOEs, especially to local state-owned enterprises suffering business difficulties. For instance,

³⁴ Interview 14 and 30

this process has included the reorganizations of the China Ocean Shipping (Group) Company (COSCO) and the China Shipping (Group) Company in early 2016 and the Baosteel Group merged Xinjiang Bayi Iron & Steel Co. Ltd³⁵.

Beijing has also indicated that encouraging innovation will play a significant role in the supply-side reform, which related with the ‘one strengthen’ of reform to improve the ‘weak links’ of China’s industrial structure. For example, the Shanxi (山西) local government, which is China’s main coal producing area, set up a special fund to encourage coal mining enterprises to promote technological upgrading related with environment protection and support them to develop the coal chemical industry to improve their diversification business strategies³⁶. The supply-side reform also requests further administrative reform that help to break down the barriers of market allocation of factors and reduce the cost of institutional transaction, especially the transformation of government functions, reducing micro management and direct intervention, and laying stress on strengthening macro-control and providing better public services. So cutting overcapacity and excess inventory is not the main purpose of the supply-side reform; rather, the aim of this reform is to improve competitiveness and profitability of China’s enterprises and industries.

Since reform and opening up in 1978, market-oriented reform is always one key in China’s reform. Under the new normal, deepening the market reform will be the key task of China’s rebalancing and sustainable development in the medium term. There are several key points of deepening market reform. One is the mixed ownership of SOEs³⁷. The mixed ownership reform aims to bring about four main changes to China’s SOEs, which are: 1) change the situation of ‘the dominance of state-owned shares’ (—股独大) of SOEs; 2) operations of SOEs in the fully competitive industries will be mostly

³⁵ Interview 30

³⁶ Interview 14

³⁷ Interview 14 and 30

based on market and competition and assessment of these SOEs will focus on their 'earning power' ; 3) the supervision and assessment of state-owned enterprise taking more public welfare responsibilities will more respect public opinions; 4) deregulation to improve the autonomy of SOEs. Beijing also wants to improve the market reform in public service field³⁸, including education, public culture service³⁹, health care, to improve the quality of public service, designed to narrow the rural-urban gap in quality of public service provision. Take Public-Private Partnerships (PPP)⁴⁰ as an example. China has now introduced PPP in urban public services and infrastructure, which makes the government can pay more attention to improve these in rural areas.

The financial reform is always important in China's market-oriented reform⁴¹. In this high-speed to high-quality reform under the new normal, the financial reforms will mainly be realized in four aspects, including establishing a multi-level financial market system; opening up of capital market; improving the marketization of interest rate and exchange rate; and reform of financial regulation system (Lin,2017 188-190). The main aim of financial reform is to improve the internationalization of RMB because China needs a currency with international status matching its economic status in the global economy. (Yu, 2012). Eichengreen and Kawai (2014) indicate that a high level of internationalization of the RMB 'requires significant capital account liberalization—supported by financial market liberalization including market-determined interest rates, and by effective financial regulation and supervision—which in turn would call for greater exchange rate flexibility so that the People's Bank of China (PBoC) can enjoy monetary policy autonomy'.

For the long term, China has launched the One Belt One Road (OBOR) strategy to improve China's restructuring and rebalancing⁴². In late 2013, during his visit to

³⁸ Interview 30 and 6

³⁹ Public culture services include public libraries, museums, theatres, and so on, which now are mainly run by government.

⁴⁰ Interview 6

⁴¹ Interview 13 and 31

⁴² Interview 27, 31, 14 and 6

Kazakhstan and Indonesia, Chinese President Xi Jinping put forward new initiatives for China and the surrounding regions: the New Silk Road Economic Belt and the 21st-Century Maritime Silk Road, which is more often known as 'One Belt, One Road' strategy. The One Belt will try to connect China, Central and Western Asia, Russia and Europe and the Road will seek to link China with the Association of Southeast Asian Nations (ASEAN) region, Africa and Europe. Then in late March 2015, the Chinese National Development and Reform Commission, along with the with Ministry of Commerce and Foreign Affairs, released a more detailed blueprint of the OBOR, in which the Chinese government elaborated the background, principles, frameworks and focus and mechanism of cooperation of the OBOR.

The influence of OBOR in China's geopolitical strategy is still uncertain, but the domestic economic drivers of OBOR is plain to see⁴³. The OBOR can be seen as the external face of the 'new normal' programme of economic restructuring and reform. Firstly, it is designed to benefit China's industrial upgrading by improving international cooperation on production under OBOR and helping the export opportunities of China's enterprises⁴⁴. Then with OBOR's efforts on infrastructure construction in the hinterland of Eurasia and Indochina, further developing the markets of Eurasia and ASEAN. The OBOR is also designed to improve China's enterprises, capital and products going abroad and developing the new markets for China's trade and investment, which help to increase the requests of trade settled in RMB⁴⁵. Also with the increase of overseas capital investments by financial supporting institutions established with OBOR, such as AIIB, Silk Road Fund and BRICS Development Bank, considering the role of China in these three, it must be that part of flowing capitals is RMB and increase of using RMB in international investment. All this is designed to help improve the internationalization of RMB. Moreover, the international economic cooperation will help China's financial institutions going abroad to set up branches,

⁴³ Interview 25

⁴⁴ Interview 26 and 30

⁴⁵ Interview 31

which will build the financial channels for internationalization of RMB⁴⁶. As China's long term strategy, the future of OBOR and China's economic rebalancing are still uncertain, but the two initiatives need to be seen as two sides of the same coin.

5.4 Conclusion

In this chapter, I first examined the four features of China's model, which should be considered as political prerequisites of China's rebalancing. The one-party system is one feature of China's model and compared with western democracy, the political imperative is to build an efficient and responsive state institutions to enhance the capacity to meet the demands of economic and social development. Based on China's state-led market economy, China's distinctive and strong government is one important characteristic of China's model, which can be seen especially from the guidance function of the CPC's economic plans and the strategic role of SOEs in China. Gradualism is another significant features of China's model, which shows mostly clearly in China's approach to reform, which is both bold in policy innovation but prudent and gradualist in the scale and implementation of these innovations. In China, gradualism is related with the principles of stability prioritization and practice-based governance philosophy. Since reform and opening up, China's processes of modernization has been inspired by foreign experiences but assimilation and adoption of foreign practices is not enough. Learning experiences from others is important for China's reform and development but valuing localization is a key to ensure the successes of China's modernization, which is learn from China's own experiences of modernization in the last 150 years.

Then I examined China's rebalancing under the new normal in the post-crisis era. I indicated that the slowdown of economic growth is just one aspect of China's new normal and also needs to be considered in the context of a 'new mediocre' of the world

⁴⁶ Interview 27 and 12

economy in the post-crisis era and four-trillion yuan economic stimulus program by Beijing in 2009. However, I argued that rather than adopting strong stimulus policies as it did in 2009, under the new normal, Beijing put economic restructuring in the center of China's rebalancing in post-crisis era. This strategy has three principal drivers: capital investment and production factors to innovation; new composition of growth- from trade and investment-oriented to consumption-driven and from manufacturing to services; and environmentally sustainable development, including environmental sustainable and economic sustainable. Based on these three key drivers, there are three core reforms in China's rebalancing under the new normal, which are supply-side structural reform in short term; deepening market reform in the medium term; and One Belt One Road (OBOR) in long term. After examining the macro picture of China's rebalancing under the new normal in the post-crisis era, in the next chapter I will study the case of the Pilot Free Trade Zones (PFTZs), first established in 2013, to provide detailed analysis of the approach of China's rebalancing under the new normal. As one of the most important policy laboratory of reform under the new normal, many of China's rebalancing reforms are being first tested in these 'zones' before nationwide implementation. So studying the reforms in the PFTZs will help to further and more comprehensively understand the approach to reform of China's rebalancing in the post-crisis era.

Chapter Six

The Political Economy of Internal Rebalancing: from ‘Special Economic Zones’ to ‘Pilot Free Trade Zones’

6.1 Introduction

In chapter five, I indicated that with 40 years development, China’s government-led market economy characterized as investment-oriented and trade-oriented now faces many internal imbalances and external pressures in post-crisis global rebalancing. Then I indicated that facing these structural imbalances, especially after the 2008 GFC with unexpected changes in global economy and sharply slowdown of China’s economic growth since 2012, China’s unsustainable model of development needs to be rebalanced, which is recognized by Beijing as the new normal of China’s economic development. As the last chapter argued, under the new normal, Beijing shows its higher tolerance with lower economic growth rate but more focuses on economic restructuring by launching serious of new reforms, such as establishing new pilot free trade zones, supply-side structural reform, mixed ownership reform of SOEs, market reform of public service and also OBOR strategy. Noteworthy here is that the previous chapter also identified four core features of China’s model of development, namely: the one-party system; the role of the state as an economic agent; gradualism and incrementalism with respect to policy innovation and reform; and the assimilation and adoption of foreign practices but only according to local circumstances and customs. I argued that these features are deeply rooted in China’s culture, social and political backgrounds and can be seen as political prerequisites of China’s reforms, which will still to be followed in China’s restructuring and rebalancing in post-crisis era.

In this chapter and the next chapter, I will take the so-called ‘Pilot Free Trade Zones’ (PFTZs) as a case study to examine the approach of China’s rebalancing under the new

normal. There are two reasons that justify the choice of PFTZs as the case study. First, since the first economic reforms in 1978, the CPC has used 'zones' as an important testing lab for the adoption of market-oriented policies before extending these to the Chinese economy as a whole. Second, PFTZs represent a cornerstone of China's most recent economic reforms and are strongly related with various other restructuring reforms or policies in China, such as OBOR, Internet+, Made in China 2025. This chapter will first examine the Special Economic Zones (SEZs) in China. The main aim to do this is to show the important role of 'zones' in China's previous reforms, especially in China's marketization reforms. Moreover, the economic development pattern of SEZs is the best example of China's trade-oriented and investment-oriented economic model that also show the internal imbalances under this model, as indicated in chapter four. So by comparing the SEZs and PFTZs-'old' and 'new' zones in China's reform-, it can show the changes in paths of China's reforms under the new normal. Beside comparing two 'zones', this chapter will also briefly introduce the four PFTZs and main areas of reforms in PFTZs, which will be further examined in next chapter.

Before the study of SEZs and PFTZs in China, SEZs and PFTZs will be clarified here. In general, SEZs can be said to consist of some common basic features: 1) geographically delimited area, usually physically secured (i.e. 'fenced-in'); 2) a single management/administration structure; 3) eligibility for benefits based upon physical location within the zone; and 4) a separate customs area and streamlined procedures. (World Bank, 2008:9). Besides these characteristics, in China a comprehensive definition of SEZs must also include coastal development areas, industrial parks, economic and technological development zones, high-tech industrial development zones and so on. However, in this chapter SEZs refers to the five SEZ classified as such by the CPC: Shenzhen, Shantou, Zhuhai in Guangdong Province, Xiamen in Fujian Province and Hainan province SEZ. These five SEZs were established in the 1980s and were the earliest special economic zones in China following the launching of the opening up process. They were the first test lab for the new institutions and new policies for market economy and are very representative of the early phase of China's

market-oriented reform.

In China, the free trade zones (FTZs) can be traced back to the 1990s. Shanghai Waigaoqiao FTZ (1990) was the first state-level free trade zone in China and the purpose of FTZ in the 1990s was to 'experiment with free trade before China's accession to the WTO' (Zeng, 2010:11). The Pilot Free Trade Zones (PFTZs) were first established in Shanghai in 2013. The five main tasks of PFTZs are: speeding up the transformation of the functions of government; opening more fields to foreign investments; restructuring of Chinese trade; improving the innovation and marketization in China's financial field; perfecting the legal system and mechanism. The PFTZ is a more comprehensive 'zones' than a traditional free trade zones, which is a 'trail zone' for China's new round of opening up and reform and 'its main impacts are not on the amount of its trade volume or foreign investment, but on the institutional innovation it generates' (Yao and Whalley, 2016:2). To end of 2017, there are 11 PFTZs in China but in this chapter the PFTZs just refers to first four PFTZs in China, namely Shanghai PFTZ established in 2013, and Fujian PFTZ, Guangdong PFTZ, Tianjin PFTZ set up in 2015. The other 7 PFTZs were just established in early 2017 and are not yet formally in operation.

6.2 The Role of SEZs in China's Market-Oriented Reform and Economic Development

The establishment of SEZs in China was strongly inspired by the successful experiences of other Asian countries and regions, who 'have used free trade zones as instrument of development' more than any other areas, especially the establishment of export processing zones (EPZs) in Taiwan (Rondinelli, 1987:89-91). In the mid-1960s, Taiwan established its first EPZs in Kaohsiung in 1966, and then set up two another EPZs in Nanzih and Taichung in 1969. These EPZs strongly improved the economic development and transition in Taiwan. Take the Kaohsiung as an example. Some scholars point out that the Kaohsiung EPZ improved the Taiwan's economy from following several aspects, including attracting foreign investment, creating jobs,

promoting exports, and improving regional development (Chen, 1994; Rondinelli, 1987). According to Xiangming Chen, the number of workers in Kaohsiung rose rapidly during the 1960s and the 1970s, increased from an average 42 workers per firm in 1967 to 278 in 1972, which accounted for 0.3% of Taiwan's total employment in 1968 but rose to 0.7% in 1977 (1994: 10-1). He also indicated that establishing EPZ in the mid-1960s made Kaohsiung transfer from a small seaport city in 1965 with only 600,000 people, severe housing shortage and poor infrastructure to a metropolis with 1,000,000 people and world's fourth largest container port in 1975 (1994: 16-7). Moreover, in 1966-67, foreign investment in Kaohsiung was \$26 million and accounted for about 30% of Taiwan's total, which 'achieved the goal of pulling in badly needed foreign capital at the initial stage of export-oriented industrialization (EOI) (1994:8-10). The main purpose of the establishment of EPZs in Taiwan is to promote export with various preferential measures within a market economy, that 'intensified their efforts to produce light industry manufacture goods for export after they had abandoned their import-substitution industrialization (ISI) strategy to switch to the EOI strategy' (Ota, 2003:6). This shows clearly in the case of Kaohsiung EPZ, which ran trade deficits of \$5.4 million in 1967 but turned to have trade surplus in 1969 and to 1976, Kaohsiung accounted for 24.5% of Taiwan's \$567 million trade surpluses (Chen, 1994:12).

After Nixon's visit to China in 1972, trade between China and western advanced economies, especially the US, grew rapidly. Under this background, Beijing noticed the successes of Taiwan's EPZs. In 1972, Zhou Enlai (周恩来), the then prime minister of China, mentioned that Beijing was studying the practices of EPZs in Taiwan and considering the similar Chinese society of Taiwan, their successful experience as well as lessons, which were worth using for reference for mainland China (Mei 梅, 2015). On December 13, 1978, Deng Xiaoping made an important speech of China's reforms in the closing session of the Central Working Conference, in which he stated that China 'should allow some regions and enterprises ... to earn more and enjoy more benefits sooner than others ... If the standard of living of some people is raised first, this will

inevitable be an impressive example to their “neighbours”, and the people in other regions and units will want to learn from them. This will help the whole national economy to advance wave ... in a comparatively short period’ (Deng, 1995:161). This laid down the political foundation for the establishment of SEZs in China in 1980. After the Third Plenary Session of the Eleventh Central Committee of the CPC in 1978, Guangdong province proposed to Beijing that the province wanted to play the role as the policy laboratory in China’s market-oriented reform. On January 1979, Wu Nansheng (吴南生), then the Party chief of Guangdong province, in his visit to Shantou (汕头), first indicated the ideas of setting up Shantou EPZs, which followed the practice of Kaohsiung EPZs in Taiwan, considering the similar situations of these two cities, both of which were middle size seaport cities with poor infrastructures located far from the political center and economy mainly relied on agriculture, before reform. This idea was strongly supported by the Guangdong provincial Party committee, who pointed out that this proposal should not be just limited in Shantou but needed to expand to whole province. On 19 July 1979, the central government officially approved the establishment of four SEZs - Shenzhen, Zhuhai, Shantou and Xiamen - and on 26 August 1980 the National People’s Congress approved the implementation of the ‘Regulation on Special Economic Zones in Guangdong Province’, which meant the formal establishment of SEZs in China. Then the Hainan SEZ was approved at the 1st Meeting of the Standing Committee of the Seventh National People's Congress on 13 April 1988.

Noteworthy here is that as argued in the preceding chapter, China’s reform often adopt foreign practices but only according to local circumstances and customs. The establishment of China’s SEZs were inspired by successful experiences of EPZs in Taiwan and other Asian countries as argued before but also with Chinese characteristics. As some scholars point out, the SEZs in China indeed shares some similarity to the EPZ in other Asian countries in providing preferential treatments to foreign investors to attract overseas capital and technology (Wong and Chu, 1984:3).

However, the SEZs in China have many differences with EPZs in other Asian countries and regions, such as in Taiwan, South Korea, and Singapore, which relate with four aspects. First, as Wong and Chu (1984:3) indicate, China as a socialist country but the SEZ system represents western capitalist market economy so ‘by allowing foreign participation, including foreign sole proprietorship, China's SEZs serve as an important laboratory for the reception of the capitalist mode of production in China and thus might have more far-reaching implication to the country than elsewhere in Asia’. Then, compared with EPZs, China’s SEZs are much larger in scale and cover more comprehensive content, where foreign investments not just go to manufacturing but also to real estate, tourism, agriculture and other services. Thirdly, considering the SEZs’ role as a policy laboratory in China, Beijing has taken a rather flexible measure by providing preferential treatments to foreign investors to set up business ‘in areas adjacent to but outside the boundaries of SEZs’ (1984:3). Last but not least, the Chinese government played various but always important roles in different forms of financial participation to facilitate overseas investments in the SEZs (1984:3-4). As some Japanese scholars indicate that the SEZs in China ‘operate in a manner similar to a free market economy’ under China’s planned economy system, which provides favourable investment climate with various well prepared public utilities and attractive preferential treatments to attract foreign investment and to increase exports (Nishitateno, 1983:177).

Figure 6.1 The Size of the Five SEZs in China (2007)

| Name | Shenzhen | Zhuhai | Shantou | Xiamen | Hainan | Total |
|---|-----------------|---------------|----------------|---------------|---------------|--------------|
| Year of Establishment | 1980 | 1980 | 1980 | 1980 | 1988 | |
| Area of SEZs (sq. km) | 396 | 121 | 234 | 131 | 33900 | 34782 |
| Total areas of cities/provinces (sq. km) | 1952 | 1688 | 2064 | 1565 | 35000 | 42269 |

Source: Zhong (钟) (2008)

The establishment of the SEZs was one most significant economic and political experiment in China's opening door reform in the late 1970s and the early 1980s, which strongly improved China's economic development. As Tatsuyuki Ota says, the establishment of SEZs in China 'apparently triggered her economic growth together with various growth-oriented schemes' (2003:1). Even though there are different opinions of the 'success' of China's SEZs (see Gopalakrishnan 2007; Rondinelli, 1987), there is a consensus that SEZs indeed improve China's economic development. Since the establishment of the five SEZs, they are always one fastest growing areas in China. Especially in the early phase of China's market-oriented reform, they were the most important economic engines of China's development, which can be supported by the data of GDP growth. As Figure 6.2 shows, in 1980, the GDP of the five SEZs was 4.127 billion RMB that just accounted for 0.91% of China's GDP but the GDP of the five in 1990 were 44.51 billion RMB, which was 2.39% of national GDP. In 2008, the number of GDP of the SEZs dramatically grew to 1272.26 billion RMB, which was 308 times as much as that in 1980 when the five SEZs established. Also, in the early period (1980s), the GDP growth of the five were much faster than rest of China. For example, in 1980-1984, compared with China's average annual GDP growth of about 10% per year, Shenzhen grew at 58%, followed by Zhuhai with 32%, Xiamen with 13% and Shantou with 9% (Yeung et al, 2009:225). The data of per capita GDP also show the leading roles of the five SEZs in Chinese economic development. In 1980, the average of the five SEZs was RMB 541, that was just RMB 81 more than national average but to 1985, the differences between them were RMB 1284, which was about 16 times that in 1980. In 2000, the average per capita GDP of the five SEZs were RMB 24349 that was about 3.44 times of national average⁴⁷.

With the rapid growth of GDP of the five SEZs, the local government and residents benefit from the development. In 1995, government revenue derived from five SEZs was 18.72 billion RMB, which accounted for 3% of China's revenue in that year to 2008,

⁴⁷ Data of five SEZs from China Statistical Yearbooks Database: <http://tongji.cnki.net/kns55/index.aspx>.
Date of China from National Bureau of Statistics of China: <http://data.stats.gov.cn/english/index.htm>

the government revenue of the five was 130.9 billion RMB, which was 270 times that in 1980. Noteworthy here is that the percentage of government revenues of the five in China's total (see Figure 6.3) always were lower than the percentage of GDP (see Figure 6.2). This shows the strong support from central government to the five SEZs to adopt special preference policies in attracting investments and businesses, such as preferential tax policy, lower tariffs, to build a sound business environment. Not just the local government, the residents of the Five also enjoy the benefits from economic development of the SEZs. The urban resident incomes of the Five was just 349 RMB in 1980 that was even much less than the average income of urban residents in China- 476 RMB. But to 2000, this number of the Five was 12323 RMB, which was about double of China average and in 2008, the urban resident incomes of the SEZs was 19355 RMB, the 55.46 times of that in 1980 (see Figure 6.4).

Figure 6.2 The GDP of the Five SEZs in China (billion RMB)

| | | 1980 | 1988 | 1990 | 1994 | 1998 | 2000 | 2004 | 2008 |
|---|--|-------|--------|--------|--------|--------|--------|---------|---------|
| Shenzhen | | 0.196 | 8.698 | 17.17 | 61.52 | 128.9 | 166.55 | 342.28 | 780.65 |
| Zhuhai | | 0.261 | 2.507 | 4.143 | 15.72 | 26.35 | 33.03 | 54.63 | 99.21 |
| Shantou | | 1.079 | 5.714 | 7.245 | 19.72 | 42.32 | 47.7 | 60.38 | 97.48 |
| Xiamen | | 0.64 | 3.598 | 5.709 | 18.7 | 41.81 | 50.19 | 88.32 | 156 |
| Hainan⁴⁸ | | 1.93 | 7.71 | 10.25 | 33.1 | 43.89 | 51.85 | 79.01 | 145.92 |
| Total of SEZs | | 4.127 | 28.23 | 44.51 | 148.76 | 283.27 | 349.31 | 624.62 | 1272.26 |
| GDP of China | | 451.8 | 1492.8 | 1854.8 | 4662.2 | 7834.5 | 8940.4 | 13658.4 | 30285.3 |
| Total of SEZs in China's GDP (%) | | 0.91 | 1.89 | 2.39 | 3.19 | 3.62 | 3.91 | 4.57 | 4.2 |

Source: data of five SEZs from China Statistical Yearbooks Database: <http://tongji.cnki.net/kns55/index.aspx>. Date of China from National Bureau of Statistics of China: <http://data.stats.gov.cn/english/index.htm>. (Access by Nov, 2016).

⁴⁸ Data of Hainan SEZ before it established (1980, 1985, 1988), refer to the data of Hainan province.

Figure 6.3 The Government Revenue of the Five SEZs (billion RMB)

| | 1980 | 1985 | 1990 | 1995 | 2000 | 2004 | 2008 |
|---|---------|--------|--------|--------|--------|---------|---------|
| Shenzhen | 0.0304 | 0.629 | 2.171 | 8.802 | 22.5 | 32.15 | 80.04 |
| Zhuhai | 0.0365 | 0.303 | 0.444 | 1.317 | 2.423 | 3.446 | 9.232 |
| Shantou | 0.116 | 0.173 | 0.606 | 2.302 | 3.833 | 2.465 | 5.122 |
| Xiamen | 0.183 | 0.391 | 1.029 | 3.451 | 5.185 | 6.502 | 22.02 |
| Hainan⁴⁹ | 0.119 | 0.316 | 0.739 | 2.853 | 4.491 | 6.93 | 14.49 |
| Total of the five SEZs | 0.485 | 1.812 | 4.989 | 18.72 | 38.44 | 51.49 | 130.9 |
| Total China | 115.993 | 200.48 | 293.71 | 624.22 | 1339.5 | 2639.65 | 6133.04 |
| Total of SEZs in China's revenue (%) | 0.418 | 0.904 | 1.698 | 3 | 2.869 | 1.95 | 2.13 |

Source: see Figure 6.2

Figure 6.4 The Income of Urban Resident of the Five SEZs (RMB/per person)

| | 1980 | 1985 | 1990 | 1995 | 2000 | 2004 | 2008 |
|----------------------------|------|------|------|-------|-------|---------|---------|
| Shenzhen | N/A | 1915 | 4127 | 13059 | 21626 | 27896 | 26729 |
| Zhuhai | N/A | 1106 | 3048 | 9748 | 15110 | 18347 | 20949 |
| Shantou | 330 | 709 | 1917 | 6132 | 8707 | 9930 | 12542 |
| Xiamen | 406 | 878 | 2345 | 7135 | 10813 | 14443 | 23948 |
| Hainan⁵⁰ | 310 | 680 | 1534 | 4770 | 5358 | 7736 | 12608 |
| Average of the SEZs | 349 | 1058 | 2594 | 8169 | 12323 | 15670.4 | 19355.2 |
| China | 479 | 802 | 1686 | 4283 | 6280 | 9421.6 | 15780.8 |

Source: see Figure 6.2

As argued before, the SEZs are one of the best example of China's trade-oriented and

⁴⁹ See note 47

⁵⁰ See note 47

investment-oriented economic model. The aim to establish SEZs in China ‘was to foster and stimulate economic development through attracting foreign investment, expanding exports and technology imports’ (Wei, 2000: 203). Since establishment, the gross value of imports and exports of the Five has increased from US\$ 0.423 billion in 1980 to US\$ 380.65 billion in 2007, which increased by about 900 times (see Figure 6.5). The average growth rate of trade of the SEZs in 1980-2007 was 28.7%, which was much higher than national average growth in the same period - 15.6% (Qi 祈, 2008:12).

Figure 6.5 The Gross Value of Imports and Exports of the Five SEZs (US\$ 100 millions)

| | 1980 | 1990 | 2000 | 2003 | 2007 |
|-----------------|-------------|-------------|-------------|-------------|-------------|
| Shenzhen | 0.1 | 54.7 | 639.4 | 1174 | 2875.3 |
| Zhuhai | 0.2 | 6.5 | 85 | 167.8 | 398.7 |
| Shantou | 2.5 | 8.7 | 42.1 | 33.5 | 61.1 |
| Xiamen | 1.4 | 11.5 | 100.5 | 187.1 | 397.8 |
| Hainan | N/A | 2.1 | 12.9 | 22.7 | 73.6 |

Source: Qi 祈 (2008), table 3

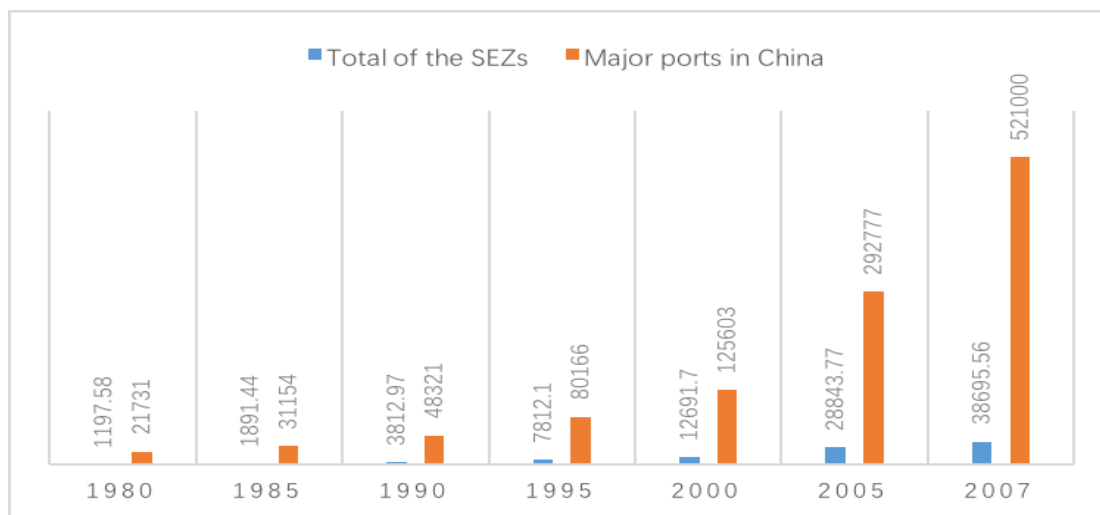
In 1980, the port cargo throughput of the SEZs was about 5.51% of that of Chinese major ports but to 2000, this number had doubled to 10.10% (see Figure 6.6). The SEZs also play leading role in attracting and using FDI in China. As some scholars indicate, the SEZs had an ‘immediate impact’ from China’s reopening to foreign investment and trade that in 1981, the four SEZs⁵¹ accounted for 59.8% of total FDI in China and in 1984, the Four still accounted for 26% of China’s total FDI (Wong, 1987:31; Yeung et al, 2009: 224). Moreover, according to Yeung et al (2009), in the 1980s, more than half of the total number of equity joint venture projects in China were hosted in the Five. In 1990, the actual utilized FDI of the Five was US\$ 1.2 billion, accounted for 32.1% of realized FDI in China – US\$ 3.49 billion⁵². In the end of 2007, actual utilized of FDI of

⁵¹ Except Hainan SEZ, which was established until 1988.

⁵² Data of the Five SEZs from Statistical Yearbook of Statistical Yearbook of Shenzhen, Zhuhai, Shantou,

the five SEZs was US\$ 7.26 billion that was about 100 times of that in 1980-US\$ 73 million⁵³.

Figure 6.6 The Port Cargo Throughput of the Five SEZs (10000-tonnes)



Source: see Figure 6.2 and Qi (祈) (2008), table 4.

As the reform laboratory, the influences of the five SEZs were not just in economic development but also in political areas. Just as Victor Sit indicates, the SEZs serve as the vanguard in China's market-oriented reform and more important is that 'as a socialist state, China needs the SEZs to function as a bridge-one which can lead to a system that is more open and better able to serve the requirements of socialist modernization by combining the "best" of the two worlds- [socialism and capitalism]' (1985: 84-5). On one hand, as Figure 6.7 shows, the location of the Five SEZs are all far away from Beijing - the political center of China - and reforms follow the gradual approach restricted in limited regions, to reduce the potential risks of political effects brought by this market-oriented reform to CPC authorities (Yeung, et al, 2009). But on the other hand, the economic successes of the SEZs, to some extent, are because in

Xiamen and Hainan Province (1990). Source from: China Statistical Yearbooks Database:

<http://tongji.cnki.net/kns55/index.aspx>; Data of Chinese realized FDI from Wei (1996),

⁵³ Data from Statistical Yearbook of Shenzhen, Zhuhai, Shantou, Xiamen and Hainan Province (1980/2007).

Source from: China Statistical Yearbooks Database: <http://tongji.cnki.net/kns55/index.aspx>.

the context of its planned economy system in the 1980s, China could introduce a more open and viable economy system by incremental policy reform and experimentation in SEZs. More specifically, as some scholars indicate, the economic successes of SEZs are based on four factors, including 'overcome the common problem of limited resources by supporting large-scale investment; ... foster incremental experimentation -and trade-based learning, supporting by government policies; attract FDI to promote export growth; ... facilitate economic liberalization ... through policy measures and in situ innovations; (Yeung et al, 2009: 223; Wei, 2000).

Figure 6.7 The Geographic Location of the Five SEZs and Hong Kong, Macau and Taiwan



notes: ★ refers to the five SEZs ○ refers to Hong Kong, Macau and Taiwan

As the policy laboratory of China's opening up reform, the SEZs were very important to introduce market economy mechanisms, especially in the 1980s and 1990s. As scholars conclude, the SEZs 'encouraged to pursue pragmatic and open economic policies, serving as a testing ground for innovative policies that, if proven effective,

would be implemented more widely across the country' (Yeung et al, 2009:223). In 1980, when Shenzhen SEZ was established, there was no market economic system in China that all production factors were controlled by the government, including lands, labor, energy, capital, and technology. So introducing the market system of factors of production was a difficult but pressing need. Take the land access of foreign enterprises and private enterprises as an example. As a socialist country, all land in China belong to Chinese citizens as a whole. Under the planned economic system of China, before market-oriented reform, once infrastructure projects of state-owned enterprises (SOEs) approved by government, the SOEs can use state-owned land free but just paying former land users certain amount compensation fees for land requisition. But this could not work for foreign enterprises and private enterprises in Shenzhen SEZ. In order to solve this problem, the Shenzhen government announced that foreign investors needed to pay a yearly site use fee based on the usage, location and acreage of the land, which was the first in China. In 1990, based on the experiments in five SEZs, the State Council of China approved 'Order 55' about allowing foreign investors to acquire land use rights for business operations.

Hiring workers was another challenge for foreign investors and the Chinese government. The SEZs introduced the contract labor system, breaking the traditional 'iron rice bowl' (铁饭碗) system⁵⁴, which allowed foreign enterprises to hire workers independently based on their needs. Another case was the foreign currency exchange system. Before reform and opening up, the RMB was an inconvertible currency under the direct planning of the People's Bank of China (PBoC). As I discussed earlier, the SEZs proved to be a magnet for FDI and their trade-oriented economic model also made large amount of foreign money flowing into SEZs. In 1985, SEZs set the foreign exchange swap centers to ensure enterprises could 'adjust' their needs of foreign

⁵⁴ The 'iron rice bowl' system is the system of guaranteed lifetime employment. Under this system, the work units would look after their worker for life but also most aspect of daily life of workers were controlled by work units. More information to see: http://news.bbc.co.uk/1/shared/spl/hi/in_depth/china_politics/key_people_events/html/4.stm.

currencies, which set the base of China's dual exchange rate system in the 1980s and early 1990s. In 1994, based on the experiences of SEZs, China unified its official and swap market exchange rates to take a big step towards currency convertibility (Huang and Wong, 1996:42-57). In sum, the SEZs always embark on brave exploration in their roles as first movers in China's market-oriented reform.

As argued before, in China's market-oriented reform, the SEZs make great achievements in economic development and market system building. However, the SEZs, as the policy laboratory of China's market-oriented reform, just simply a transplant of western market system did not work. I argue that there are two related aspects to this. First, I indicated in Chapter Five, in the processing of China's development, assimilation and adoption of foreign practices but only according to local circumstances and customs is one significant feature, which is also one key of socialism with Chinese characteristics. Beijing's approach to economic reform is thus both bold in policy innovation but prudent gradualist in the scale and implementation of these innovations. Second, as a policy laboratory, their experiences should can be learned by other parts of China. Considering the more important role of state-owned and planned economies in other areas of China, especially in inland China such as north east and central parts of China, immediately and totally discarding whole old systems will make the other areas hard to copy SEZs' successes and very possibly to cause chaos. So in China's market-oriented reform, as a model of China's mode of modernization, the SEZs represented an uneasy balance between the adoption of Western economic ideas and development norms and the needs to translate there according to Chinese customs and traditions, and the political imperatives for the CPC to retain political control.

The example of price reform in the Shenzhen SEZ in the 1980s best illustrates this. In the 1980s, Shenzhen's price system was a mixed and complicated system with 'two market, three prices, three currencies'. The two markets were the planned market and the free market. Three prices referred to the state-fixed price, the state guidance price

and the market price (Feng and Chen, 1992: 127). Three currencies included the renminbi (RMB), the foreign exchange certificate (FEC), and the Hong Kong dollar (HKD). In the first two years of Shenzhen SEZs, commodity shortage was a big problem. But under China's state monopoly for purchase and marketing of commodities (统购统销), solving this problem became more difficult. Because this system for commodities was very rigid with an annual quota system and was mostly controlled by central government there was almost no leeway for local government. So how to break the exclusive control of central government but without threatening the stability of prices became most important. If it discarded the state's monopoly system and directly purchased commodities from producers in other parts of China in RMB, it would threaten the stability of prices in those areas. But by following the old systems, it was hard to solve the problem of commodity shortage. So the Shenzhen government decided to set up an import and export service company outside the old trade and supplying system. They went to Canton Fair (广交会) to use foreign currencies including HKD and FEC, to purchase commodities from inland manufacturers and also signed special supply contracts with them, mostly denominated in HKD. This not only solved the problem of commodity shortage in Shenzhen SEZ but also allowed inland manufacturers to earn more foreign exchange. The special contracts with SEZs were outside the planned supplying system, which meant the products sold to SEZs would not be included in yearly production targets and quotas of producers. This made sure that these special contracts would not directly challenge the local supplies or threaten the stability of local prices in those areas.

Moreover, in the late 1980s and early 1990s, based on the special contracts with inland suppliers, the SEZs improved cooperation with inland enterprises to set up many inland associated enterprises (内联企业). Through this, these associated enterprises underwent a market transformation and gradually introduced the market system to their inland parent companies. So even though price reform Shenzhen SEZ did not

immediately break China's monopoly for purchase and marketing of commodity, Shenzhen SEZ was the first to make the market-oriented price reform that in the following five years led to a gradual reform of supplying system and price system in the rest of China (Li 李, 2009: 129-139). Just as scholars indicate, 'as an integral and critical component of China's gradualist approach toward economic reform and opening up ... the impact of the SEZs on the path of economic transition in China has been much deeper than would have resulted from a simpler version of export processing zone' (Ge, 1999:8).

The SEZs played a significant role in China's market-oriented reform and economic transitions in the 1980s and 1990s, so the SEZs are also strongly related with China's imbalanced economic model. As argued before, the main purposes to establish SEZs is to attract FDI and to expand exports in China but as scholar points out, 'as a result of enhanced economic growth in China after [reform and opening up in the late 1970s] ... the on-going development policy [of SEZs] needed to be reconsidered ... this accelerated economic development had brought forth at the same time considerable regional disparities, economic and social problems' (Ota, 2003:1).

As argued in Chapter Four, China suffers from an imbalanced industrial structure, which also can be clearly seen in the SEZs. Manufacturing is always the key industry in SEZs and most FDI also went to this sector. For example, between 1981-1986, the four SEZs (except Hainan) accounted for about 25% of China's total FDI and among these, in Shenzhen 49% went to manufacturing industries, followed by Xiamen of 45%, Shantou of 42% and Zhuhai of 24% (Wong, 1987). To 2000, the manufacturing in SEZs accounted for an average 45.8% of their GDP and this number in Shenzhen, Zhuhai and Xiamen were all more than 52%, which was much higher than the national average of 45%⁵⁵. More important is that in the 1980s and early 1990s, due to lack of

⁵⁵ The average percentage of the five SEZs was just 45.8%, very close to national average level, was mostly because of the low number of Hainan-19.8% in 2000-, which is a big agriculture province in China that agriculture always accounts for one third of its GDP.
Data of five SEZs from China Statistical Yearbooks Database: <http://tongji.cnki.net/kns55/index.aspx>;

investments, technologies and talents, the SEZs actively developed the foreign-oriented manufacturing economy characterized by the 'three-plus-one trading-mix' (三来一补). The 'three-plus-one trading mix' refers to the trade ventures involving processing and assembly with supplied materials and parts and compensation trade. In the 1980s and early 1990s, these strongly improved the economic development of SEZs that not only expanded exports and increased foreign exchange reserves, but also created millions of jobs, which also strongly improved the urbanization of SEZs in the 1980s. However, SEZs' rapid growth of manufactories in the 1980s and early 1990s was characterized as 'three high' (high input, high consumption, high pollution) but with 'two low' (low efficiency, low value added) as argued in Chapter Four. The supply of raw materials, product design and sales were largely controlled by foreign parent companies. As scholars indicate, even though the SEZs established an export-oriented and foreign-financed industrial base, it less functioned as a conduit for technology transfers to China, which actually was another key aim to establish the SEZs (L. Wong, 1987).

These low efficiency and low value added features of SEZs industries also lead to the problem of a gulf between rich and poor in SEZs, especially for migrant workers in SEZs. This problem of the SEZs can be related with the rise of hyperliberalism globalization, as Cox called. According to Cox (1996), the new global mode of production has increased the structural powers of capital and weakened the power of the organized working class. Cox argued that hyperliberalism globalization exposed conflicts and contradictions between the transnational ruling group, which includes MNCs, officers in big international organizations, senior officers of authorities, high-income core workers who benefited from globalization, and subordinate groups including the national bourgeoisie, lower-income peripheral workers and other social groups marginalized by globalization. These conflicts and contradictions weaken the subordinate groups' common identity with the dominant global ideology in era of

Date of China from National Bureau of Statistics of China: <http://data.stats.gov.cn/english/index.htm>.

globalization, e.g. competitiveness, deregulation, privatization, and restructuring. Hence the rise of hyperliberalism and globalization produced a global crisis of legitimacy (1996:30-31).

According to data, there were seven million migrant workers in Shenzhen, accounted for more than 50% of Shenzhen's 12 million population and until 2003, about one-third of Chinese zone workers received less than the minimum wage and about half of firms in Shenzhen owed their employees wage arrears, especially in manufacturing (Gopalakrishnan, 2007: 1493; Jayanthakumaran, 2003). Moreover, most of migrant workers hold a rural hukou (户口)⁵⁶ that make them unable to join the urban welfare system. The sharp rural-urban distinctions in the public provision of schooling, health care, and retirement benefits, make their urban lives one of suffering. Treiman points out that 'economic disparities are exacerbated by institutional arrangement that have created a two-class society based on registration (hukou) statuses' (2012:33).

The economic disparities are not just within the SEZs, the regional disparities are also exacerbated by the 'special status' of SEZs. As Figure 6.7 shows, all five SEZs are located in south east coast areas of China and are close to one of China's long-established trading ports. According to Sit, 'many Chinese overseas in the region originated in these port cities [five SEZs] and some still have relatives there. Such a connection offers the SEZs an edge in terms of foreign relations ... investment promotion by the SEZs were aimed at the overseas Chinese' (1985:76-7). So the location of SEZs will help them to attract FDI and expand exports. As Fujita and Hu's (2001) study of regional disparity in China shows between 1985 to 1994, the exports from the coast were four times of those of the interior before 1992 even increased to seven times in 1994. The FDI also had an extreme coastal bias in the same period, which as Fujita and Hu(2001) say, strongly related with China's biased 'open-door' policies, especially the

⁵⁶ Hukou is a household registration system establishment in 1955 in China that divided the population into 'agricultural' and 'non-agriculture' with a cross-cutting distinction between 'local' and 'non-local' registration (Treiman, 2012:33-4).

establishment of SEZs. Some other scholars also conclude that

‘Chinese government policies that give preferential treatment to certain cities by promoting openness can account for a large portion of the differences in growth rates across cities. ...These policies affect growth directly by creating an environment more conducive to production and indirectly by encouraging foreign direct investment to flow to these cities ... we estimate that the effect of awarding SEZ status is a 5.5 percentage point increase in the annual growth rate of real per capita income for an average city’ (Jones, Li and Owen, 2003:198).

Just as established before, the five SEZs play a significant role in China’s gradual market-oriented reform and economic transition as a policy laboratory but also shows the internal imbalances of China’s model of development as argued in Chapter Four. But with 20 years of development, especially after the widely national promotion of the SEZ model since the mid-1990s and national unification reform of tax, foreign exchange rates and foreign trade in 1994, the Special Economic Zones were no longer that special. Many special benefits to SEZs in the 1980s and early 1990s became national policies and after leaning the experiences of SEZs, some inland areas even did some braver explorations in marketization reform. The end of ‘specialization’ of the five SEZs was not about abandoning the SEZs but more was that the five SEZs had completed their economic and political missions in the early phrase of China’s market-oriented reform. They set the stage for a new policy laboratory in the next round of market-oriented reform and economic restructuring in China: the Pilot Free Trade Zones (PFTZs) that will be studied in next section.

6.3 The Pilot Free Trade Zones (PFTZs): the Policy Laboratory 2.0 and China’s Economic Restructuring

The establishment of the Pilot Free Trade Zones (PFTZs) in China is strongly related with the structural changes in international and domestic political economy since the

2008 financial crisis. As I argued in Chapter Four, the single dynamic structure in the current global system based on American debt-financed consumption was undermined by the 2008 GFC, which, for some, spelled the end of laissez-faire capitalism and the beginning of the populist-nationalism of the post-crisis era (see Helleiner, 2014; Feldstein, 2010; Davies, 2010; Kriesi and Pappas, 2015). As argued before, according to Keohane and Nye (2001), even that globalization is a multilateral process, more powerful actors are dominating the process of globalization. Moreover, vulnerability and sensitivity interdependence are both significant part of globalism. In the era of globalization, vulnerability interdependence is more important in world politics because globalism implies vulnerability 'has more implications for uneven distribution of global power and autonomy than a form of globalism involving only sensitivity' (2001:38). In the post-crisis era, China's trade-oriented and investment-oriented economy makes its economy more vulnerable and suffer more from the rise of protectionism in international trade and the decline in liquidity in international financial system. These highlight the domestic structural imbalances in China's economy, as I indicated in Chapter Four, including over dependence on external demands and investment, excessive growth of foreign exchange reserve (FER), the extensive development mode, regional disparities and urban-rural disparities in China.

Moreover, with the challenges, there are also some new opportunities in the post-crisis era, such as the rapid rise of the green economy and services trade, the rise of regionalism and some new trends in trade agreements, especially the rise of regional trade agreements with higher and more comprehensive standards, like Trans-Pacific Partnership (TPP) and Trade in Service Agreement (TISA). Facing the changing global order and imbalanced domestic economic structure, economic restructuring is a pressing need for China and the PFTZs is one significant policy laboratory of China's economic restructuring in the post-crisis era. As indicated before, to 2017 there are 11 PFTZs in China but this section will only focus on the first four PFTZs established before 2015 that have operated for years, namely Shanghai PFTZ, Fujian PFTZ, Tianjin PFTZ and Guangdong PFTZ. In the following, I will first briefly introduce four PFTZs. Then I

will examine the main focus of reforms in PFTZs and after this, this chapter will analyze the main changes from SEZs to PFTZs to show the path of China's rebalancing.

The China (Shanghai) Pilot Free Trade Zone (Shanghai PFTZ) was launched on September 29, 2013, which is the first PFTZ in China. On December 28, 2014, the Shanghai PFTZ was enlarged from 28.78 square kilometers to 120.72 square kilometers. As the testing ground for economic reforms and decentralization, its establishment is 'in a bid to reduce administrative interventions, ease restrictions on investments, further open up its financial system and internationalize its currency to booster shipping logistics, and commerce' (Wan, Zhang, Wang, Chen, 2014:1). Compared with other PFTZs, Shanghai PFTZ more focuses on financial reform, which mainly refers to liberalization of interest rate and foreign exchange rate, international of RMB and opening up of the capital accounts including the cross-border use of RMB and RMB capital account convertibility and financial stability. Then on December 31, 2014, the State Council approved the establishment of another three PFTZs in Fujian, Tianjin and Guangdong, which officially started to operate on 21 April, 2015.

The Fujian PFTZ area was 118.04 square kilometer and consisted of three main areas- Fuzhou, Xiamen and Pingtan⁵⁷. There are two local characteristics with Fujian PFTZ. One is Taiwan advantage of Fujian. As Figure 6.8 shows, there is a close economic and trade relations between Fujian and Taiwan. Fujian PFTZ 'adopt innovative cross-Strait cooperation mechanism, promote free-flowing of good, services, capital and personnel and enhance the economic connection of Fujian and Taiwan' is one strategic positioning of Fujian PFTZ (HKTDC, April 07, 2017). As the core area and start point of the 21st Century Maritime Silk Road (the Silk Road), improving the cooperation and exchange between China and countries along the Silk Road is another local character of Fujian PFTZ. As Justin Yifu Lin says, both as new opening up strategies 'developed in

⁵⁷ See official website of China (Fujian) Pilot Free Trade Zone: <http://www.china-fjftz.gov.cn/html/en/page-2-0.html>.

response to the changed domestic and international circumstance’, cooperative implementation of One Belt and One Road (OBOR) and Pilot Free Trade Zone will benefit China’s market-oriented reform and provide a better external environment to China’s further opening up (2015:585-590).

Figure 6.8 Trade Between Taiwan and Fujian (100 million USD)

| Year | Export | | | Import | | |
|------|--------------------------------------|--------------------------------|---|--------------------------------------|--------------------------------|---|
| | Fujian to Taiwan total ⁵⁸ | On total exports of Fujian (%) | On total mainland China’s exports to Taiwan (%) | Fujian to Taiwan total ⁵⁹ | On total imports of Fujian (%) | On total mainland China’s imports to Taiwan (%) |
| 2005 | 0.79 | 0.23 | 0.48 | 4.09 | 2.09 | 0.55 |
| 2013 | 32.21 | 3.03 | 7.93 | 96.27 | 15.32 | 6.16 |

Source From: China Statistical Yearbooks Database: <http://tongji.cnki.net/kns55/index.aspx>.

The total area of China (Tianjin) Pilot Free Trade Zone (Tianjin PFTZ) is 119.9 (sq.km.), which consists of three areas: Tianjin Port Dongjiang Area (30 sq.km.), Binhai CBD Area (46.8 sq.km.) and Tianjin Airport Area (43.1 sq.km.)⁶⁰. The unique geographical and strategic position is the most important local character of Tianjin PFTZ. Among the first four PFTZs, Tianjin PFTZ is the only one located in Northern China, where it is one fastest growing city in Northern China in recent two decades. Compared with the five SEZs all located in south east coast area of China, Tianjin is very close to Beijing and also is the core city of Beijing-Tianjin-Hebei (BTH) region. Creating a high-level open platform for the coordinated development of BTH region and establishing offshore financial service for Northern China are core tasks of Tianjin PFTZ. Moreover, Tianjin Port is one long-established port in Northern China and was already the 10th biggest

⁵⁸ Fujian’s total exports to Taiwan (100 million USD)

⁵⁹ Fujian’s total import from Taiwan (100 million USD)

⁶⁰ See official website of China (Tianjin) Pilot Free Trade Zone: <http://www.china-tiftz.gov.cn/html/home/ZMQGK25051/List/index.htm>.

container port in the world in 2015, which is also the main maritime gateway to Beijing. So establishing the core functional zone of the international shipping and logistical center in Northern China is also the priority to Tianjin PFTZ. That mainly serves on five major functions, 'ranging from container terminal port handling, container logistics processing, commercial trading, to living and accommodation as well as leisure and tourism' (HKTDC, April 11, 2017).

China (Guangdong) Pilot Free Trade Zone (Guangdong PFTZ) consist of three main areas: Nanshan Area of Guangzhou (60 sq.km., including 7.06 sq.km. Nanshan Bonded Port Area), Qianhai and Shekou Area of Shenzhen (28.2 sq.km.), and Hengqin Area of Zhuhai (28 sq.km.)⁶¹. Integration with HK and Macau is the most important local character of Guangdong PFTZ. The economic connection between Guangdong and HK and Macau is very close, such as that in 2013, about 70% of China's exports to HK and Macau were from Guangdong. So according to the report from PwC, 'the primary task and measure of the Guangdong PFTZ which are distinguishable from the other three... is the further promotion of the liberalization of trade in services between Guangdong and ... [HK and Macau] ... and the push to deepen the opening up of the financial sector in these three locations innovatively' (April 2015: 2). Among three Areas of Guangdong PFTZ, Shenzhen and Zhuhai are two of the five SEZs so they can fully play to the advantages of being the frontline of opening up and form a new pattern of opening up at higher level. Moreover, high-tech industries play an important role in Guangdong and in 2013, the exports of high-tech products in Guangdong was \$ 475.07 billion dollar that accounted for 43.51% of total exports of Guangdong⁶². So improving the upgrading to high-end manufacturing is another core task of Guangdong PFTZ.

As argued before, the establishment of PFTZs is in the background of serious internal imbalances in China and dramatic changes in the international system in the post-crisis

⁶¹ See official website of China (Guangdong) Pilot Free Trade Zone: http://www.china-gdftz.gov.cn/en/ABOUT_GDFTZ/Introduction/201502/t20150214_587.html.

⁶² Data from: China Statistical Yearbooks Database: <http://tongji.cnki.net/kns55/index.aspx>. (Guangdong Statistic Yearbook 2014)

global order. According to Palmioli and Heal (2014), there is a consensus among Chinese policymakers of the necessity of a structural transformation from trade-oriented and investment-oriented model to a 'more efficient service- and consumption-driven economy in China. They also indicate that in CPC's Third Plenum in November 2013, Beijing re-ensured their promises to further improve the market-oriented reform by 'allowing market to play a more decisive role in resource allocation' and as the testing ground, the PFTZs are planned to 'play an important catalytic role' in these reforms and transformation (2014: 3-4). As some scholars indicate, there are five main purposes of the PFTZs, which include 1) 'improving the efficiency and effectiveness of government functions'; 2) 'open up economy to new investment opportunities'; 3) improving the development of trade, especially the quality of it; 4) more opening up of service industries; 5) 'align the existing legal framework with respect to foreign investments' (Lui, 2014:31). Based on these, this chapter argues that the reforms in PFTZ mainly focus on four aspects⁶³, including trade facilitation, investment liberalization, financial reforms and encouraging innovation. I will briefly introduce them below before discussing them in more detail in the next chapter.

Improving trade facilitation is the basic function of free trade zones. Even though the PFTZs still provide the tax incentives to improve trade facilitation, the PFTZs more focus on providing better public services and improving the efficiency of customs supervision, such as improving fast customs clearance, electronic and pre-declaration system, to promote the efficient and fast flow of goods and sources in the zones. Moreover, besides trade of goods, the PFTZs also focus on the development of services trades especially widening opening up to more services industries in China, including shipping industry, medical services, telecommunication services, e-commerce and so on. Investment liberalization is another core aspect of PFTZ's reform. As argued before, the establishment of PFTZs is in the context of the rise of regional trade agreements with higher and more comprehensive standards, such as TPP and TISA. Considering

⁶³ Interview 25, 28 and 29.

the high administrative barriers in the Chinese market, Beijing also needs to follow this new trend in attracting investment by opening up more sectors to foreign investors and also by simplifying its administration approval system. The key reform of this in PFTZ is the establishment of a 'negative list' approach. In China's market-oriented reform, financial reforms always attract more abroad attentions. The PFTZs are the most important policy laboratory of financial policies innovation to do the stress tests for further financial opening up in China. The financial reforms in PFTZs are related with four aspects, namely cross-border use of RMB; RMB convertibility on capital account; piloting marketization of interest rate and foreign exchange control reform (Song 宋, 2014). As argued in last chapter, under the new normal, China not only encourages enterprises innovation but also strongly improves institutional innovation. In PFTZ, institutional innovation, especially streamlining government and delegating authorities (简政放权), is the key approach of promoting reforms in PFTZs. The transformation in government functions in PFTZs are embedded on all reforms in PFTZs⁶⁴. In accordance with internationalization, marketization and legalization, the PFTZs tend to simplify approval procedures, to improve administrative transparency, to establish an administrative system adapted to the international high standard investment and trade rules system⁶⁵.

Being the policy laboratory of China's reform and economic transitions, just as argued in the last chapter, the basic guiding principles of SEZs and PFTZs are the same that Beijing's approached to economic reform is thus both bold in policy innovation but prudent gradualist in the scale and implementation of these innovations, which helps to improve economic development and restructuring but prevents potential threat to China's one party system. As argued before, to the mid-1990s, the SEZs were not that special as they were in the 1980s. After SEZs, China also established many different types of special economic zones, such as high-tech industrial development zones,

⁶⁴ Interview 25 and 29.

⁶⁵ Interview 28

export-processing zones, economic and technological development zones and so on. But they still followed the similar pattern of SEZs, which was attracting FDI and advanced technologies to improve export-oriented economy by offering various preferential policies, mostly on tariff and tax. However, there are many fundamental differences between approaches to reform of PFTZs and SEZs, which I argued mainly in four aspects.

1. From manufacturing to services industries. I argued before that the main purposes of establishing the SEZs was to promote exports and to increase foreign exchange earnings, which made the five SEZs a potent symbol of China's trade-oriented and investment-oriented economic model. So from labor-intensive industries in the 1980s, such as textiles, shoe-making and garment industries, to high-tech industries in the later 1990s and 2000s, such as the electronics industry, the SEZs always focus on manufacturing. But the priority of PFTZs is given to modern service industries, such as financial services, leasing industry, logistics industry, and tourism. Noteworthy here is that priority to service industries does not mean that in PFTZs the manufactories are not important. Tianjin PFTZ is a good case. Tianjin is one of the most important production base of high-tech products in Northern China. For example, in 2013, the total export-import volume of high-tech products of Tianjin was 49.926 billion USD, accounted for 38.84% of total export-import volume of Tianjin⁶⁶. But in China, the development of service industries in Northern China are much slower than that in Southern China, such as poorer urban logistics system and underdeveloped financial leasing, which often blocked the rapid growth of manufactories there. So Tianjin PFTZ tries to facilitate investment and to cluster high-end industries through providing high-quality financial services, efficient legal services and more effective regulations. Improve the development and upgrading of manufactories cooperated with promoting the development of modern service industries is the industrial strategy of

⁶⁶ Data from China Statistical Yearbooks Database: <http://tongji.cnki.net/kns55/index.aspx>. (Tianjin Statistic Yearbook 2014).

PTFZs. As two interviewees indicate, the one priority of PFTZs is to be the testing ground for further opening more services industries to private and foreign investment in China, especially for former highly state controlled services industries, such as education, health care, telecommunication and financial services⁶⁷. Some Chinese officials also mention that the further opening up to high state control services industries in PFTZs, will also related with the marketization reforms of SOEs to see the potential risks and problems when private and foreign investments joining these service industries⁶⁸. All of them mention that priority to services is one key feature of PFTZs.

2. From providing preferential policies to institutional innovation. For the SEZs, the main measures are preferential policies, such as tax incentives and tariff cuts. But as argued before, the special preferential policies to certain areas led to many social problems, such as regional disparities and homogeneity competitions between local governments. Compared with promoting quantity growth of economy of SEZs, the main aim of PFTZs is to improve the high quality and sustainable development of China's economy. So a new path to improve reforms is very important to PFTZs. Eliminating policy barriers and improving efficiency and effectiveness of government functions are the main measures to promote reforms in PFTZs. According to the Report on the Work of the Government of China (2017), in China's deepen reform and opening up, 'to balance the government-market relationship-the pivotal issue in economic structural reform - we continued reforms to streamline administrate, delegate powers, and improve regulations and services'.

I argued that in detailed these measures mainly related with three aspects. First is deregulation, especially in investment areas. For deregulation, the transferring from 'positive list' to 'negative list' approach in investment management is one important step of investment liberalization and easing market access for foreign investments in

⁶⁷ Interview 6 and 28

⁶⁸ Interview 12 and 13

China. Then, the simplified administration process is also important in PFTZs. The PFTZs have launched various policies to simplify the administrative processes of registration and approval system for investment and also improve trade facilitation by providing more efficient customs services. Last but not least, perfecting the legal system and mechanism is significant. Establishment of pluralistic dispute resolution mechanism in PFTZs to improve the rule of law in PFTZ. For instance, Fuzhou Area of Fujian PFTZ established two main bodies of legal system-Fuzhou PFTZ Court that focus on domestic cases and Fuzhou PFTZ Court of Arbitration that however more on solving international disputes. Fuzhou Area also establish 'judge studio' to provide legal advisory services to foreign investors, especially to Taiwan investors. According to an official from Fujian CPPCC, the approach to reform in PFTZs is to provide a more open and fair business environment with high degree of internationalization, transparency and rule of law⁶⁹.

3. From one-way to two-way opening up. For the SEZs, the opening up was only one way of attracting FDI, expanding exports and earning foreign exchanges. The opening up of PFTZs is a new two-way pattern. Encouraging to expand imports and to increase overseas investment make PFTZ different from traditional export-oriented and attracting FDI economic model of SEZs. Actually in recent years, with the development of China's economy, the demand of Chinese consumers for foreign goods continues to grow. But considering China's high imports taxes, many Chinese consumers tend to choose Daigou (代购)⁷⁰ as the new way to buy foreign products with lower prices, from luxury goods to groceries. For example, many western medias reported that the daigou phenomenon should be seen as one very important reason of Australia's baby formula shortage in 2017⁷¹. Now the international direct-selling supermarket may

⁶⁹ Interview 6

⁷⁰ Daigou: a person or agent outside of China purchases commodities for a customer in China.

⁷¹ See reports: 1) <https://www.perthnow.com.au/news/wa/rise-of-daigous-sees-perth-man-publicly-list-aumake-ng-b88694195z>; 2) <https://thenewdaily.com.au/news/national/2017/09/14/baby-formula-shortage-coles/>; 3) <https://www.nytimes.com/2017/05/02/world/australia/china-students-daigou.html>.

become another choice for Chinese consumers. For instance⁷², in 2015 Fujian PFTZs signed contracts with Spanish DIA chain supermarket groups, who will enter Fuzhou Areas of Fujian PFTZ and co-operate a EU procurement center to provide better quality and lower priced EU commodities to local consumers, including food, fast-moving consumer goods, wine, and even fashion goods. In the international commodity direct-selling supermarkets in Fuzhou Areas of PFTZ opened in early 2015, you can easily to find lots foreign goods such as German black beer, French brandy, Spanish wine, Thailand's dried mango and rice, Turkey's sunflower oil, and the prices of these goods are about 20-30% cheaper than normal prices⁷³. The PFTZs provides a platform to foreigner producers and domestic importers to introduce more foreign goods with lower price to China's consumers, which will help to improve the importing and China's domestic consumption.

The cooperative implementation of PFTZs and OBOR also improve China's overseas investment. For example⁷⁴, many Chinese enterprises can set up an offshore company in PFTZs before investing in oversea infrastructure projects, which mostly are Build-Operate-Transfer (BOT) or PPP projects lasting about 20-30 years. This can help to reduce the financial risks of these investments because once projects suffering liquidity problems, the investors can transfer the shares of offshore companies in PFTZ through China's domestic multi-level property markets to provide an effective exist channel to them. Also, it will help to avoid most restrictions in host countries on the transfer of shares of foreign companies. Through policy innovation and providing better financial services, the tasks of PFTZs are not just attract FDI and expand exports as to SEZs but more is to help to improve China's overseas investment.

4. From introducing market economy mechanisms in line with international practices to actively participating in international competition and to put forward China's

⁷² Interview 1 and 21.

⁷³ Interview 21 and 25.

⁷⁴ Interview 27, 12 and 22.

proposals of reforms. The five SEZs were established in the 1980s and China was still in the early phase of opening up and market-oriented reform in the context of a national wide planned economy system. So the priority of SEZs was to introduce market economy mechanisms and to eliminate internal obstacles from planned economy system for market-oriented reforms. In 1980, China's GDP just accounted for 1.7% of global GDP and ranked 10th in the world and China's influence in international society was very limited either in economy or politics⁷⁵. So in line with existing international practices, whether a benefit to China or not, was the only choice of China to join the international economic system. But now China is the second largest economy in the world and to 2016, the GDP of China already accounted for about 14.6% of global GDP⁷⁶. The influence of China on the global economic system has been dramatically enhanced. Moreover, facing the decline of the powers in global governance in the post-crisis era, the advanced economies represented by the US, try to build up a new more comprehensive and higher standard to global trade and financial system by proposing new regional trade agreements, such as TPP, Transatlantic Trade and Investment Partnership (TTIP), TISA, to maintain the current American-centric international economic order. Under the background of anti-globalization and the stalled negotiations of the Doha trade round in the post-crisis era, establishment of PFTZ can be seen as an important experiment of opening up to more actively participate international competition to respond the those changes in global trade and financial order after the 2008 GFC. With this, China also advances its own proposals to reform.

Take the financial reforms in Shanghai PFTZ as the case. As argued in Chapter Four, many western scholars consider that liberalization in line with current global financial practices is the only path of China to further involve in international financial system. In the interviews with China's officers of financial sectors⁷⁷, they mentioned that they

⁷⁵ Data of GDP of China (current US\$) and GDP of World (current US\$) from the World Bank online data base: <https://data.worldbank.org/>.

⁷⁶ See above.

⁷⁷ Interview 12 and 13

agreed that the international financial centers in the countries or areas without leading influences on global economic system, such as Taipei, Seoul, indeed can benefit from higher level of liberalization. Then they said that Shanghai as the financial center of China, needs to more focused on domestic situations and a simple transplant of liberalization is not the best choice for Shanghai. It does not mean to ignore the international rules and practices but is more about promoting the reform step by step and focusing on domestic needs rather than the external pressures. For example, allowing offshore financing in Shanghai PFTZ and introducing the free trade account (FTA), which will help 'Chinese companies, especially those engaged in foreign trade, secure cheaper yuan-denominated funding from offshore, where financing costs have been lower than that on the Chinese mainland' (China Daily, March 26, 2014). So from SEZs to PFTZs can be seen as a process of turning 'passive' into 'active' of China in international competition whilst following its own pace.

6.4 Conclusion

There are three main findings in this chapter. First, as a policy laboratory in the early of China's opening up and reforms since 1978, the SEZs strongly promoted economic growth and moreover played a significant role in introducing market economic mechanisms in the context of China's planned economy in the 1980s. All these show the importance of 'zones' in China's economic reform. The economic model of SEZs was highly trade-oriented and foreign investment-oriented which means that economic development in SEZs also led to several economic and social problems, including imbalanced industrial structure, regional disparities and a gap between poor and rich, all strongly related with China's internal imbalances. Second, the establishment of PFTZs can be seen as an important experiment of deepening opening up to more actively participate in international competition to respond to structural changes in international and domestic political economy since the 2008 GFC. This chapter argues that the reforms in PFTZ mainly focus on four aspects, including trade facilitation, investment liberalization, financial reforms and encouraging innovation.

Then, I argued that there are four main differences between the PFTZs and SEZs, namely from manufacturing to services industries; from providing preferential policies to institutional innovation; from one-way to two-way opening up; from introducing market economy mechanisms in line with international practices to actively participate in international competition and put forward China's reform proposals. This also shows the different approach to reform of China's rebalancing under the new normal. In the next chapter, I will further study several detailed cases in PFTZs of financial reform, investment liberalization and facilitation, trade facilitation and encourage went to innovation to show the implementation of reforms in PFTZs and how they relate with China's rebalancing and economic transformations.

Chapter Seven

China's Pilot Free Trade Zone and Economic Restructuring

7.1 Introduction

In Chapter Six, I argued that as policy laboratories, the five Special Economic Zones (SEZs) played a significant role in the early phase of China's market-oriented reform and opening up in the 1980s and 1990s. The five SEZs with strong character of investment- and trade-orientation, was the best example of China's traditional model of political economy, as outlined in Chapter Four. The SEZs indeed reached many economic achievements with the development of China's economy, including more rapid GDP growth and a larger increase in government revenue and resident income than China's average level; an outstanding record in attracting FDI and expanding exports; and help to promote China's industrial upgrading. Moreover, the five SEZs also had political significance: which was as a policy laboratory of market-oriented reform; as a model of China's modernization; and, closely related, a key vehicle for China's unification with Hong Kong, Macau, and Taiwan. As indicated in Chapter Four, in the post-crisis era, China faces challenges, not just from changes in the international order, but also from China's internal imbalanced economic structure under the 'new normal'. Against this background, China's Pilot Free Trade Zones (PFTZs) have overtaken the SEZs to play the role as policy laboratory in China's economic restructuring and further opening up.

The PFTZs are fundamentally different from the traditional pattern of SEZs, which mainly focused on attracting FDI and advanced technologies to improve export-oriented manufacturing by offering various preferential policies, mostly related to tariffs and quotas. The priority for the PFTZs is to improve the development of modern service industries, mainly through the elimination of policy barriers to provide more

efficient public services and to encourage innovation, but not depending on the preferential policies that the SEZs did. Also, the opening up in the PFTZs is two-way compared with one-way of SEZs: that is, the PFTZs are not just about attracting FDI and expanding exports to increase FERs as SEZs, but are very focused on expanding imports, stimulating consumption and improving China's overseas investments. More important is that the establishment of PFTZs is China's responses to changes in the international order in the post-crisis era - both in respect of its domestic imbalances and its greater willingness to involve itself in the formulation of new global rules. The differences between PFTZs and SEZs show that China is changing its traditional way to improve the development of the economy, as it tries to rebalance and restructure its economy through new reforms. As the most important policy laboratory of China's new reforms, PFTZs are a crucial case to understand China's economic restructuring and further market-oriented reform in the post-crisis era.

In this chapter, I will continue to study the PFTZs as a policy laboratory of China's economic restructuring. The reforms in the PFTZs are mainly related to four areas of reform. The first is investment liberalization and facilitation. As argued before, the PFTZs focus on eliminating policy barriers to improve the development of the economy. The investment liberalization and facilitation in PFTZs is mainly based on administrative reform, which is mainly about streamlining government and delegating authorities (简政放权). This chapter will study the case of negative list and the case of the 'Three in One' approval system for investment to promote a simplified administration regime for investment in PFTZs. Second, trade facilitation is another core task of PFTZs. The case of the 'Single Window' online system of international trade and the case of mobile App for customs clearance of individual international mail, will be studied to show how the PFTZs are designed to improve trade facilitation by providing better and more efficient public services. Then, the financial reform is another priority for the PFTZs. I will study the case of the 'free trade account' system in the Shanghai PFTZ to see the progression of China's financial reforms, especially the

internationalization of the RMB and RMB convertibility on the capital account. Last but not least, PFTZ will also focus on encouraging innovation and I will study the case of cross-Strait startup incubators in Fujian PFTZ to see the effectiveness of the PFTZs in attracting talents to drive innovation.

7.2 Simplified Administration for Investment

As argued in the last chapter, compared with tax incentives and tariff cuts in SEZs, the PFTZs mainly depend on the elimination of policy barriers to attract investment and improve the development of service trade. Actually, administrative reform is one key point of China's new round of reforms in the post-crisis era - and streamlining government and delegating authorities (简政放权) lies at the core of administrative reform. In a speech on 12 May 2015, Premier Li Keqiang pointed out that 'For years, excess intervention and stifling supervision by the government over microeconomic activities, as well as too much emphasis on review and approval to the neglect of regulation, have sapped economic vitality, incurred high administrative costs and provided breeding grounds for corruption' (Xinhua, May 22, 2015). So rebalancing between the market and government is key to China's new round of economic reforms, and streamlining government and delegating authorities is the first move to this. In the PFTZs, the simplified administration for investment is one core of the administrative reform and the main task is to improve the liberalization and facilitation of investment in China. The simplified administration for investment in the PFTZs is related with two main aspects of the reforms: one is the investment management approach and the other is the investment approval system. This chapter will give one specific case for each to show the implementation of simplified administration for investment in PFTZs.

1. Case Study: the 'Negative List' in Shanghai PFTZ.

The negative list is a new approach of investment management implemented in the PFTZs. The main task of the negative list is to improve investment liberalization in China, and open up more industries, especially services, to industrial competition and foreign investment. As some Chinese officials say, the purpose of the negative list is less about guiding industrial adjustment but more is to 'improve the market's role of regulation ... make enterprises the major investment sources' by reducing government regulations (China Daily, 25 September, 2017). Compared with the negative list, the positive list of governance of foreign investment outside the PFTZs, which is the 2011 Catalogue Guiding Foreign Investment (CGFI), is 'very complicated and time-consuming, involving verification, and registration with the National Development and Reform Commission, the Ministry of Commerce and the State Administration for Industry and Commerce' (Lui, 2014: 32). In 2013, the negative list of investment was first launched in the Shanghai PFTZ. In the negative list, industries were divided into three kind of catalogues, namely, 'prohibited'; 'restricted'; and 'encouraged'. Compared with the positive list approach that all foreign investment needs to follow the application process of CGFI, the negative list approach means that except the industries explicitly listed, the foreign investments in other sectors will be treated as 'permitted'. The 2013 version of the negative list covered 1069 industries in 89 divisions within 18 main categories, and also maintained 190 regulations on the conduct of business that were inherited from CGFI (Yao and Whalley, 2016:10). However, too many restrictions on the conduct of business and too long list made some analysts criticize that the opening up was too limited⁷⁸. Then in 2014, the Shanghai PFTZ issued a new version of the negative list and the 190 restrictions in the 2013 version were decreased to 139 and, in 2015, this number further decreased to 122. In 2015, the implementations of the negative list approach was extended from the Shanghai PFTZ to the other three PFTZs (Fujian, Tianjin and Guangdong).

The setting of a negative list is strongly related with China's industrial upgrading,

⁷⁸ Interview 23 and 24

especially its manufacturing upgrading strategy of 'Made in China 2025' and China's opening up to modern services⁷⁹. Take the latest version of the negative list issued in 2017 as an example. Compared with the 2015 version, 27 special regulations were removed from the list and there were only 95 restrictions remaining in 15 categories and 40 items. For manufacturing, the list of encouraged industries in the 2017 version shows that the Chinese government showed more welcome to foreign investments in intelligent manufacturing, high technology, high-end manufacturing, which strongly benefits China's industrial upgrading. For example, smart emergency medical rescue equipment, manufacturing of virtual reality (VR) and augmented reality (AR) equipment, design and manufacturing of 3D printer equipment were first listed in encouraged industries in 2017, which are also listed as core industries in the strategy of 'Made in China 2025' (KPMG, June 2017). Opening up services industries for foreign investment, to improve the development of modern services and industrial upgrading, is one key goals of PFTZ. There are 18 services sectors designed to be opened up in the PFTZ; among this, the opening up of financial services, E-commerce, the shipping industry, telecommunication services, medical services are most significant to PFTZ (Lui: 33-5).

The 2017 version also shows this and more emphases on production services related with these five services sectors, such as removing the restrictions and prohibitions in highway passenger transportation, and cargo handling. But it also set forth more restrictions in cultural sectors, such as editing of books, newspapers, magazines, internet-based news and information services, audio-visual products and so on (KPMG, June 2017). Just as argued in Chapter Five, the primary aim of China's reforms is to maintain CPC's authority and in the post-crisis era with the opening up in economic areas, Beijing now is much more prudent about political reforms, especially rewards democratization. As Shambaugh (2016) indicates, in the post-crisis era, China more tends to shift from soft-authoritarianism to hard-authoritarianism. I argue that this

⁷⁹ Interview 14

may relate with three aspects. First, the rise of democratic revolution in Middle East - Arab Spring - and the chaos in Hong Kong caused by the so-called 'Umbrella Revolution', make Beijing more guarded against potential political risks. Second, the rise of nationalism with the economic development allows Beijing to operate economic and political reforms in opposite directions. Last but not least, the rise of populism in western democratic countries seems to provide support to Beijing's shift.

In the financial sectors, the 2017 negative list shows that Beijing still adopts a prudent attitude to opening up in financial services, but a slow opening up can be found⁸⁰. This can be found, for example, in eliminating the 'prohibition on issuance and underwriting of governmental bonds by branches of foreign banks; removing the minimum operating period requirement in allowing foreign banks to carry out RMB business; removing the restriction on reinsurance business between foreign insurance companies and their affiliated companies' (PwC, June 2017). Noteworthy here is that, as argued in Chapter Five, in China the priority of reform is to maintain the legitimacy of CPC authorities and gradualism is a principle of China's reform, which both can be seen in this 2017 list of services sectors.

The negative list is also one good case to see the role of PFTZ as the policy laboratory of China's reforms. When reviewing the process of extending the implementation of the negative list approach, it can be found that it follows the typical processes of testing of policies in China's reform⁸¹, which was initially tested only in the Shanghai PFTZ and then extended to the other three PFTZs. In 2017, negative lists were made available in all 11 PFTZs in China. Moreover, in 2018 negative list approach will be adopted nationwide⁸² and this can be supported by issuing of the draft nationwide measures taking negative list approach for establishment and alteration of foreign investment enterprise (FIE) by the Ministry of Commerce of China in 2017. As an

⁸⁰ Interview 10 and 13

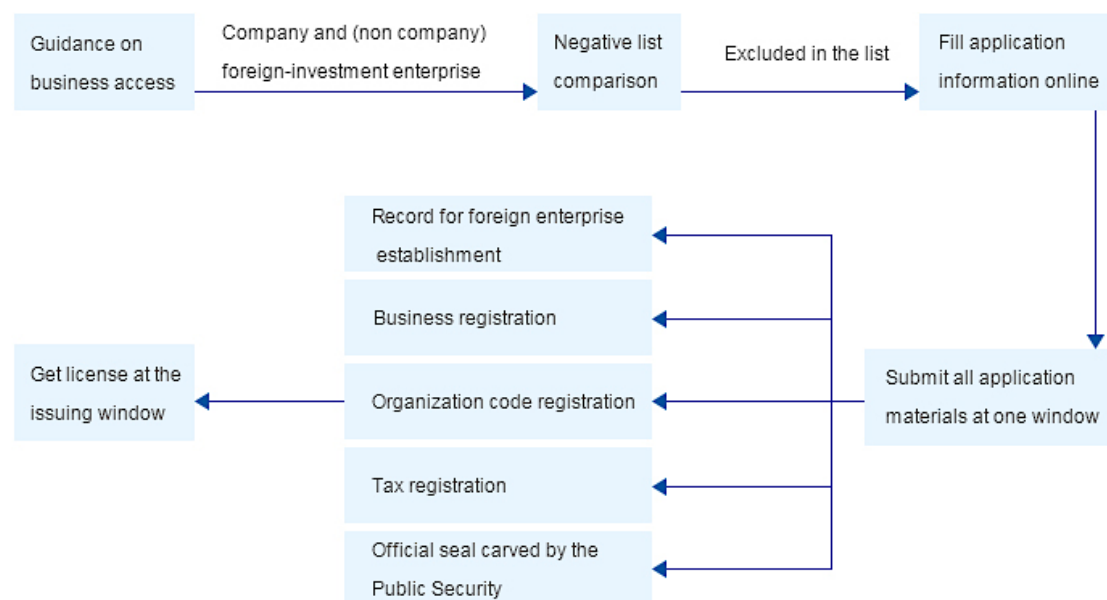
⁸¹ Interview 11 and 14

⁸² Interview 14

official from the National Development and Reform Commission said, ‘introduction of the negative list is a creative approach at home and abroad ... [the 2017 version of negative list] is rather important to be prepared before making it a nationwide practice’ as early as 2018 (China Daily, September 25, 2017).

2. Case Study: the ‘Three in One’ registration and approval system for investment in Fujian PFTZ⁸³

Figure 7.1 the Process of Business Registration Under ‘Three in One’ System



Source from: official website of Fujian PFTZ: <http://www.china-fjftz.gov.cn/html/en/page-3-2.html>

The ‘Three in One’ system of registration and approval system of investment is a policy innovation to improve the investment facilities in Fujian PFTZ. The ‘Three in One’ system refers to the process of business registration: where the enterprise just needs to fill ONE form and can submit all application materials in ONE window and the approval of investments from different departments will be processed at once, that only ONE stamp is needed for approval. Before implementation of the ‘Three in One’ system (see Figure 7.1), it often took 29 workdays to secure business registration

⁸³ Part data in this case is based on the field work of author in Fujian PFTZ.

outside PFTZ but now it takes only one workday to get the license for business⁸⁴. Moreover, under the new system, the enterprises will get just one business license, combining the old organization code certificate, business license, tax registration certificate, social security registration certificate and the record for establishment of FIE, all of which needed to be applied for separately before.

The simplification of the approval system of investment is the core of the 'Three in One' system⁸⁵. The old approval system of investment outside the Fujian PFTZ was very time consuming and complicated. Under the old system, the applicant needs to submit about 250 different kinds of administrative materials and 5-7 kinds of professional reports by a third party, including a project feasibility study report, an environmental impact assessment report, a soil and water conservation plan, an evaluation report of energy saving, risk assessment of social stability and so on⁸⁶. The preparatory works of applying often took from at least half a year to as long as 3 years⁸⁷. But under the 'Three in One' system, the enterprise just needs to submit 19 administrative materials, less than 10% of before, and only one project feasibility study report for government approval⁸⁸. For government, the approval items have decreased from 116 to only 26⁸⁹. The Fujian PFTZ administrative Committee also announced a time guarantee for approval, which is 93 workdays for approval and 88 workdays for record compared with 6 to 9 months in general outside the PFTZ⁹⁰. This includes 14 workdays for approval for land planning and site selections; project approval for 30 workdays or record for 25 workdays; 17 workdays for design review and construction permits; and 39 workdays for completion acceptance⁹¹. Moreover, related with this time guarantee,

⁸⁴ Interview 8

⁸⁵ Interview 1 and 4

⁸⁶ Interview 1, 4 and 7

⁸⁷ Interview 7

⁸⁸ Interview 2, 3, and 5

⁸⁹ Interview 1, 4, and 5

⁹⁰ Data from: official website of Fujian <http://www.china-fjftz.gov.cn/article/index/gid/74/aid/4712.html>.

⁹¹ Data from: official website of Fujian PFTZ: <http://www.china-fjftz.gov.cn/html/en/page-3-2.html>.

the Fujian PFTZ committee also launched the measures of ‘tacitly approving timeout’ and ‘tacitly approving absence’, which means that if the related administrative departments cannot finish the approval process in due time, the project will be tacitly approved⁹². If that one department has three times of tacitly approving record in one month or five times in one quarter, they will get a warning on efficiency that will influence the performance-related pay of officers in this department.

Limitations and problems of reforms of investment liberalization and facilitation in PFTZs

As argued, PFTZs try to improve the investment liberalization in China by changing the management approach of foreign investment from a positive list to a negative list. Under the negative list approach, the investment liberalization of China, especially for services sectors, is improved, such as more services industries opening up to foreign investments and quasi-national treatment to foreign investors. But reforms of investment liberalization still have many limitations. First, the opening up level to financial sectors is limited⁹³. Actually, in China’s opening up to service sectors, the financial services attract most attention in both domestic and the international community. Because compared with the development of China’s real economy, the financial sector is the weak point of China development but also the sector with most potentiality and profits. But as argued before, China’s opening up in financial sectors is slow and prudent. If comparing the 2015 version and 2017 version of negative list, it can be found that there were 15 restrictions of financial sectors in 2015 and in 2017 version, this number was 14. Even though reducing one regulation, the restrictions of financial sectors accounted for 14.7% of all restrictions, which in 2015 version was 12.3%. Actually in the negative list, the restrictions of financial sectors are always much more than other industries and controlling the risks, both for the economy and politics,

⁹² Interview 8 and 2

⁹³ Interview 10

is the key for Beijing in improving investment liberalization of financial sectors. This reflects China's tradition of gradualism and priority to maintaining CPC authority in reform but slow opening up of financial sectors still disappointed foreign investors and observers.

Second, there are two problems with the negative list approach: 1) the regulatory mechanism of implementation of the negative list includes dozens of government departments. But there is no coordination mechanism between them, which escalates tensions between departments and often causes overlapping supervision⁹⁴. This reduces the efficiency of regulation but moreover makes it easier for departments to 'pass the buck'; 2) the setting of the negative list follows China's classification methods of industries, which is very detailed but complicated. Moreover, the restrictions and regulations in the negative list are very complicated. For example, some restrictions are depending on the differences in equity ratio of enterprises⁹⁵. In the 2017 version of the negative list, for different regulations, there are many different ratios, such as the proportion of Chinese holdings more than or less than 50%; holding of SOEs more than 70%; foreign ownership less than 20%; 35%; 50% or more than 70%. This makes the negative list very complicated and hard to understand.

For the reforms of investment facilitation in PFTZs, the challenges still come from further simplification of administration. According to the business environment report of the World Bank (2017), China ranked 78 among all 190 economies but in the sector of starting business, China ranked in 127 because of the process of dealing with construction permits is extremely complicated and time-consuming (rank 177 among 190). Further simplification of the approval system and registration processes is the key. Moreover, how to expand the successful practices in PFTZs nationwide, such as the 'Three in One' system, as argued before, is another challenge to China's

⁹⁴ Interview 6, 7 and 8

⁹⁵ Interview 23

administrative reform. This need to reform the existing regulatory structure of China and especially in less developed inland areas faces the ‘humans’ challenge, such as related low civil servant quality and outdated ways of thinking.

7.3 Trade Facilitation

As argued in Chapter Four and Five, China’s economic development is characterized as trade-oriented: imbalances between external and domestic demand and between investment and consumption are two very serious challenges to China’s sustainable economic growth in the post-crisis era. But this does not mean that trade is less important in China’s economic restructuring, but rather, it is more about developing a new trade development mode. As the last chapter indicated, just as the SEZs did, China tends to use preferential policies and currency devaluation, to attract investments and then to expand exports to earn FERs. But under China’s ‘new normal’ as discussed in Chapter Five, only pursuing trade surpluses will no longer benefit China’s sustainable economic development so, to PFTZs, promoting imports is as important as expanding exports, which also benefits local consumptions. Based on this, the measures of PFTZs also changed from tariff cuts or tax incentives to improving trade facilitation by providing better and more efficient public services, which also related with China’s administrative reform, as argued before⁹⁶. In what follows, two specific cases of improving trade facilitation in Fujian PFTZ will be studied to show their role in China’s new trade development strategy aimed at boosting consumption.

1. Case Study: the ‘Single Window’ online system for international trade in Fujian PFTZ⁹⁷

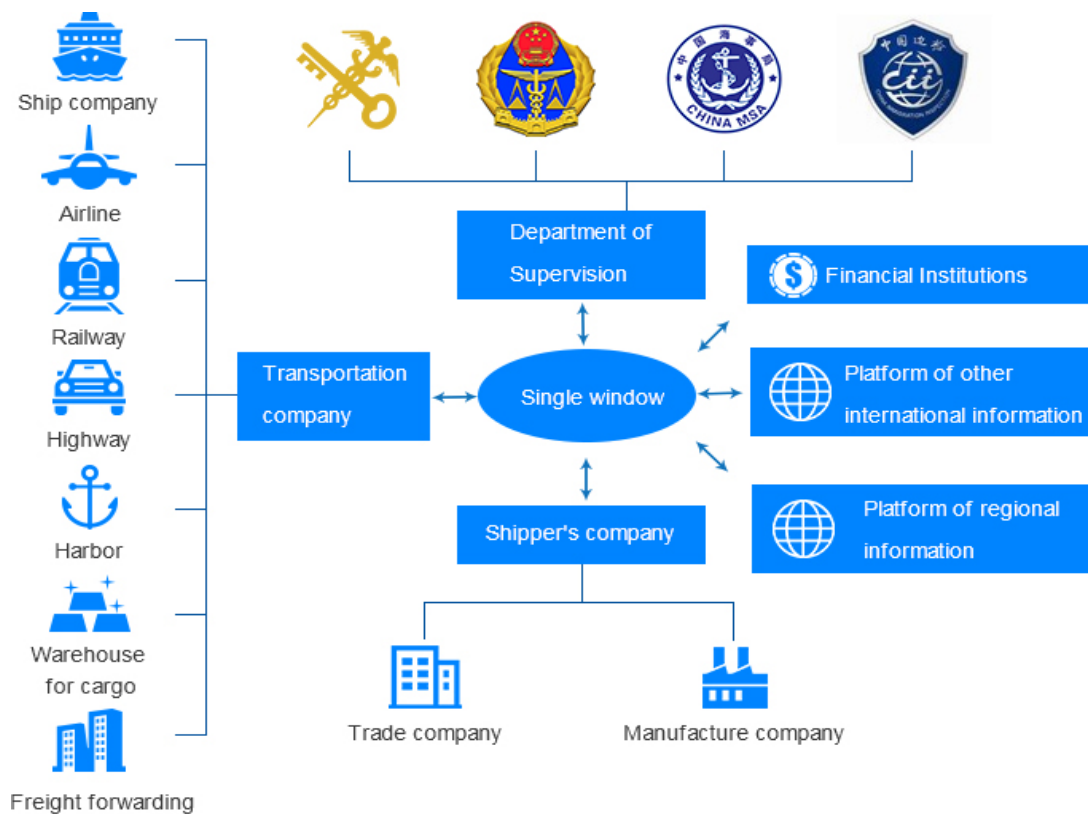
In August 2015, Fujian PFTZ first launched the new ‘Single Window’ online integrated

⁹⁶ Interview 3 and 7

⁹⁷ Part data in this case is based on the field work of author in Fujian PFTZ.

system for international trade. This online system is designed with four main functions combined with two supporting information systems and one special platform (see Figure 7.2). To the end of 2017, more than 50,000 enterprises in Fujian PFTZs have opened an account in this ‘Single Window’ online system, which processed more than 110,000 pieces of various types of declaration, including custom, inspection and quarantine, and declaration of transport facilities, each day⁹⁸. In the following, I will introduce the main functions of this system and how it is designed to improve the efficiency of government.

Figure 7.2 the Design of ‘Single Window’ Online System for International Trade in Fujian PFTZ



Source from: official website of Fujian PFTZ: <http://www.china-fjftz.gov.cn/html/en/page-3-3.html>.

Fujian’s version of the ‘Single Window’ online system (see Figure 7.2) includes four main functions, namely goods import and export declaration; custom inspection;

⁹⁸ Data from official website of Fujian PFTZ: <http://www.china-fjftz.gov.cn/article/index/aid/7993.html>.

declaration of the transport facilities and trade license application, and two supporting systems. 1) For the import of goods and export declaration, the system covers most types of declarations of goods, such as general trade, cross-border e-commerce, goods from special customs supervision zones and even the harbor entry declaration for ships carrying dangerous goods. The enterprises can submit all data and documents for declaration online at once. This helps to decrease the time for declaration from 4 hours to 5-10 mins⁹⁹. 2) For custom inspection. Whereas before, the goods declaration and custom inspection needed to be submitted separately, under this system the enterprises can submit them at the same time or either of them to achieve the goal of 'one declaration, one inspection and one release'. Under this 'three one', the number of data and documents required for declaration and custom inspection is decreased from 149 to 96 and the cost of declaration is reduced by 600 RMB per TEU¹⁰⁰. The fees, tariffs and tax rebates can be processed online in this 'Single Window' system. 3) Under this system, enterprises can submit the entry and exit declaration of transports facilities, including ships and aircrafts and also cover the declaration of custom electronic lock. Take the entry and exit declaration of ships as example. Under the 'Single Window' system, enterprises need to submit only 384 kinds of documents or data, which is 257 less than before and the approval of declaration often takes only 2.5 hours for entry and 0.5 hours for exit, much shorter than 36 hours of before¹⁰¹. 4) For trade license applications, this system connected with various licenses application system, such as applying annual inspection of overseas enterprise from the Commerce department, or applying quota certificate of the agricultural products from the Customs. This online system connected with more than 90% of licenses applying systems¹⁰². 5) The two supporting systems under the 'Single Window' are: information query of public services system that provides online windows and 7*24 hours hotline to answer the questions of users of 'Single Window' system; and financial supporting

⁹⁹ Interview 1 and 3

¹⁰⁰ Data from official website of Fujian PFTZ: <http://www.china-fjftz.gov.cn/article/index/aid/7032.html>.

¹⁰¹ See above

¹⁰² Interview 7 , 17 and 19

system that connected with system of banks, foreign exchange administration, export credit insurance corporation and other financial sectors to provide financial supporting information to enterprises¹⁰³.

Compared with the SEZs, where trade facilitation policies mainly focused on exporting, the 'Single Window' system will benefit both imports and exports. For example, according to Xiamen Customs, from January to July 2017, imports of wines from South Africa through Xiamen Haicang Port of Fujian PFTZ increased 58% year-on-year to 300 thousand liters and under the 'Single Window' system, wine importers save more than 1000 hours and 80000 RMB in declaration¹⁰⁴. Also, in an interview with a fruit importer in Fujian PFTZ¹⁰⁵, he mentioned that imported fruits, such as grapes from Chile, cherries from Australia, apples from New Zealand, mangoes from Thailand and oranges from the US, are more and more popular in China. But the high price of imported fruits slows down the growth of their sales. By the green channel under the 'Single Window' system, the approval of goods declaration often just takes 30 seconds and the whole process of customs clearance generally only takes one to two hours and the costs of importers are reduced by 10%-40%. This strongly boosts the consumption of imported fruits and according to them, sales rose more than 50% in the first half of 2016. Considering the successful practices of the 'Single Window' system in Fujian PFTZ and the other 10 PFTZs, in mid-2017, China's General Administration of Customs launched the nationwide standard version of the 'Single Window' online system for international trade and to the end of November 2017, users of this system had increased to 35000 and daily processes more than 100,000 pieces of declaration¹⁰⁶.

2. Case Study: mobile platform for customs clearance of individual international mail

¹⁰³ Interview 1, 3 and 18

¹⁰⁴ Interview 3 and 17

¹⁰⁵ Interview 19

¹⁰⁶ Interview 14

*in Xiamen Areas of Fujian PFTZ*¹⁰⁷

In recent years, Haitao (海淘), referring to buying from overseas e-commerce, has become a fashion among Chinese consumers, especially among middle-class Chinese and young Chinese. With the rapid development of e-commerce, mobile payment and logistics in China, Haitao is one key growth area in China's consumption. Against this background, in mid-2015, Xiamen PFTZ Customs, cooperating with the Xiamen branch of China Postal Express & Logistics Company Limited (Xiamen EMS), launched a mobile platform for customs clearance of international mail based on the WeChat (微信) app¹⁰⁸. There are three main functions of this mobile platform, including tracking, declaration, and payment. First, after registration on this platform, the recipients of mails can find the tracking information of the mails and the information of the whole process of customs clearance, such as declaration of parcels, customs inspection, taxing, waiting for payment, and finishing customs clearance. The platform also connects with hotline of China postal express company to answer the questions of users of this platform. Second, the recipients can submit online the declaration of goods on this platform. Based on the tracking functions of the platform as mentioned before, the platform will send the notification of declaration of goods to registered recipients and recipients can submit online the declaration forms and required documents, such as the copy of ID card and purchase invoices. Moreover, based on the mobile payment function of the WeChat app, the recipients can pay the tax online on this platform after receiving the electronic tax notice but need not go to pay in the bank counter or in the post office with paper-based tax notice as before.

¹⁰⁷ Data in this case is based on the field work of author in Fujian PFTZ and 2016 internal working report of Xiamen Area of Fujian PFTZ (unpublished). Interview 3, 5 and 18.

¹⁰⁸ WeChat is a mobile text and voice messaging communication service developed by Tencent in China. It includes various functions, such as video chat, games, voice calling, SMS and full M-commerce capabilities. WeChat is most popular social media app in China. For further information, please see website: <http://www.whatiswechat.com/>.

Since launching this mobile platform of the end of March 2016, the number of international mails in Xiamen Areas of Fujian PFTZ increased more than 90% year-on-year. Online submission of declaration also improves the efficiency of Xiamen Customs that helps to generally save about one day for customs clearance. To parcels of Haitao, the success rate of one declaration increased to about 80% on this platform, which was about 15% more than before. This platform was expanded outside the PFTZ in mid-2016 and by the end of 2016, more than 90% of declaration and tax payment of individual international mails in Xiamen Customs is through this platform. Moreover, as the logistics center in southern Fujian, many individuals' international mails to neighboring cities, such as Zhangzhou (漳州) and Quanzhou (泉州), are processed in Xiamen Customs. So this mobile platform helps to save an average about 100 RMB in traffic cost for recipients from neighboring cities.

Improving reforms of trade facilitation in PFTZs

Compared with other reforms, PFTZs do better in the area of trade facilitation¹⁰⁹. But trade facilitation still can be improved in the following areas. First, by further improving the facilitation of customs clearance. Whereas before, the PFTZ improved this mainly based on the simplified administration of customs clearance, such as 'Single Window' system; in further, the PFTZ can more promote customs technologies and equipment updating to improve the efficiency of customs clearance. Improving the implementation of rules of origin is also important to trade facilitation in PFTZs. Currently the rules of origins, are still too restricted in PFTZs. This can be improved by implementation of a pre-ruling mechanism to improve the processing of applications of certification of origins. Last but not least, it is important to improve system construction in PFTZS, including the information release system, the post clearance

¹⁰⁹ Interview 19, 20 and 7

audit system, the risk management system, the pre-pass mechanism¹¹⁰ and so on.

7.4 Financial Reforms

The financial reforms are always one key part of China's market-oriented reform. But reviewing the previous financial reforms in China, it can be found that Beijing is very prudent in financial liberalization, especially in the post-crisis era. There are two related aspects to this. First, Beijing very worries about the problem of 'finance calls the tune' in its economy, as Strange called, which means that real economy of manufacturing is controlled by financial economy (1998: 179-180). According to Strange, this will make states lose their control over their economies and societies, comparing with the rising power of owners of international financial capital, and even worse is that policy making is controlled by international financial capital and causes legitimacy issues of the authorities (1998:180). Moreover, this is also related with the reflection of the laissez-faire financial regulatory regime in the post-crisis era. As Strange (1986) indicates, lacking of efficient regulation of American and international financial system is one root of financial crises. She further points out that the rising of speculative international financial system and world economic disorder should be seen as the failure of laissez-faire financial regulatory regime (1986:25-60). So according to Strange, state intervention is very significant and necessary in governance of international monetary and financial system. But China's stalled financial reforms also causes some problems.

As argued in Chapter Four, China's large foreign reserves caused by its large 'twin surpluses' is one structural imbalance of China's political economy; and further market-oriented reform of financial sectors and improving internationalization of RMB is one key to rebalance this. According to the Third Plenary Session of the 18th CPC

¹¹⁰ Pre-pass mechanism is that after enterprises submitting the declaration and documents for taxing, the customs can release the goods first, then process the clearance.

central Committee, there are three core tasks of China's new round of financial reform, which are establishing a multi-level financial market system; improving the marketization of the interest rate and exchange rate; and reform of the financial regulation system. Based on this, the PFTZs set up four main tasks for financial reform, namely cross-border use of RMB; RMB convertibility on the capital account; piloting marketization of interest rate and foreign exchange control reform (Song 宋, 2014). The PFTZs are the most important testing ground for China's financial reform. Especially the Shanghai PFTZ is in the frontline of China's financial liberalization and marketization. The financial reform in Shanghai PFTZ is strongly connected with the Shanghai international financial center (IFC) schemes. Beijing strongly supports these for two reasons, namely: 'making China a moderately prosperous society by 2020 and ... internationalization the RMB', which are two important goals of CPC (Lombardi and Malkin, 2017: 793). According to Lombardi and Malkin, financial reform in PFTZs is important to China but also to the global financial community because it will pilot the RMB convertibility on the capital account and liberalization of interest rate. Among all new measures, they consider that the Free Trade Accounts (FTA) is the most important one (Lombardi and Malkin, 2017: 794). In what follows, the case study of 'Free Trade Accounts (FTA) in Shanghai PFTZ will be studied to see the implementation of financial reform in PFTZs and China.

Case Study: the Free Trade Accounts (FTA) in Shanghai PFTZ

On December 2, 2013, about 3 months after the establishment of the Shanghai PFTZ, the PBoC issued the '30 opinions' (央行 30 条) on financial reform in Shanghai PFTZ, in which PBoC indicated that innovation in banking system to facilitate risk management is one key task of financial reform in Shanghai PFTZ. Based on this, on 22 May 2014, Shanghai Head Office of PBoC published the detailed implementation rules for separate accounting system of the Free Trade Account Unit (FTA) and then on 22 April 2015, they announced that in Shanghai PFTZ, the FTA will expand to the foreign

currency business. This means that the FTA system was officially applied in Shanghai PFTZ.

The implementation of FTA in Shanghai PFTZ follows five requirements, namely separate labeling, separate accounting unit, independent statements, special reports and self-balancing¹¹¹. 1) Separate labelling. There are five different kinds of account in the FTA systems (see Figure 7.3), which are for institution holders, Free Trade Enterprise account (FTE), Free Trade Non-resident institution account (FTN), Free Trade Unit account (FTU); and for individual holders, Free Trade Individual account (FTI) and Free Trade Non-resident individual account (FTF). All free trade accounts shall be prefixed with corresponding synchronous labels as showing before. 2) Separate accounting unit. This is the key of regulation of implementation of FTA. Financial institutions in Shanghai should set up separate accounting units (FTU) to process the payment, liquidation, exchange and receipts of RMB and foreign currency funds in free trade accounts and all financial and capital transactions for the FTU itself must also be subject to separate accounting system, such as funds deposited in domestic financial institutions for accounting needs of FTA businesses. For financial institutions in Shanghai PFTZ, the administration of FTA should be independent from other existing non-FTA as FTU and FTU will directly connected to accounting system of PBoC (Shanghai). 3) Independent statement and special reports. This means that financial institution in Shanghai handing the FTA businesses should make independent statement of their FTA businesses and special reports on development planning, major events, potential risks and other relevant matters of FTA businesses to PBoC (Shanghai). 4) Self-balancing. Management of FTA businesses should follow the principle of self-balancing and this means that the square trading of synthetic positions of foreign exchange settlement and sale of financial institutions for the FTA businesses can only be conducted in interbank foreign exchange market in Shanghai PFTZ or overseas markets. This also shows the principle of implementation of FTA system, which is 'to

¹¹¹ Interview 10 and 12

ease control on the first line but to have efficient control on the second line' (一线放开, 二线管住) (see Figure 7.4), to prevent the potential risks to China's domestic financial markets. But this also one big problem of FTA system, which will be discussed later.

Figure 7.3 Free Trade Account Types and Requirements for Account Holders

| Account Type | Requirements for account holder |
|--|--|
| Free Trade Enterprise account (FTE) | (1) enterprises lawfully formed in Shanghai PFTZ (with or without the corporate status); and (2) overseas institutions' establishments in Shanghai PFTZ |
| Free Trade Non-resident institution account (FTN) | Overseas institutions are corporate bodies and other organizations registered and formed outside of China (including Hong Kong, Macao and Taiwan). |
| Free Trade Unit account (FTU) | Free trade accounts of interbank institutions. Financial institution in Shanghai that have already established separate accounting units |
| Free Trade Individual account (FTI) | Chinese citizens working in Shanghai PFTZ who have paid income taxes to the tax authorities of China for one year or more through their employers in Shanghai PFTZ. |
| Free Trade Non-resident individual account (FTF) | Overseas residents (including Hong Kong, Macao and Taiwan) who have overseas identity certificates, have been working in Shanghai PFTZ for one year or more, and hold permits for employment in China. |

Summarized from PBoC No.46 [2014] 'the Detailed Rules for the Prudential Management of Risks in Separate Accounting in China (Shanghai) Pilot Free Trade Zone (for Trial Implementation)';

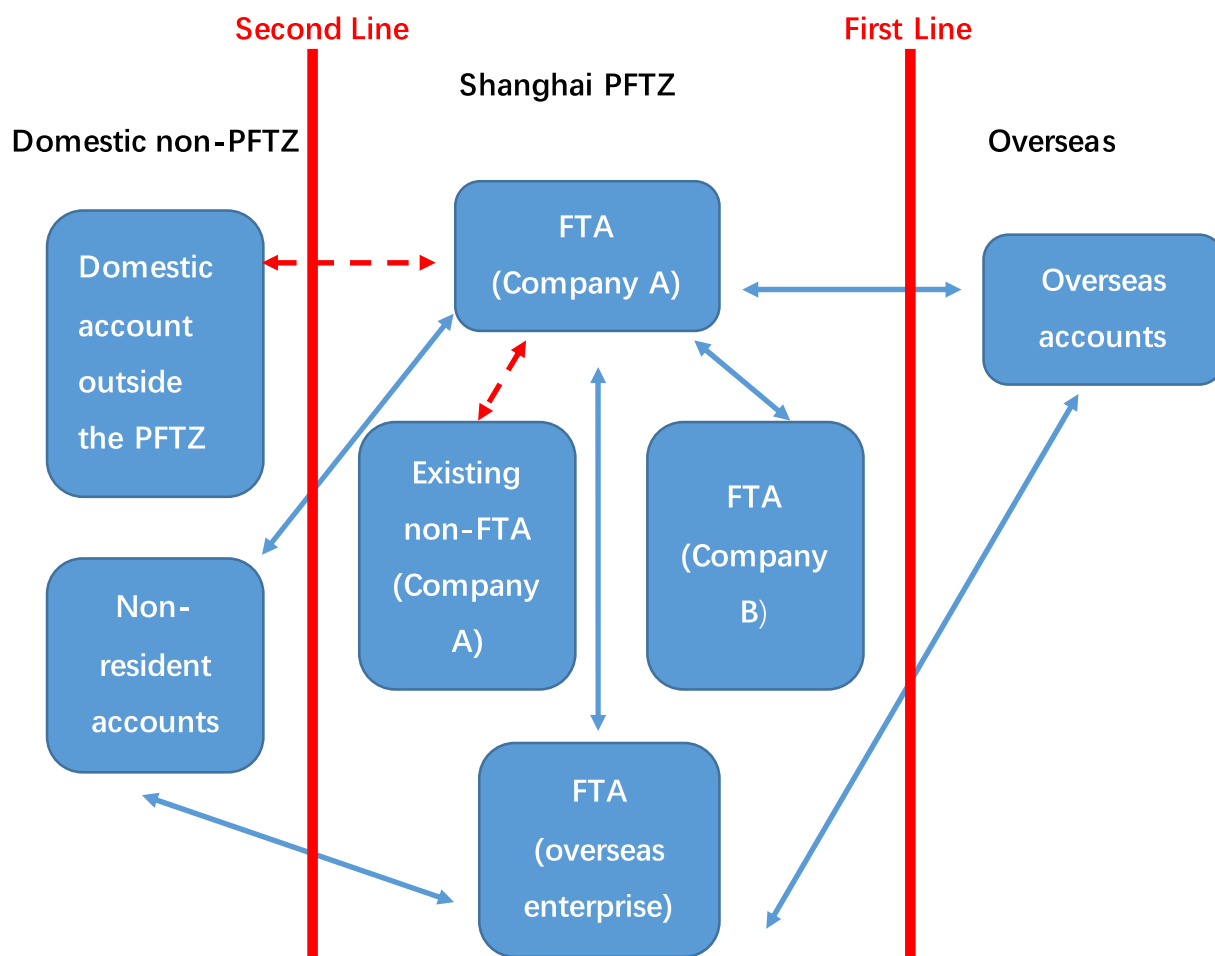
Translated version of implementation rules from:

<http://www.lawinfochina.com/display.aspx?id=26179&lib=law;>

Mizuho China Business Express (No. 328). Available from:

https://www.mizuhobank.com/fin_info/cndb/express/pdf/R419-0333-XF-0105.pdf

Figure 7.4 Designs of Fund Transfers Through FTZs in Shanghai PFTZ



Note:
 ↔ Unrestricted fund transfers;
 - - - RMB fund transfers within the prescribed scope

Reference from: Mizuho China Business Express (2014). Available from: https://www.mizuhobank.com/fin_info/cndb/express/pdf/R419-0333-XF-0105.pdf.

The implementation of FTA improves the internationalization of RMB and RMB convertibility on capital account. The main purpose of the establishment of FTA is to allow easier movement of capital between Mainland China and offshore markets and then to improve the RMB convertibility on capital account and internationalization of RMB¹¹². As Figure 7.4 shows, according the report from Mizuho Bank (China), currently

¹¹² Interview 13 and 10

FTZ can be used for ‘cross-border settlement and RMB and foreign currency conversion under current account and direct investment account items ... currencies in the FTA are freely convertible for use in innovative investment and financing activities [related with business requirements]’ (2014:3). Moreover, in 2016 the FTA businesses have expanded to RMB settlement for cross-border e-commerce, overseas financing, interest rate swap, cross-border financial planning, cross-border interbank lending and so on. To the end of 2016, in Shanghai PFTZ there were about 63500 free trade accounts; 51 financial institutions were connected to separate accounting system of FTA; FTA system processed 10.5 trillion RMB of cross-border settlement for 28000 enterprises in 118 countries and areas; and overseas financing by FTA system were 828.9 billion RMB with average interest rate of 3.89%; cross-border RMB borrowing by FTA increased to 30.43 billion RMB and two-way cross-border RMB pooling reached 770.4 billion RMB (Liu 刘 and Xie 谢, 2017: 56-9).

As argued above, the financial reform in Shanghai PFTZ is closely related with the Shanghai IFC strategy. The implementation of FTA system will also improve the development of the IFC strategy of Shanghai, especially as the international pricing centre¹¹³. Take the gold trade as example¹¹⁴. On July 2014, the Shanghai Gold Exchange (SGE) launched the SGE International in Shanghai PFTZ, which allows foreign investors to access to gold trading of SGE. All trades of SGE International are under the FTA system and foreign investors need to open free trade account in Shanghai PFTZ to use offshore RMB and to do foreign currencies exchanges. To the end of May 2016, the gold trading in SGE International was 5605 tons, worth 1.34 trillion RMB. Based on this, in 2016 SGE launched the Shanghai Gold Price, which according to World Gold Council, is the ‘benchmark to cement China’s role in the Chinese market’¹¹⁵ and Shanghai now

¹¹³ Interview 13, 10 and 12

¹¹⁴ Interview 12

¹¹⁵ Source from: World Gold Council website: <https://www.gold.org/what-we-do/gold-market-structure/global-gold-market>.

is the world largest purely physical spot exchange of gold¹¹⁶. The international financial platforms established in Shanghai PFTZ still include Shanghai International Energy Exchange, Shanghai-Hong Kong Gold Connect (黄金沪港通), Shanghai-Hong Kong Stock Connect (沪港通), Shanghai Insurance Exchange and CCP12¹¹⁷.

Limitation and Challenges of Financial Reforms in PFTZ

I argued that PFTZs, especially Shanghai PFTZ, are the most important testing ground of China's financial reform in the post-crisis era. But reviewing the financial reforms in PFTZs, it can be found that Beijing is still very prudent in financial liberalization. Even though that it reaches some achievements, including announcement of ease limits on foreign ownership of financial services groups in late 2017, there is no a clear timetable for financial liberalization. Some observers also indicated that even though opening financial sectors to more foreign ownership is a very important move to show China's new leadership under Xi Jinping is still committed to financial liberalization but foreign investors need to be more cautious about this move because 'it will take time to go from rhetoric to action' just as China did before (FT, November 10, 2017). The limitations and challenges of financial reforms in PFTZs are related with three aspects.

First, the principle of 'to ease control on the first line but to have efficient control on the second line' of implementation of FTA system is a problem¹¹⁸. As Figure 7.4 shows, there are two lines in FTA system, which is first line between PFTZs and overseas and second line between PFTZs and China's domestic non-PFTZs. The capital transactions cross-first-line has been opened but the restrictions of capital transactions between PFTZs and China's domestic markets are still not eased (see Figure 7.4). This caused

¹¹⁶ Note: the gold volumes of Shanghai are combine of trading in SGE and in Shanghai Futures Exchange (SHFE).

¹¹⁷ CCP12 is a global association of 35 major central counterparty organizations in EMEA, Asia-Pacific and the Americas. Reference: <http://ccp12.org/ccp12-new-members/about/>.

¹¹⁸ Interview 10 and 31.

the 'hard to in, hard to out' of capital transactions under the FTA system, which limits the functions of FTA system. The 'hard to in' is because of restrictions on second lines and separate accounting system of FTA, capitals of enterprises in Chinese domestic markets and in non-FTA accounts in PFTZs find it hard to transfer to their free trade accounts in PFTZs, which limits the sources of capitals going into FTA system. The problem of 'hard to out' is more serious. Because the whole FTA system is totally separated from other accounts system in China and the capitals in FTA cannot fully access to China's domestic markets, most enterprises just use their FTA to do trade settlements or overseas financing. This means the enterprises will not put too much money in their free trade accounts and that further limits the sources of capitals and functions of FTA system. Moreover, the controls on second lines make the practices of FTA system in PFTZs hard to expand to nationwide. Compared with other practices of trade facilitation and investment facilitation that have been expand to outside the PFTZs even nationwide, to the end of 2017 the full FTA system still limited in Shanghai PFTZ and just part of FTA system has been implemented in other three PFTZs, not to mention piloting in non-PFTZs domestic or even nationwide.

Second, the limited functions of FTA system slow down the reforms of RMB convertibility on capital account and then further influences the internationalization of RMB¹¹⁹. Compared with IMF's annual report on exchange arrangement and exchange restrictions 2013 and 2016, it can find that in 2016 among 13 areas of capital transactions, there are 12 in China that are restricted in prescribed scope, which was the same with that in 2013. So the implementation of FTA system mostly just improves the facilitation of capital transactions in China but not make fundamentally change the level of RMB convertibility on capital account. Just as some Chinese scholars indicated, the implementations of FTA system is not to reach the free RMB convertibility on capital account but more is to gradually reduce the existing restrictions on this (Ma, 2016: 155). Moreover, besides establishment of FTA system, according to '51 measures

¹¹⁹ Interview 27 and 25

of financial reform' (金改 51 条) launched in 2014 and new '40 measures' (金改 40 条) issued in 2015, there are many reforms of RMB convertibility on capital account in PFTZs that have not been implemented¹²⁰, such as allowing eligible institutions and individuals to invest in China's domestic and overseas bonds and futures markets; allowing individual industrial and commercial households in China's domestic non-PFTZ to provide cross-border RMB to their overseas bodies; piloting the offshore services of RMB in banks outside PFTZs. Most unimplemented reforms are critical to improve the piloting RMB convertibility on capital account outside the PFTZs. This also shows Beijing's prudence in financial reform and priority of stability in China's reform as argued in Chapter Four.

Last but not least, the slow reforms of RMB convertibility also influenced the internationalization of RMB and the Shanghai IFC scheme¹²¹. According to Global Financial Centres Index (GFCI) No.22 in September 2017, Shanghai has ranked the 6th in global financial centers, the ranking of which was up 7 compared with ranking in March 2017 (No.21). This is very impressive but the report also indicated that the development of Shanghai as IFC is more benefited from China's economic development. However, compared with its main competitors, including Tokyo, Singapore, London, New York, Shanghai needs to do more in improving its reputation among global investors and also need to improve in the areas of availability of capital and market liquidity. Also, as RMB Internationalization Index (RII) by Renmin University of China shows, in the end of 2016 the RII was 2.26, which decreased 29.8% year-on-year and in 2014-2016, the RII floated between 2.16 to 3.91, which was lower than the expectation of Beijing¹²². Besides OBOR and being added to SDR, in the internationalization of RMB, China needs to do more in domestic.

¹²⁰ Interview 31 and 22

¹²¹ Interview 27 and 28

¹²² Interview 13

7.5 Encouraging Enterprises Innovation

As argued in Chapter Five, innovation plays a key role in new round of China's reform and industrial upgrading. In model of structural power, Strange indicates that knowledge is one of four sources of structural power and she emphasizes the importance power is more through 'consent' rather than 'coercion' in her model of structural power (1988a: 25; 18). In the study of the US hegemony, she also points out that besides providing order and stability, as HST concluded, hegemons can have alternative ways to exercise their power than exercise to maintain their governance of global order, such as the US's continued exercise of hegemonic power in knowledge structure due the preponderance of American's R&D inputs and outputs (1987). With 40 years' development since 1978, Beijing has realized that the sustainable development of China's economy should be more driven by innovation but not mostly depends on trade and investment as nowadays.

According to China's Report on the Work of Government 2016, 'To strengthen the new growth engines, an innovation-driven development plan was adopted ... to encourage public participation in starting businesses and making innovations ... a great number of makers started businesses and made innovations'. I indicated in Chapter Four that compared with customer-focus and efficiency-driven innovation, the science-based and engineering-based innovation is the weak point of China's industrial upgrading. Based on this background, the PFTZs launched many policies to encourage the innovation¹²³, including providing tax incentives, financing supports, fee reduction, even prize-money incentives to starting businesses and high-tech enterprises. In the following, I will study the case of 'cross-Strait startup incubators' in Xiamen Areas of Fujian PFTZ to see the detailed policies of encouraging innovation in PFTZs. Actually there are startup incubators in all PFTZs but choosing this case is related with two aspects. One is that the cross-Strait startup incubators in Xiamen is an innovation

¹²³ Interview 4 and 15

based typically for young persons and focusing on SMEs, which is the related weak point of policies of encourage innovation in China. Also, one local features of Fujian PFTZ is its special connection to Taiwan so the cross-Strait case not just have important economic components but also essentially political in nature, which is to improve China's unity of Taiwan.

Case Study: Cross-Strait Base for Youth Innovation and Entrepreneurship (RQ Space) in Xiamen Areas of Fujian PFTZ (厦门两岸青年创业创新创客基地)¹²⁴

The Cross-Strait Base for Youth Innovation and Entrepreneurship (the Base) was established in June 2015 in Xiamen Areas of Fujian PFTZ. The target of the Base is the youth makers from both Mainland China and Taiwan. It is the one key project in Fujian PFTZ and the successful practices of the Base also improve the establishment of another cross-Strait Base for Entrepreneurship in Pingtan areas of Fujian PFTZ, both of which are recognized by Taiwan Affairs Office of the State Council of China (TAO) as cross-Strait key bases. To mid of 2016, there were 93 enterprise operated in the Base and more than 150 Taiwan residents working in the Bases.¹²⁵ The Base mainly focus on four industries, namely high-tech entertainment, Taiwan O2O e-commerce, cultural and creative industries and internet agriculture, but also encourage the industries of animation, software and app development, innovative finances, third-party payment and so on.

The detailed supporting policies of the Base are mainly in five aspects¹²⁶. 1) Subsidies to worship building and office decoration. The Committee of Xiamen Areas will provide subsidy of 800 RMB per square meter to enterprises or makers. 2) One-off subsidies of starting. To the enterprises established in the Base and operated more than one

¹²⁴Data in this case is based on the field works of author in Fujian PFTZ and interview 15, 4 and 29

¹²⁵ Source from Interview with official from Xiamen Area of Fujian PFTZ

¹²⁶ Interview 15 and 4

year, the Committee will give special one-off subsidy of starting, according to the registered capital of enterprises (see Figure 7.5). Moreover, besides the one-off subsidy for all enterprises, the Taiwanese investment enterprises can have extra subsidies according to their registered capital from Taiwan. For example, one enterprises with registered capital of 3,000,000 RMB, including 1,000,000 Taiwan capital. After one year operations, this enterprise can have 1,165,000 RMB one-off subsidies of starting¹²⁷. 3) Housing subsidy. For Taiwan residents working in the Based, according to their records of paying social security, they will have housing subsidies of 1000 RMB per person per month. For non-Taiwan residents (including Chinese citizens) working in the Base, they will have this of 500 RMB per person per month¹²⁸. 4) Rent reduction. The enterprises in the Based do not need to pay the rents of office (less than 100 square-meter part) for the first year and in the second and third year, the enterprises just need to pay 30% and 50% of their rents of offices (less than 100 square-meter part). 5) Various supporting policies in financing, including providing financing guarantees, interest subsidy loans and so on.

Figure 7.5 One-off Subsidy of Starting for All Enterprises

| Registered Capital (RMB) | Less than 200,000 part | 200,000-500,000 part | 500,000-1,000,000 part | 1,000,000-2,000,000 part | More than 2,000,000 part |
|---|-------------------------------|-----------------------------|-------------------------------|---------------------------------|---------------------------------|
| One-off Subsidy (percentage of registered capital) | 25% | 20% | 15% | 10% | 300,000 (RMB) |

¹²⁷ 1,165,000 RMB=subsidy for all enterprises
 $(200,000 \times 25\% + 300,000 \times 20\% + 500,000 \times 15\% + 1,000,000 \times 10\% + 300,000 = 585,000)$
 plus subsidy for Taiwan capital
 $(100,000 \times 50\% + 100,000 \times 40\% + 300,000 \times 30\% + 500,000 \times 20\% + 300,000 = 580,000)$.

¹²⁸ The maximum number of employees having housing subsidies for each enterprise is 10.

Figure 7.6 Extra Subside of Starting for Enterprises with Taiwan Capitals

| Registered Capital from Taiwan (RMB) | Less than 100,000 part | 100,000-200,000 part | 200,000-500,000 part | 500,000-1,000,000 part | More than 1,000,000 part |
|--|-------------------------------|-----------------------------|-----------------------------|-------------------------------|---------------------------------|
| Extra Subsidy (percentage of Taiwanese registered capita) | 50% | 40% | 30% | 20% | 300,000 (RMB) |

In order to improve the science-based innovation in the Base, the operator of Base also develops cooperation with several Taiwan universities¹²⁹, such as National Taipei University, National Chung Hsing University, Hsiuping University of Science and Technology, to as the practice base of these universities. Moreover, the operator also introduces the entrepreneurial mentor mechanism in the Base, which includes 18 leaders of famous enterprises in both mainland China and Taiwan to help youth to start their businesses. The Base also provide free ‘one-stop’ services to makers that want to start their businesses in the Base¹³⁰, including registration services that also apply to the ‘Three in One’ registration system in Fujian PFTZs as argued before; policy and law advisory; and protection of intellectual property. Moreover, in order to better help the Taiwan youth to start their businesses in the Base¹³¹, the operators also introduce the Angel groups and funds from Taiwan, such as Taiwan’s Evan Clan Angel Groups, 500 million RMB funds of FCC Partners (蓝涛国际), and Sinovation Ventures (创新工场)¹³².

¹²⁹ Interview 4

¹³⁰ Interview 4 and 15

¹³¹ One Taiwan interviewee in interview 15

¹³² An famous Chinese technology-savvy investment firm, established by Dr. Kai-Fu Lee in 2009

Improving of Innovation in PFTZs

Compared with the reforms in other three areas, the development of innovation in the PFTZ is not that distinct. But to further development, the PFTZs can further improve the innovation in two aspects. First, it is to improve the intellectual property protection in PFTZs. As the testing ground of reforms responding to new high-standard global trade system, intellectual property protection should be the important part of this. Actually, perfecting the legal system and mechanism is one of five main tasks of PFTZs. But the PFTZs achieve least in this area compared with other four as indicated in last chapter. According to Global Innovation Index 2017 by World Intellectual Property Organization (WIPO), China ranked on 22 in the world in innovation but the indicate of China's regulatory environment is much lower (ranked 107) than other indicators that all other indicates rank above 30, including knowledge and technology outputs ranking on 4 and business sophistication ranking on 9 (WIPO, 2017:209). In the 2017 international IP Index by US Chamber of Commerce, the score of China was just 14.83 even lower than global average of 15.39¹³³. The PFTZs can apply more reforms and practices in the areas of IP protections. Second, focus on improving the innovation of SEMs¹³⁴. In China, the innovation is more often from large enterprise, especially SOEs and MNCs and SEMs is always the weak point of in development of innovation in China. PFTZs can do more in this. For example, it can launch more tax deduction policies for R&D investments of SEMs and help to improve the high-tech transforming of new start businesses by providing policy supporting and financing supporting.

7.6 Conclusion

In this chapter, I examined the implementation of reforms of four areas in PFTZs. First, the investment liberalization and facilitation in PFTZs is mainly based on the

¹³³ Data from: official website of US Chamber of Commerce. Available from: <https://www.uschamber.com/event/2017-international-ip-index-the-roots-innovation>.

¹³⁴ Interview 6

administrative reform, which is mainly about streamlining government and delegating authorities (简政放权). This chapter examined the case of negative list and the case of 'Three in One' approval system for investment to see the simplified administration for investment in PFTZs. The reform of 'negative list' is one key in China's reform of trade liberalization to fundamentally change China's approach of management of investment approval. But this chapter also indicated that the implementation of negative list still face several problems, including the lack of a coordination mechanism of regulating the implementation of negative list; simplifying the setting of list and setting the standard processes of negative list revising. In trade facilitation, PFTZs still need to further improve the simplification of administration in investment.

Second, the PFTZs have launched various policies to improve the trade facilitation and, compared with reforms in other areas, PFTZs do better in the trade facilitation. As the case of trade facilitation in this chapter – 'Single Window' online integrated system for international trade, it strongly improve the trade facilitation from simplification the processes in declaration of custom, inspection and quarantine and declaration of transport facilities and improve the efficiency of government. Moreover, the reforms of trade facilitation are not just about exports but also imports. This chapter examine the case of mobile platform for customs clearance of individual international mail to show that by simplification administration and providing better public services, PFTZs's efforts at promoting consumption and imports, in the context of rapid development of E-commercial in China.

Third, the PFTZs are one most important testing ground for China's financial reform, and especially the Shanghai PFTZ is in the frontline of China's financial liberalization and marketization. There are four main tasks for financial reform in PFTZs, namely cross-border use of RMB; RMB convertibility on capital account; piloting marketization of interest rate and foreign exchange control reform. The one pillar reform of financial liberalization and marketization is establishment of Free Trade Accounts in Shanghai

PFTZ, which is strongly related with the Shanghai international financial center (IFC) schemes and internationalization of RMB. The establishment of FTA allows easier movement of capital between Mainland China and offshore markets and then to improve the RMB convertibility on capital account and internationalization of RMB. But reviewing the financial reforms in PFTZs, it can be found that Beijing is very prudent in financial liberalization. Even though that it reaches some achievements, including announcement of ease limits on foreign ownership of financial services groups in late 2017, there is no a clear timetable for financial liberalization.

Last but not least, as argued in Chapter five, innovation is the pillar of China's economic growth under the new normal, especially the encouraging enterprises innovation. The PFTZs launched many policies to encourage the enterprises innovation, including providing tax incentives, financing supports, fee reduction, even prize-money incentives to starting businesses and high-tech enterprises. Compared with the reforms in other three areas, the development of encouraging enterprises innovation in the PFTZ is not that distinct. In future, the PFTZs can further promoting enterprise innovation in two aspects. First, it can be the testing ground of new policies of intellectual property protection in China. Second, FPTZs can focus on improving the innovation of SEMs, which is the weak link of enterprises innovation in China.

Chapter Eight

Conclusion

8.1 Background and Research Puzzle

The starting point for this thesis was the academic and political debate about the so-called 'rise of China' in the post-crisis era and its growing influence in the global economic order. After World War II, in the following decades, even facing some geopolitical challenges, such as from Soviet Union during Cold War, and some economic challenges from EU and Japan in the 1980s, the US kept its hegemonic role in the global order. However, in the 21st century, more and more academics and popular commentators are arguing with growing confidence that this century will be a 'Chinese Century'. Even though not everyone agrees with this assessment, since the 2008 global financial crisis (GFC) the dynamic nature of the international political economy has become more and more evident.

There are actually three elements to this - US power in the 21st century looks unlikely to match the resilience of its hegemony shown in the 20th century; the rise of China will be a key defining feature of the early 21st century; the GFC itself, which may come to be seen as a key inflection point that accelerated the underlying trends towards the decline of the US and the rise of China. Although the GFC may not in itself have fundamentally changed the shape of the global order, it arguably altered perceptions, not least in China itself, where its entire economic strategy can arguably be seen as a response to the global imbalances that were said to be the cause of the crisis. Indeed, the different positions of the US and China with respect to the global imbalance, in which China enjoys large twin surpluses in its current account and capital accounts in comparison with the US' large twin deficits, is suggestive of a fundamental power shift in IPE. As such, these global imbalances formed the starting point for this thesis, as I

investigated China's economic reforms in the post-crisis era.

In this context, the thesis posed two related research puzzles. First, in order to gauge the rise of China in the post-crisis era global order I needed to understand, in theoretical terms, what are the key concepts, variables and causal relationships. The thesis drew on classical theories of IPE to examine the influence of power and institutions in the changing global order. This helped us to understand and describe the respective positions of the US and China in the global order and how these positions relate to the function and form of global regimes and institutions of global governance. Also, empirically, although much is written and said about the rise of China, the puzzle remains - is China's emergence based on Westernisation and assimilation or non-conformism and confrontation? In what ways is China reshaping the international institutional order? Likewise, what evidence is there that China's internal politics, especially its economic reform process, is being shaped by its growing global role? The answers to these questions are obviously complex. The thesis assessed contrasting interpretations but did so on the basis of a more specific topic.

The second puzzle of the thesis was the role of China in the 'global imbalance', which has formed such a key aspect of the immediate pre- and post-GFC order. Some scholars and political commentators, especially in the west, consider China to be a 'free-rider' and beneficiary of these global imbalances while others saw the GFC as a symptom of a fundamental power transition from West to East. However, the other interpretation suggests that these imbalance are more of a mixed blessing for China, as they point to the link between China's own imbalances between its export-oriented and domestic sectors. The thesis has analysed the relationship between these external and internal imbalances in the context of the decline of the US hegemony, the rise of China and the emerging post-crisis global order.

The key question of this thesis centred on the relationship between the rise of China and the global imbalance in the contemporary order. In answering this question, I

asked four subsidiary questions: 1) How do key theorists of IPE account for the relationship between changing power structures, trade imbalances and the global order? 2) What lessons can I draw from the experiences of Britain and the US in managing global imbalances in the 19th and 20th centuries respectively? 3) What is the role of China with respect to contemporary global imbalances and efforts to reduce these in post-2008 financial crisis period? 4) What influence have these efforts at rebalancing affected China's internal economic reform process?

In this conclusion, I provide an outline of the central contribution from each chapter, in turn, and of the thesis overall. On the basis of these conclusions, I offer an overall conclusion of the thesis in response to the thesis research questions and puzzles outlined above. I then summarize the contribution that this thesis had made and offer some thoughts on a potential future research agenda.

8.2 Chapter Findings

In Chapter Two, I reviewed the key theorists of four representative IPE schools on their key debates, which were the realist theory of Robert Gilpin; the complex interdependence and liberal institutionalism of Robert O. Keohane, structural power and its diffusion of Susan Strange; and theories of states, social forces and world orders of Robert W. Cox. The main aim of this chapter was to understand different concepts and approaches to understanding the relationship between power, institutions and global order. From the American School, I took from Gilpin the importance of power, anarchy, self-interest and free-riding; and from Keohane, the importance of institutions as an 'intervening variable' that may outlive hegemony and provide states with incentives to cooperate and pursue absolute or positive-sum gains. From the British School, I took from Strange the importance of not just relational power but also structural power, based on the four primary structures of the international political economy (production, security, finance and knowledge); and from Cox, I took the importance of hegemony and historical blocs as class-based projects based on both

coercion and ideological consent. My aim was not to 'test' these theories, but rather to use the key concepts - power/hegemony, institutions/regimes and world order - to describe and analyse China's rise, global imbalances and China's economic reforms as a strategic response to its emerging hegemony.

Chapter Three provided a historical account of global imbalances in three periods: the pre-1914, interwar and postwar periods. The main aim of this chapter was to examine the relationship between power shifts, global imbalance in the international financial system and the wider stability of global order. I found that the interactions between power, the international financial system and global order, in the context of global imbalance, did not always follow the same paths and there was no clear causal link between global imbalance and the changing global order. However, there was a strong link between global imbalances and changes in the international financial system. In sum, serious global imbalance often led to the collapse of established international financial systems. Moreover, in the context of global imbalances, if leading powers can maintain or rebuild international financial systems, it would be more possible to maintain their hegemonic role in global order, such as the case of the US in maintaining its hegemony after the collapse of the Bretton Woods system in the 1970s, related with the global imbalances between 1965 to 1971.

In Chapter Four, I first examined two more recent periods of global imbalance – in the late 1970s and in the 1980s - under the 'Jamaica System'. This chapter indicated that, under the Jamaica System, with a relative weak adjustment mechanism, rebalancing mainly depended on the managed depreciation of the US dollar, which set the stage for further imbalances since the late 1990s. Then I examined the contemporary global imbalance, characterized by its large size and greater persistence since the late 1990s. I introduced three mainstream explanations of this contemporary global imbalance, namely, the exchange rates, saving gluts and Bretton Woods II. Even though these schools explained the rise of the global imbalance from different aspects, they tend to see the US deficits as a systemic problem rather than a domestic problem. Further,

each school pointed the finger at China as the key actor in the global imbalance and rebalancing.

The chapter then indicated that, in the post-crisis era, China faces more external pressures on rebalancing from the dramatic changes brought by the 2008 GFC, including rising challenges to the world economy based on debt-consumption in the US, rise of anti-globalization and populism and end of laissez-faire capitalism. Moreover, these increasing external pressures highlight China's serious imbalance, namely, imbalances between external and domestic demands; between investment and consumption; between excessive growth of FER and a low level of internationalization of the RMB; its imbalanced industrial structure dominated by manufacturing characterized as 'three highs'- high input, high consumption and high pollution - and 'two lows' - low efficiency and low value added; and the regional and urban-rural disparities. Finally, I showed that external pressures and internal imbalances combined to push Beijing to accelerate its rebalancing processes.

In Chapter Five, I moved to focus more specifically on China, first, its model of development and, then, the political economy of its rebalancing in the post-crisis era. I identified four features of China's model, which I argued are political prerequisites of China's rebalancing, namely, the one-party system; the role of the state as an economic agent; gradualism and incrementalism with respect to policy innovation and reform; and the assimilation and adoption of foreign practices but only according to local circumstances and customs. I argued that these features are deeply rooted in China's culture, social and political backgrounds, and political prerequisites of China's reforms. As argued in Chapter Four, with 40 years development, China's government-led market economy, characterized as investment-oriented and trade-oriented, now faces many internal imbalances and external pressures in the post-crisis global rebalancing, which together have pushed Beijing to accelerate its rebalancing. I analyzed China's rebalancing under the new normal in the post-crisis era. I found that the economic slowdown is just one aspect of China's post-crisis rebalancing and the

economic restructuring is the central pillar of China's rebalancing under the new normal. I then identified three key themes of China's rebalancing – new economic drivers, a new composition of growth and a commitment to environmentally sustainable development - tied to supply-side structural reform in short term, deepening market reform in the medium term, and One Belt One Road (OBOR) in the long term.

In Chapters Six and Seven, I turned to the case study of China's Pilot Free Trade Zones (PFTZs), which was first established in 2013. The aim of this case was to further understand the approach to reforms of China's rebalancing under the new normal. As one of the most important policy laboratories of reform under the new normal, many of China's rebalancing reforms are being first tested in these 'zones' before nationwide implementation. Studying the reforms in PFTZs helped me to further and more comprehensively understand the approach to reform under China's rebalancing in the post-crisis era. First, I examined the Special Economic Zones (SEZs), which were one of the most important policy laboratories for China's market-oriented reform in the early period and were also the best example of China's old export and investment-driven economic growth model. By comparing PFTZs and SEZs, I found four main differences in their respective approaches to reform: namely, from manufacturing to services industries; from providing preferential policies to institutional innovation; from one-way to two-way opening up; and from introducing market economy mechanisms in line with liberal international norms to actively participating in international competition and putting forward China's proposals for reforms.

In Chapter Six, I analyze the four main areas of reforms in PFTZs, including trade facilitation, investment liberalization, financial reforms and streamlining government and delegating authorities. Then, I studied several detailed cases of implementation of reform in PFTZs concerning investment liberalization and facilitation, trade facilitation, financial reforms and encouraging innovation. I indicated the limitations and weak points of these reforms in PFTZs and how they might be improved to better

support China's rebalancing under the new normal. I found that compared with investment and trade, Beijing is more prudent in financial reforms and very concerned about the potential risks associated with the rapid liberalization of financial sectors. Even though there is a sign of more opening up in financial areas, I did not find a clear timetable for China's financial liberalization. Equally, innovation is a key part of China's rebalancing and restructuring but also is the weakest point of China's political economy in the past decades, as argued in chapter five. The PFTZ not as yet played an important role in China's reforms of innovation, but the PFTZs innovation policies do target the small and medium-sized enterprises (SMEs), which is a weak point of China's innovation and help to complement the policy system of improving innovation in China.

8.3 Conclusion of the Thesis

Returning to the research questions that this thesis posed, there are three main findings of this thesis. By reviewing the concepts and arguments about the relationship between power, institutions and global order according to four key thinkers and representative of the 'American' (Robert Gilpin, Robert Keohane) and 'British' (Susan Strange, Robert Cox) Schools, the thesis provided an eclectic theoretical synthesis on the basis of key shared concepts but differing interpretations of the key drivers of continuity and change in the international political economy. This thesis is more concerned to draw on shared concepts that help me to capture and assess key aspects of China's political economy in post-crisis global order. The reason to do this is, in large measure, due to the particularity of China as a rising power and the western-centric character of IPE studies highlight China's particularity. The theoretic section of this thesis focuses on several key questions, which mainly includes the definition of power; the ways of hegemony applying their powers in global order; the interaction between powers and institutions in international system and how this shape the global order. The thesis found that the theories, while based on different epistemological approaches and ontological assumptions, shared a view that power is never just a straightforward expression of raw power but is mediated through institutions, or

regimes, and the legal and moral basis of these creates stability or instability in world order, depending on the strength and resources of the hegemon. The thesis argues that these concepts and theories provide the tools for examining the 'rise of China' but more importantly the international and domestic politics of the global imbalances.

Based on this, this thesis first critically reviewed key phases and episodes of global imbalance in their historical context. The thesis explained the role of dominant powers in influencing the extent and form of global imbalances - and, more importantly, the interactions between these dominant powers, the international financial system and global order during former episodes of global imbalance. This can be seen as the application of theoretical reviewing of the concepts and arguments about the relationship between power, institutions and global order to empirical materials. I found that there is no clear causal link between global imbalance and power shifts in global order but there is a strong link between global imbalances and the international financial system, and serious global imbalances often leads to the collapse of the established international financial system. This means that global imbalances do not directly lead to or reflect power shifts in global order but do influence the level of instability in the international financial order. However, the interactions between power, institutions and global order in globally imbalanced periods do not always follow the same paths. The case of US hegemony in the 1970s is the only exception in which the unravelling of the international financial system did not lead to an obvious power shifts or sharp decline of hegemonic powers in global order. I found there to be two aspects to this. First, if the leading powers in global order can maintain or rebuild the international financial system, even facing serious global imbalance, the established or leading power is more likely to maintain its key role in global order. In the case of US hegemony, this was also because, compared with former leading powers such as the UK in the 19th century, its power was more complex and 'structural', hence providing the basis for a more longer-lasting form of hegemony.

Second, applied to the current global imbalance, the 2008 GFC arguably represented

a significant turning point, after which the level of global imbalances sharply decreased, albeit perhaps only temporarily. More important is that the GFC exposed the frailty of the post-Bretton Woods, the so-called 'Jamaica System', based on the US' debt-financed consumption economic model and the global trend of economic and financial liberalization since the 1980s. The interaction between the US and other rising powers, such as Japan and Germany, in global imbalances and rebalancing under the Jamaica system, also shows Strange's structural power of hegemon, Keohane's interdependence and HST's claims of importance and responsibility of hegemon to maintain the stability of the global order. Not only this, but equally important for our purposes, the GFC also exposed problems and vulnerabilities associated with China's post-1978 growth model, which proves opinions of Keohane and Nye of vulnerability and sensitivity interdependence in the era of globalization. I found that the external constraints and pressures in the post-crisis era highlighted, and arguably worsened China's own, internal imbalances, that is: 1) an imbalance between external and domestic demand and between investment and consumption; 2) China's 'twin surpluses' and excessive growth of foreign exchange reserves; and 3) China's imbalanced industrial structure dominated by manufacturing, as described above; and 4) China's regional and coastal/urban-rural disparities. Different from many western accounts that see China as a free-rider and beneficiary of the global imbalance, I argued that these imbalances are also internal to China and thus a key driver of China's rebalancing in the post-crisis era, described in Beijing as the new normal.

The pillar of the China's rebalancing under the new normal is economic restructuring that will be critical to the rise of China in the post-crisis era global order – and hence the shape of the future global order itself. First, the rebalancing reform, if successful, will help to promote a more sustainable growth model and improve the quality and efficiency of the Chinese economy, that will ensure the rise of China as the economic powerhouse of the future. Structural reforms are at the center of China's rebalancing under the new normal, but do not follow the western-styles, as China arguably did in 2009, focusing on orthodox fiscal and monetary policies. China is proposing its own

solution to solve its internal imbalances, as a response to external pressures and changes in the post-crisis era. China's detailed plans of rebalancing under the new normal involve more than just Western-style ideas for improving capacity and international competitiveness of China's enterprises; they are also tied to the launching of OBOR, arguably designed to chart an alternative, Chinese model for global governance. Moreover, as Cox indicates, the structural changes in production will stimulate the contradictions between social force, which will finally cause the elimination of old form of state and world order and the rise of a new one (1987:7-8). According to Cox, 'change can occur at all levels –in production relations, in class relations, in the emergence of new historic blocs and of alternative forms of state, and in the structure of world order... Where change does occur, it will be through mutually sustaining relationships at all of these levels' (1987:8).

As an illustration of these complexities, the thesis focused on the case of the PFTZs, as a key policy laboratory of reforms in China's rebalancing towards the new normal. By comparing the SEZs, which are the representative of China's 'old' economic model, to PFTZs, this thesis found 'one constant and four changes' between rebalancing reforms and China's former economic reforms, which also further supported the conclusion of how China's rebalancing will influence the rise of China in post-crisis global order. The 'one constant' is the enduring political philosophy behind China's model, based on the four key features mentioned above. The practices in PFTZs in the 2010s have followed those four principles, analogous to the SEZs in the 1980s. However, the 'four changes' of the PFTZs under the new normal, also mentioned above, show that, as the key policy of China's rebalancing under the new normal, the practices and reforms in PFTZs strongly follow the directions of China's rebalancing and China is continuing to open and further integrate into the established international system. But they also show China's increasing desires to put forward China's proposals and set China's standards and rules in the global system.

8.4 Distinct Contributions

In this thesis I aimed to make three specific contributions that shed light on and underpin my empirical study. The contribution that this thesis has made is to increase our understanding of the role of China in the global imbalance, in two key respects. First, the thesis does not consider China as a 'beneficiary' of the global imbalance. As argued in this thesis, mainstream Western accounts of IPE tend to see the US with large deficits as a 'victim' of the global imbalance and criticizes China's so-called 'free-riding' behaviour as a surplus country. Based on this, they also more consider the US deficits as a problem made abroad and more pressing on China of its specific monetary policies and trade policies. However, I argued that China's internal imbalances should be considered in examining the role of China in global imbalance. Because of the changes in post-crisis era, as the external constraints and pressures on China, including the rise of protectionism, rise of populism and the end of laissez-faire capitalism, have highlighted, and arguably worsened, China's serious internal imbalances associated with its trade-oriented and investment-oriented post-1978 economic model. So I indicate that, compared with external pressures, China's internal imbalances are the key driver of its rebalancing in the post-crisis era.

Moreover, I consider that promoting China's internal rebalancing will benefit global rebalancing much more than just putting pressure on China in monetary policy or trade policy. The reason to say this is that the preoccupation of Western scholars with China's role as a 'surplus' country underplays significantly China's internal imbalances and the domestic origins of these imbalances. I argue that there are three related aspects to this. First, the notion of China as an unqualified beneficiary of global imbalances belies the extent to which there are independent pressures for domestic structural reform. Second, because of this, China is unlikely to follow the precedents set in the 1980s regarding the Plaza Accord and Louvre Accords, when Germany and Japan bore the brunt of the managed devaluation of the dollar (see Chapter Four). Some scholars also indicate that China is proving to be far more independent in economic policy-making than Japan was at a comparable stage of the monetary

imbalances of the 1980s (see Jacques, 2012:467). Third, based on this, to the extent that China is and in future years will be susceptible to external pressure, such as calls for greater exchange rate flexibility or offering improved market access, I argue, the effects are likely to be temporary, given China's independent interests and domestic priorities.

Another contribution of this thesis is to fill the gap of research into Pilot Free Trade Zones (PFTZs) and the new normal of China in English literatures. As one of the most important policy laboratories of China's rebalancing reform in the post-crisis era, the PFTZs are very important and demand study. But the English literatures study of PFTZs are very limited and mostly very general, and rarely provide any systemic research of detailed reforms and policies of PFTZs, especially less about implementation of reforms in PFTZs. In my case study, I analyzed the implementation of various reforms in PFTZs, including in investment liberalization and facilitation, trade facilitation, financial sectors and encouraging innovation. By comparing the SEZs, which are representative of China's 'old' economic model, to PFTZs, this thesis finds 'one constant and four changes' between rebalancing reforms and China's former economic reforms, to show the approach of China's post-crisis rebalancing under the new normal. Moreover, English literatures study of China's new normal mostly focus on the slowdown of China's economic growth but rarely pay attention to the economic restructuring behind the economic slowdown. This thesis indicates that the CPC's tolerance of slower growth rate shows their determination to improve economic restructuring. So economic restructuring should be considered as one key aspect in China's new normal. This thesis provided a systemic study of the main lines of China's economic restructuring under the new normal.

8.5 Future Research

One of the aims of this thesis was to examine the relationship between the rise of China and the global imbalances in the contemporary order. I have indicated that

China's internal imbalances should be considered in examining the role of China in current imbalances, because the changes of global order in the post-crisis have arguably worsened China's internal imbalances. So in the study of global rebalancing processes, it is important to examine China's rebalancing processes through economic restructuring. In this thesis, I have provided a systemic study of China's economic restructuring and rebalancing under the new normal, including the macro analysis and the micro case study of PFTZs. But the study of China's economic restructuring can be further improved in the following two aspects. First, for macro analysis, further research on the main lines and main reforms of China's economic restructuring, especially the internal connection between them, will help to expand an understanding of China's economic restructuring under the new normal. For example, the three main reforms of economic restructuring – supply side reforms, market-oriented reforms and OBOR strategies – are closely related with each other and only together can they improve the restructuring of China's economy. So a further study of comparative implementation of them will help to draw a more comprehensive picture of China's economic restructuring. Also further answering questions like: how to improve innovation and accelerate the restructuring of the composition of growth; or how does promoting enterprise innovation improve China's environmentally economic development will also help to further understand China's economic restructuring. Then, this thesis has examined the implementation of economic restructuring reforms in PFTZs and also these efforts influence China's internal economic reform process. But a further study of how China's efforts at rebalancing its economy influence global rebalancing is meaningful. This thesis does not answer this question fully because the influences of China's economic restructuring since 2013 on global rebalancing will take time to unfold. But in the next five years, I think that it is an important aspect to understand both global rebalancing and rise of China in the post-crisis era.

Moreover, the starting point for this thesis is the academic and political debate about the so-called 'rise of China' in post-crisis era and its growing influence on the global

economic order. Although much is written and said about the rise of China, the puzzle remains - is China's emergence based on Westernisation and assimilation or non-conformism and confrontation? In what ways is China reshaping the international institutional order? For this, this thesis indicates that China's detailed plans of rebalancing under the new normal involve more than just Western-style ideas for improving capacity and international competitiveness of China's enterprises. They are also tied to the launching of OBOR, arguably designed to chart an alternative, Chinese model for global governance. And by comparing the SOEs and PFTZs, it shows that, under the new normal, China more actively participates in international competition and puts forward China's proposals of reforms but also strongly promotes western-styled marketization reforms in many fields, such as introducing PPP and promoting investment liberalization. This may show that China is able to take a third path to influence global order, which is China's continued socialization into selected global standards, rules, practices and norms, 'alongside registering its desire and right to be at the table for rewriting some others' (Chin and Thakur, 2010:120). But two more questions need to be answered for this conclusion. The first question is what kinds of global standards, rules and norms that China will choose to follow and what kind of factors will influence China's choice? For example, this thesis has listed four features of China's model and indicated that they are hard to challenge in China's reform, which can be seen as one factor influencing China's choices. But it needs more further and detailed analysis. Then, a further question is how this third path of China will affect global order in the post-crisis era. As this thesis indicated China may not be a 'state quo' power but also not a 'revisionist' power in global order. So how to deal with a rising China with the 'third path' in the global order will be a significant question for IPE study in the coming decades.

Appendix: List of Interviews

| <i>Interview number</i> | <i>Description of Interviewees</i> | <i>Place</i> | <i>Date</i> |
|--------------------------|--|--------------|----------------|
| <i>Chinese Officials</i> | | | |
| 1 | Trade official of Fujian PFTZ, (Fuzhou Area) | Fuzhou | June 2016 |
| 2 | Finance official of Fujian PFTZ (Fuzhou Area) | Fuzhou | June 2016 |
| 3 | Senior trade official of Fujian PFTZ (Xiamen Area) | Xiamen | July 2016 |
| 4 | Industry official of Fujian PFTZ (Xiamen Area) | Xiamen | July 2016 |
| 5 | Commercial official of Fujian PFTZ (Xiamen Area) | Xiamen | July 2016 |
| 6 | Senior official of Fujian CPPCC | Fuzhou | July 2016 |
| 7 | Senior trade official of Fuzhou Government (city) | Fuzhou | July 2016 |
| 8 | Senior commercial official of Fujian Government (Province) | Fuzhou | July 2016 |
| 9 | Senior trade official of Fujian Government (Province) | Fuzhou | August 2016 |
| 10 | Finance official of Shanghai PFTZ | Shanghai | August 2016 |
| 11 | Senior trade and industry official of Shanghai PFTZ | Shanghai | August 2016 |
| 12 | Senior finance official of Shanghai PFTZ | Shanghai | September 2016 |

| | | | |
|-----------------------------------|---|----------|---------------|
| 13 | Finance official of State Council of China | Beijing | February 2017 |
| 14 | Trade and industry official of State Council of China | Beijing | February 2017 |
| <i>Enterprises Representative</i> | | | |
| 15 | Enterprises representative (start-up) (Xiamen Area of Fujian PFTZ) (x3) | Xiamen | July 2016 |
| 16 | Enterprises representative (Finance) (Xiamen Area of Fujian PFTZ) | Xiamen | July 2016 |
| 17 | Enterprises representative (export) (Xiamen Area of Fujian PFTZ) | Xiamen | July 2016 |
| 18 | Enterprises representative (logistics) (Xiamen Area of Fujian PFTZ) | Xiamen | July 2016 |
| 19 | Enterprises representative (export) (Fuzhou Area of Fujian PFTZ) | Fuzhou | July 2016 |
| 20 | Enterprises representative (logistics) (Fuzhou Area of Fujian PFTZ) | Fuzhou | July 2016 |
| 21 | Enterprises representative (retail) (Fuzhou Area of Fujian PFTZ) | Fuzhou | August 2016 |
| 22 | Enterprises representative (finance) (Shanghai PFTZ) | Shanghai | August 2016 |

| | | | |
|---------------------|---|----------|----------------|
| 23 | Enterprises representative (export) (Shanghai PFTZ) | Shanghai | August 2016 |
| 24 | Enterprises representative (logistics) (Shanghai PFTZ) | Shanghai | August 2016 |
| <i>Commentators</i> | | | |
| 25 | PFTZ expert – Fujian Normal University (x2) | Fuzhou | June 2016 |
| 26 | Trade expert – think tank | Xiamen | July 2016 |
| 27 | Finance expert – think tank | Shanghai | August 2016 |
| 28 | PFTZ expert – think tank | Shanghai | August 2016 |
| 29 | PFTZ expert – think tank | Fuzhou | September 2016 |
| 30 | Trade and Industry expert – think tank | Beijing | March 2017 |
| 31 | Finance expert – think tank | Beijing | March 2017 |

List of Abbreviations

| | |
|-------|--|
| AR | augmented reality |
| ASEAN | Association of Southeast Asian Nations |
| BATJ | Baidu, Alibaba, Tencent and JD.com |
| BOT | Build–Operate–Transfer |
| BRIRs | Brazil, Russia, India, China and South Africa |
| BTH | Beijing-Tianjin-Hebei |
| CGFI | Catalogue Guiding Foreign Investment |
| COFER | currency of official foreign exchange reserves |
| CPC | Communist Party of China |
| CPPCC | Chinese People’s Political Consultative Conference |
| CRA | Contingent Reserve Arrangement |
| DPI | disposable personal income |
| EOI | export-oriented industrialization |
| EPU | European Payments Union |
| EPZ | export processing zone |
| EU | European Union |
| FDI | foreign direct investment |
| FEC | foreign exchange certificate |
| FER | foreign exchange reserves |
| FIE | foreign investment enterprise |
| FT | Financial Times |
| FTA | Free Trade Account |
| FTE | Free Trade Enterprise account |
| FTF | Free Trade Non-resident individual account |
| FTI | Free Trade Individual account |
| FTN | Free Trade Non-resident institution account |

| | |
|------|---|
| FTU | Free Trade Unit account |
| GATT | General Agreement on Tariffs and Trade |
| GDP | gross domestic product |
| GFC | global financial crisis |
| GFCI | Global Financial Centres Index |
| HKD | Hong Kong dollar |
| HST | Hegemonic Stability Theory |
| IBRD | International Bank for Reconstruction and Development |
| IFC | international financial center |
| IMF | International Monetary Fund |
| IMO | International Maritime Organization |
| IPE | International Political Economy |
| IR | International Relations |
| ISI | import-substitution industrialization |
| MNC | multinational corporations |
| NDB | New Development Bank |
| O2O | online-to-offline |
| OBOR | One Belt One Road |
| OEEC | Organization for European Economic Cooperation |
| OEP | Open Economic Politics |
| OPEC | Organization of the Petroleum Exporting Countries |
| PBoC | People's Bank of China |
| PFTZ | Pilot Free Trade Zone |
| PPP | Public-Private Partnerships |
| R&D | research and development |
| RII | RMB Internationalization Index |
| RMB | Renminbi |
| SCIO | State Council Information Office of China. |
| SDR | Special Drawing Right |

| | |
|--------|---|
| SEZ | Special Economic Zone |
| SGE | Shanghai Gold Exchange |
| SME | medium-sized enterprise |
| SOE | state owned enterprise |
| TAO | Taiwan Affairs Office of the State Council of China |
| TFP | total factor productivity |
| TISA | Trade in Service Agreement |
| TPP | Trans-Pacific Partnership |
| TTIP | Transatlantic Trade and Investment Partnership |
| UK | United Kingdom |
| UN | United Nations |
| UNCTAD | United Nations Conference on Trade and Development |
| US | United States |
| VR | virtual reality |
| WIPO | World Intellectual Property Organization |
| WTO | World Trade Organization |

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