Chinese Expansion and Global Economic Governance: Implications for the International Economic System

Undergraduate Research Thesis

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"With respect to their safety, derivatives, for the most part, are traded among very sophisticated financial institutions and individuals who have considerable incentive to understand them and to use them properly."

~Ben Bernake, Nov 15, 2005

"Fear and euphoria are dominant forces, and fear is many multiples the size of euphoria. Bubbles go up very slowly as euphoria builds. Then fear hits, and it comes down very sharply. When I started to look at that, I was sort of intellectually shocked. Contagion is the critical phenomenon which causes the thing to fall apart."

~Alan Greenspan, "The Map and the Territory"

Introduction

Late in the autumn of 2007, the bottom fell out of the global economy. The 2007-2008 global financial crisis, and the "Great Recession" that followed it, seemed to ring a death knell for the global economy. In the first year of the Great Recession alone, global economic output and international trade fell to lower levels than they did during the Great Depression.[1] Trillions upon trillions of dollars of global wealth simply vanished into thin air, as if it had never existed in the first place. Conservative estimates place the aggregate losses of asset values at $27 trillion in 2008, which was about half of *global* GDP at the time.[2] Unemployment increased by some 34 million people from 2007 to 2009, and yet still remains high (if not having risen) for others.[3] Even today, forecasts of global economic growth remain tepid and the global demand for goods and services has stagnated. Nonetheless, the world may consider itself lucky; the Great Recession pales in comparison to the Great Depression. Despite the precipitous drop in global output and wealth, the global economy rebounded much quicker than expected. Indeed, growth after the Great Recession has exceeded levels it reached after the Great Depression, with industrial output 10% *higher* than before the crash.[4] But most surprising has been the swift return to economic growth. While the global economy went through a period of prolonged contraction after the Great Depression, the global economy has actually *expanded* in the aftermath of the Great Recession. Not only did the global economy continue to grow, but this growth actually raised incomes and reduced poverty.[5] Additionally, there was no breakdown in international trade (Smoot-Hawley part deux), the specter of fascism has not returned, and the

[1] Drezner 2014, 2
[2] Roxburgh, Lund, and Piotrowski 2011, 2
[3] International Labor Organization 2010, 9
[4] Drezner 2014, 32
[5] Drezner 2014, 32-33

world has avoided the makings of another World War. It would seem then that history has not repeated itself.

In the wake of the financial collapse much ink has been spilt determining the economic causes and political failings responsible for the collapse; yet little work has been done to actually examine what these developments mean for the future. Thus, this paper will not (directly) deal with the *causes* of the Great Recession and the global financial collapse, but with their *effects*. Much has been written from an economic standpoint, highlighting deregulation, the mortgage bubble, and the perils of an unregulated banking system. Instead, this paper will focus on the effects that these watershed events will have on international relations and global economic governance. Global economic governance structures are the lynchpin of the international economic order and the current financial system, although their definition and demarcation from national interests has been problematic. Indeed, not much work has been done examining global governance in general, and economic governance in particular, despite the outsized role it plays in international relations. Even though states are the main unit of analysis in international relations, they must still rely on an assortment of global institutions (World Bank, World Trade Organization, International Monetary Fund, etc.) to operate on the world stage.[6] This paper will define global economic governance as "the set of formal and informal rules that regulate the global economy, and the collection of authority relationships that promulgate, coordinate, monitor, and enforce said rules."[7] As this paper will show, the perceived record of economic governance structures has been less than stellar, as they have been routinely challenged and criticized by most international relations scholars in the wake of the Great Recession.

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[6] Drezner 2014, 2

[7] ibid. I find it best to use Drezner's definition of global economic governance, as both he and Kirshner define it roughly the same.

Two competing theories about the nature of the financial crash, as well as its implications for global economic governance, have developed in the political science literature. This paper will first examine the arguments put forth by Jonathan Kirshner's *American Power After The Financial Crisis* and Daniel Drezner's *The System Worked: How The World Stopped Another Great Depression.* Both authors correctly diagnose the causes of the financial crisis; however, both diverge markedly as to their predictions for the future of international relations and the role the great powers will play in global economic governance. Drezner marshals support for a liberal institutionalist argument, saying that the global financial system (the World Bank and the IMF), and the great economic powers (China, the European Union, and the United States) successfully acted in concert to prevent another Great Depression. The great powers, able to cooperate in an international arena with a muted security dilemma, were able to step in to save the system. The Great Recession, unlike the Great Depression, was notable for its high levels of cooperation. In short, the system worked. Kirshner represents the realist's view of the financial crisis and is more pessimistic; the world may have avoided a crisis now, but we have only set the stage for a larger crisis down the road. The cooperation Drezner lauds during the immediate aftermath of the crash was simply the last chapter of the American-led international order. The actors so willing to help save the system were, in actuality, held "hostage" to a failing global financial system, and this last crisis was the final nail in the coffin of their support. In essence: the crisis has eroded American power relative to the rest of the world, and has made the United States more vulnerable to a future financial crash. With the increasing role of the rising powers, specifically China, in the global economy, the American era of dominance is closing fast.

Drezner and Kirshner both view China as key to these developments. For Kirshner, it is the relative power transition between a rising China and a declining America that drives the end of the US-led economic order. For Drezner, it is China's lack of revisionist aims and support for the status-quo that prevented the makings of another Great Depression. Therefore, this paper will focus on the future role of China among the great *economic* powers and how its rise to this rank will shape the global economic order. I will attempt to explain why the rise of China has serious implications for the global system. To further my claim, this paper will outline a theoretical model regarding the rise of China, using both international relations theory and integrating the claims of Drezner and Kirshner. This paper will then sketch out four future worlds that take into account the competing claims of Drezner and Kirshner, and examine their claims when applied to two separate conditions determined by global economic outlooks. The first outlook supposes a relatively stable financial system. It is optimistic in that much of the inherent risk in American banking has been reduced. Whether through the rise of populist government policies, increased regulation of the shadow banking sector, or the reduced securitization of the US economy, this paper reimagines a modern day regulated financial system in the manner of John Maynard Keynes. The second condition, however, is inherently pessimistic. In it, this paper supposes another global financial crisis, with the American banking sector once again at the epicenter of the global financial earthquake. This crisis need not be on par with the Great Depression, or even the Great Recession; the crisis just needs to be large enough that there is a significant, and rational, fear of contagion to other markets.

Finally, I will extrapolate the findings of these four worlds, and show what these findings implicate for the future of international relations. A pessimistic world, as articulated by Kirshner, combined with pessimistic financial condition, could indicate serious conflict between the United States and a rising challenger, such as China. My hope is that by laying out these future conditions I can provide a theoretical framework that others could use to examine the chances of costly conflict between the world's two largest powers. By understanding the underlying condition present in an international arena defined by anarchy and insecurity I hope to highlight useful indicators which can either point to conflict or peace.

A Clash of Ideas

Drezner's Optimism

Daniel Drezner, like many other scholars at the height of the crisis, initially did not give the global economic governance system high marks. Even before the start of the Great Recession there was growing concern over the durability of the global economic order. Drezner held an increasingly skeptical view of the operation and performance of global governance structures, and their ability to handle a serious crisis. The last set of multilateral economic institutions were created in the aftermath of the postwar period, and the current distribution of power looks vastly different today. Not only are the BRIC nations (Brazil, Russia, India, and China) rising at a truly unprecedented rate, but many European powers have become marginalized in the new global economy. London, once the financial capital of the world, had lost that distinction to New York (who, in turn, may be losing that distinction to Singapore and Hong Kong). The French economy has long been hamstrung by high marginal tax rates, burdensome labor regulations, and a dearth of business-friendly, pro-growth policies under the current Socialist administration. Germany, the one economic bright spot in Western Europe, still faces the demographic hurdle of a declining population. If these mismatches between global governance structures and the distribution of power were allowed to smolder, the thinking went, then eventually the governance structures the global economy relied upon would break down. Drezner himself pushed for drastic reform, arguing that “failure to take action would leave these institutions ill-equipped for a severe global shock” and that “proactive steps would be necessary to prevent the global economy from experiencing the 1930s all over again”.[8] The collapse of the financial sector, Federal bailouts of General Motors and AIG, and the implosion of the global economy only served to strengthen his case.

But sifting through the aftermath of the crash, Drezner was confronted by evidence that contradicted the scholarship of not only himself but countless others. He found that “the meltdown [he] had expected had not come to pass”.[9] In fact, he argues that the system worked. Specifically, “global economic performance between major powers, policymakers, central bankers, and transnational agencies [were] able to prevent the crisis from becoming a great depression”.[10] This was accomplished only because “global economic governance [supplies] the necessary public goods to prevent worst-case scenarios from being realized”.[11] In times of global economic distress it is crucial that markets be open to trade, liquidity is in sufficient supply, and macroeconomic policies between countries be more or less coordinated. During the Great Recession, Drezner argues that global governance structures were adequate in ensuring all three. That is not to say that the Great Recession wasn’t a serious macroeconomic downturn; in fact, the initial shocks to the global economy were more severe than those of the Great

[8] Drezner 2014, ix
[9] Drezner 2014, x
[10] Drezner 2014
[11] Drezner 2014, 14

Depression. Drezner notes, however, that the global economy was able to bounce back with relative speed and that "growth resumed more quickly than expected".[12] It should be admitted, however, that Drezner sets the bar for "success" relatively low. Success is not judged as to whether the policies adopted were suboptimal (they were), but as to whether they were subpar (they were not). International institutions and multilateral frameworks were not flawless, in any sense of the word, but they performed better than their (admittedly low) expectations. This is so, despite the fact that political infighting within the G20 largely scuttled Keynesian stimulus in 2010, climate change has gone largely ignored, cybersecurity is off the agenda, and the Doha Round of trade negotiations are incomplete.[13] Nevertheless, this largely optimistic outlook puts Drezner at odds with most scholars in his field, as both academic and popular thought lays the blame at the feet of the very same system he exalts.

In order to substantiate his counterintuitive argument, Drezner utilizes the fundamental building blocks of international relations: power, interest, and ideas. He attempts to build a multicausal argument, using a mix of all three variables in order to articulate the best explanations for this case study. The explanation, he argues, is a function of power, interests, and ideas: not only did powerful vested *interests* across the globe all have a stake in maintaining the system, but the shift in the global distribution of *power* was minor, and the crisis did little to challenge the widely held set of economic *ideas* that defines the system.[14] To be sure, disentangling the complex interactions between power, interests, and ideas is no small feat.

[12] ibid
[13] Drezner 2014, 15
[14] Drezner 2014, 18

Additionally, plausible monocausal arguments have been offered by other scholars.[15] Drezner's reasoning, however, is intellectually sound, and his arguments are worth examining.

Drezner's argument that the United States, the European Union, and China all stepped in to save the system is not uncontroversial. Indeed, many IR scholars consider both the United States and the European Union to be heavily invested in the status-quo, unlike China. After the crisis, China's power was seen by many as rising, while the United States' was in relative decline. Theoretically, a rising state will tend to be unhappy with the current system as is, and will seek to gain prestige commensurate with its power. But despite its relative rise in power, China has not taken significant actions to block neoliberal norms. In fact, China has acted just like US policymakers and politicians have demanded it act for decades, as a "responsible stakeholder". This is because, in reality, China has not risen as much as others believed, and the United States has not fallen as much as others expected.[16] Furthermore, while scholars such as Kindleberger argue that a hegemon is necessary to sustain global economic order, Drezner finds that a troika of the United States, the European Union, and China form a "hegemonic coalition" that supports the current structures of global economic governance.[17] The combined economic and political power of all three (of which the United States is first among equals) created a sufficiently large hegemonic coalition that was able to step in and maintain the rules of the economic game.[18] Indeed, this would also explain the breadth and depth of the Great Depression, which was truly a time of hegemonic transition between the United States and the United Kingdom (the United Kingdom was unable to save the system and the United States

[15] Refer to Davis and Pelc 2013
[16] Drezner 2014, 105
[17] Kindleberger 1973; Drezner 2014, 106
[18] Drezner 2014, 140

unwilling). However, any explanation based solely from power is insufficient to explain the preferences of the great powers and the role that economic interests played in maintaining the hegemonic coalition.

The role of interests was key in maintaining global economic openness, and of providing the necessary global public goods needed to jump start the economy.[19] The global openness of the pre-crisis system was maintained throughout the crisis, even though economic downturns of the past have devolved into beggar-thy-neighbor policies and tariff hikes (think of Smoot-Hawley). Drezner's argument is founded in "regulatory capture theory", a common staple of public choice theory. Public choice theorists warn that regulatory and government agencies that are supposed to promote the general welfare can end up advancing the private aims of special interest groups. Firms and other groups can direct their funds and energies toward lobbying government agencies for specific policy outcomes, which are then implemented by the regulatory agency in power. These actions usually have a negative externality: policies that are beneficial to a select group of entities could be injurious to the population as a whole. In this case, ironically, the interest group capture of great power governments was an important factor in predisposing the global economic system to openness. Drezner argues that a state's domestic material interests and institutions are the main factor in shaping its foreign economic policies. Since powerful interests groups in the United States, the European Union, and China all had a deep stake in an open economic order, they were able to successfully capture their respective policymaking institutions and keep the global trade of goods flowing.[20] There are, of course, hard constraints on this causal explanation, as the revised Basel Committee on Banking

[19] Drezner 2014, 77
[20] Drezner 2014, 80

Supervision's Basel III accords highlight.[21] Basel III was implemented despite vehement opposition from the banking and financial services sector.[22] The fact that "bank lobbying had almost no effect on the Basel III negotiations" highlights the limitations of explanations based solely on interests, and underscores the importance of power and ideas as well.[23]

While both power and interests are relatively easy to observe and quantify, ideas are much harder to track and analyze. They are also equally important. Power and interests alone cannot explain why China supported the system or why Germany (a staunch opponent of Keynesian fiscal stimulus) eventually enacted a substantial stimulus program.[24] Numerous times throughout the crisis both powerful states and influential sectorial interests compromised. To argue, as Drezner does, that the ideational depth of the Washington Consensus among global elites made challenging the system almost insurmountable, is a difficult argument to support. Even the term "Washington Consensus" is itself inherently murky, as there is, ironically, not a consensus as to the meaning of the term. (Whether referring to a specific set of policy prescriptions or to neoliberalism more broadly is left up to the reader's discretion, as there is actually no definitive definition.) Drezner largely stakes his claim by noting: that for ideas to be a good guide for actions they must be shared, that before the crisis there was no articulated alternative to the Washington Consensus (however broadly defined), and that after the crisis there was still no articulated alternative.[25] In essence, Drezner is arguing that the prevailing ideas supporting the system did not change. Even China, which was (and still is) in the best place to challenge the Washington Consensus, did not do so.

[21] Drezner 2014, 86
[22] Drezner 2014, 91
[23] ibid
[24] Drezner 2014, 142
[25] Drezner 2014, 143

That China did not buck the US backed system after the crisis is intriguing, especially when one remembers the levels of resentment China held in the early 2000's. Whether onerous US imposed conditions of WTO membership, or the mismanagement of the Asian financial crisis, a plurality of both Chinese citizens and leaders thought "that the United States was trying to prevent China from becoming a great power".[26] Policy makers and scholars were said to have conceptualized an "alternative" to the Washington Consensus (dubbed the Beijing Consensus) which "features an all-powerful political leadership that effectively manages social and economic affairs".[27] After the crisis, however, this viewpoint was never put into action. China, like the United States and the European Union, all took necessary actions to stabilize and resuscitate the global economy. Indeed, the developing world in general "remained invested in the existing order and served as a key constituency in its defense."[28] Additionally, the "Pew Global Attitudes Project" surveyed a wide selection of countries in 2012 about their opinion on free trade and free markets. It found that, surprisingly, the Great Recession did **not** lead to a drop in support for either.[29] Why? Drezner argues that, in fact, it is very hard to articulate a new world order, and that the necessary conditions were not met.[30] Not only did the United States retain enough power to provide a vital leadership role and maintain its system, but the Chinese themselves are fundamentally contested as to what exactly the Beijing Consensus entails. Indeed, Randall Schweller and Xiaoyu Pu are correct in ascertaining that "Chinese ideas about alternative world orders remain inchoate and contested within China itself."[31] It is hard to

[26] Drezner 2014, 144
[27] Drezner 2014, 147
[28] Kahler 2013, 40-41
[29] Drezner 2014, 150
[30] Drezner 2014, 153-154
[31] Schweller and Pu 2011, 52

articulate an alternative worldview, even if the world is in crisis, when one cannot even settle upon what one wishes to offer.

Kirshner's Pessimism

If Daniel Drezner represents the inherent optimism of liberal institutionalism, then Jonathan Kirshner articulates the pessimism of the Realist school of thought. Where Drezner sees a combination of power (a status-quo hegemonic coalition), interests (domestic capture theory), and ideas (neoliberal norms), all predisposing the global economy to greater openness, Kirshner sees the perils of relative gains and security dilemmas. While the system as a whole may be on the road to recovery, some states have recovered more than others. To Kirshner, the post-Cold War primacy of the American hegemon has come to a close. To be fair, Kirshner argues that the United States will "remain, indefinitely, a military competitor without peer", and that the American economy will remain "enormous, advanced, and robust."[32] But power is fundamentally a *relative* concept "and US *relative* power and influence are eroding."[33] Kirshner traces his argument back to the rise of "market fundamentalism"[34] during Alan Greenspan's tenure at the Federal Reserve, and the era of deregulation starting during the Clinton administration that put pressure on political institutions and the exchange rates of other states. He goes on to argue that a major contributor to the Asian financial crisis of the 1990's was due to unfettered capital flows and a lack of capital controls.[35] The fact that Malaysia was able to

[32] Kirshner 2014, 15
[33] ibid
[34] Market fundamentalism argues that "unfettered markets-even financial markets-left to govern themselves always know best, **and that there is one singularly correct cocktail of economic policies that applies to all countries in all circumstances" (**Kirshner 2014, 5. Emphasis added).
[35] Kirshner 2014, 76-77

recover from its worst recession ever by "pursu[ing] pro-growth policies, which would have been otherwise unsustainable due to the punishing capital flight" only serves to strengthen his argument.[36] Free flowing capital further exacerbated the crisis by fleeing suspect countries and creating bubbles in otherwise stable ones, with little regard to actual underlying economic variables. The Great Recession, therefore, was the second major financial crisis for most of the world within 10 years; and the US was seen as the primary culprit of both. Kirshner argues that this series of financial crises at the hands of the US-led order has completely shattered trust in the current system. And indeed, neither Drezner nor Kirshner see significant policy changes in the US in response to the crisis.

In contrast to Drezner's analysis of the fundamental drivers of international relations, Kirshner discovers a different role that interest, power, and ideas respectively play out. Kirshner sees power as becoming more dispersed within the international system, ideas as being less homogenous, and (security) interests more varied.[37] Although Realists argue that power is the fundamental determinant of international relations, when it comes to money, ideas play an outsized role. After all, a fiat currency (fiat being Latin for "it shall be done") is ideational at its core. All (fiat) money relies on the idea that others will accept your currency in return for goods and services, and vice versa. US dollars are "legal tender, for all debts public and private" only because they are backed by the "full faith and credit" of the United States' government. Lose faith in the system and the whole thing comes crashing down. Therefore, the ideas backing international finance and monetary relations are just as important as the nature of the relations themselves. Homogenous and widely accepted monetary ideas can be seen as a way to lower

[36] Kirshner 2014, 77
[37] Kirshner 2014, 14

transaction costs and promote economic relations among states. A stable financial system with a stable currency regime is more conducive to growth than an unstable, uncertain one. The delegitimization of the American monetary order has led to a "new heterogeneity of thinking" about money that Kirshner argues not only makes future macroeconomic coordination more difficult, but will also restrict American power.

Kirshner looks back to the Asian financial crisis of 1997-1998, and the response to it by the US and the IMF, as the beginning of the end of the second postwar US order. His argument is that the "ideational implications [of moving away from the US led order] were profound, and they were magnified after the 2007-8 crisis."[38] The ideological split largely followed an East-West divide, with many in Asia seeing the financial crisis as just a standard financial crisis, while in the West the crisis was attributed to "poor public policy."[39] The lessons of IMF austerity policies and US promotion of unfettered capital flows were not lost on recipient countries (who underwent tough periods of economic contraction) and other Asian states (who largely remained untouched from the crisis by retaining capital controls). The crisis, then, can be seen as a test of the East Asian financial model vs. the market fundamentalist American way.[40] Not surprisingly, US policy makers (most notably Greenspan) tended to believe that the local economic practices were inefficient, and that the US financial model of unrestricted financial capital was the best, and only, way to efficiently run an economy. Asian leaders, meanwhile, came to believe that these very same policies were not only harmful, but an attempt to promote American interests in the region.[41] It is this "smoldering resentment toward the arrogance of the American attitude that

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[38] Kirshner 2014, 61
[39] Greenspan 1988
[40] Kirshner 2014, 78
[41] Sakakibara 1999

[Greenspan] was expressing" that planted the seeds of resentment that would blossom after the financial crisis of 2007-2008.

The biggest ideological struggle, however, will not be over the nature of capital flows and best financial practices, but of the status of the US dollar as the world's reserve currency. The dollar's privileged status may come under pressure from an increasing internationalization of the Chinese renminbi (RMB) in future years. It is important to note that the US dollar will remain "first among equals" for the foreseeable future. The requisite actions to remove the dollar as the world's reserve currency would require an entirely different set of conceivable conditions that are beyond the scope of this paper. Thus, the rise of the RMB is not a matter of overthrowing the dollar's hegemony, but of creating a so-called multi-currency regime that incorporates currencies from various economic powerhouses from all over the globe. Kirshner believes that the RMB will become the currency of choice in the East Asia region, eating into areas of economics and trade that were once dominated by the greenback.[42] Indeed, a multi-currency regime centered around the dollar, the euro, and the renminbi is the scenario that the World Bank itself deems as most likely by 2025.[43]

The rationale behind China's desire to encourage the international use of their currency is twofold: first, a greater international role for the RMB will give China greater economic autonomy; second, this will increase the global political influence of the Chinese government.[44] The desire for greater economic autonomy should not be underestimated; after watching two financial crises in the last ten years, China has seen firsthand the instability that a dollar-centric, unregulated financial order can bring. Kirshner argues that the reason China acted so status-quo

[42] Kirshner 2014, 109
[43] World Bank 2011
[44] Kirshner 2014, 108

during the financial crisis was because "states that use the dollar, and especially states that hold their reserves in dollars, develop a vested interest in the value and stability of the dollar."[45] In short, China had fallen into a dollar trap. By holding large amounts of dollars in reserve China would not be able to take steps to challenge an already unstable American financial order since it would, in essence, be cutting off its nose to spite its face. After the crisis, China has been looking for ways to disentangle itself from the American-led order. Indeed, while many actions Japan took before its "lost decade" to push for yen internationalization were indicative of a desire to further enhance Japan's growing influence, China's currency ambitions are "fundamentally about insulation" from the instability inherent in unregulated financial markets, from America's willingness to use its currency to force macroeconomic adjustments abroad, and from ideological differences over the nature of global economic governance.[46] Kirshner concludes this with supporting interviews and quotations from prominent Chinese policymakers and academics.[47]

Actual measures to promote the RMB's usage internationally are more difficult to implement, given the uncertainty around China's "shadow banking" sector and limited currency convertibility. To increase the use of a currency globally there must be an increase in demand for that currency, and/or an increase in supply. After the crisis, supply has increased as China has become more willing to give the RMB "a greater role internationally", and there has been an increase in demand as a growing number of states look for ways to diversify their finances "away from the dollar, the American financial model, and the US. economy."[48] China has a few options

[45] Kirshner 2014, 141-142
[46] Kirshner 2014, 112
[47] Kirshner 2014, 115-117
[48] Kirshner 2014, 118

to meet this demand. It is important to note that for money to be used globally, it needs a steady supply of that currency moving permanently offshore (so that others can use it in their own personal dealings). In the West, this is usually accomplished through trade deficits (ie: the US trade deficit with China, from which China is currently holding trillions of US dollars). However, the main way China has promoted the use of yuans has been by the use of "bilateral currency swaps", which "facilitates the utilization of and provides easy access to yuan without requiring multilateral negotiations and without necessitating ambitious or comprehensive commitments to financial liberalization."[49] China has initiated these swaps with governments all over the world, from Latin America to the Middle East, and most notably to Japan. In addition, the former British colony of Hong Kong was practically gifted to China in 1999 with a bustling financial hub intact. In fact, China has been allowing some banks operating out of Hong Kong to issue yuan-denominated bonds, which financial hubs such as Singapore have been buying extensively.

This is not to say that there are not obstacles China must overcome in order to promote the greater use of the RMB in the world economy. Kirshner argues that the rate and scope of the adoption of the RMB by other states will depend on "politics, regionally, and economics, globally."[50] This means that if China's foreign policy actions are seen as threatening or heavy-handed by its neighbors then demand for the RMB will decrease. Smaller regional actors tend to not want to become tightly bound to a threatening regional giant. Additionally, if significant cracks in the foundations of Chinese economic growth are exposed, then one can expect the rate and scope of RMB adoption to slow down as well. However, he disagrees with the economists

[49] Kirshner 2014, 121
[50] Kirshner 2014, 122

who argue that the less than neoliberal nature of China's financial sector will severely circumscribe the role that the RMB can play in international finance.[51] In fact, China need not "fully liberalize in order for the RMB to emerge as an important international currency."[52]

This is not to say that there is not a role for power in Kirshner's analysis, despite the overwhelming role that ideas play in monetary matters. Power is a fundamental variable in international relations, and in global economic relations the state that holds the status as the issuer of the world's reserve currency is given numerous structural advantages. As long as the US dollar is used extensively abroad America is able to borrow in its own currency, sustaining deficits on its capital account that other states could never find possible.[53] The consequences of the global financial market's responses to risky economic policies and foreign interventions is severely muted when, at the first sign of panic, investors flock to the bond markets of one's own country and buy up one's currency. America's coercive abilities (namely its ability to wage wars unilaterally) and its ability to sustain massive deficits are closely tied to its ability to adopt policies that would have caused harsh market reactions for others, which is in turn tied closely to its structural power, which in fact stems from its status as the issuer of the world's reserve currency.[54]

A loss of this macroeconomic autonomy would make it increasingly harder for the US to act unilaterally on the world stage. Again, the US material power will still be unrivaled and will remain so for some time. The key here is that *relative* power decline and *gradual changes* to the balance of power are in store for America. Losing *relative* macroeconomic autonomy means

[51] As of this writing China still maintains somewhat strict controls on its currency and moderate capital account restrictions.
[52] ibid
[53] Kirshner 2014, 141
[54] Kirshner 2014, 142-143

increasing financial pressure on defense spending, the reduced ability to finance unilateral foreign policies, and greater exposure to financial distress stemming from political crises.[55] While other states have been dealing with painful economic adjustments for decades, the United States will be severely unaccustomed to bearing them. First, as states move away from holding dollars and move into holding other types of currency (RMB, euro, or otherwise) the excess dollars will begin to put monetary pressure on the issuer of the original currency, forcing them into painful macroeconomic adjustments.[56] Second, a loss of credibility and prestige tend to plague a currency on the decline. Kirshner highlights the role the pound sterling of Great Britain played in undermining their military endeavor of overthrowing Gamal Nasser in Egypt and taking control of the Suez Canal.[57] Market forces, spooked by the political crisis, started a run on the pound, and forced the English to halt their activities as a condition of receiving support from the US and IMF. Far from being an isolated incident, Kirshner traces this trend throughout the 20th century, focusing extensively on the challenges faced by the British and the French.[58] From a security standpoint, then, it is easy to argue that the United States will face greater consequences from its adventures abroad, and all else being equal, will tend to engage in those adventures less.

Interest, just like power, should not be underestimated when compared to the role of ideas. Again, structural power is important here. Structural power not only allows the United States to act more unilaterally on the world stage, but also to "affect the pattern of economic

[55] Kirshner 2014, 132
[56] Kirshner 2014, 146
[57] Kirshner 2014, 147
[58] Kirshner 2014, 147-151

relations between states and their calculation of political interests."[59] A state with structural power has the ability to shape the frameworks which states use to relate to one another. Applying this logical framework further indicates that international economic relations can have an effect on domestic politics, which in turn can shape national interests.[60] The structural power of the American led economic order shaped the way elites in some countries viewed the international system, socializing them to norms of neoliberal economics and market fundamentalism.[61] Structural power, then, is a key variable not only to power but also to interests.

In fact, domestic interests did play a key role in shaping the nature of international relations. One can articulate a pretty convincing case for the role of interests by using the "regulatory capture story" common in economics. For example, the global banking sector played a massive role in making the system less stable by seeking to make the global economy more "hospitable to business". Bankers lobbying for the dismantling of capital controls and the deregulation of their industry did not need to do much convincing when the revolving door between government and business is well documented.[62] American financial actors who had the most to gain from globalization and deregulation pushed hard for policies in government that promoted their economic interests. Their successful lobbying of the United States' government lead to decreasing levels of regulation around the start of the Reagan administration and continuing up until the most recent crisis. These domestic interests were soon translated into international political interests, with the special nature of the United States as the backer of the

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59 Kirshner 2014, 141
60 Hirschman 1980; Kirshner 1995
61 Kirshner 2014
62 Kirshner 2014, 60

global financial order giving it an unrivaled place from which to set the "rules of the game" regarding international finance. In short time, the American way came to be defined by deregulation, free flows of financial capital, and extensive privatization.

Theoretical Underpinnings

Is China Revisionist?

The fundamental question scholars of China have to ask themselves is: at its very core, is China a revisionist (and unsatisfied) power, or is it a status-quo power, and largely satisfied with the current system? The answer to this question is dire: if China is a revisionist state then the international community should either engage and integrate it (if limited aims) into the system, or strive to contain it (if unlimited aims) before it reaches hegemony.[63] If China is not a revisionist power, then very few of these measures are necessary. This key distinction will shape the nature of not only global economic governance, but international relations as a whole. To be sure, the answer is up for much debate, and two schools of thought have coalesced. The first school of thought, which relies on the successful "engagement" of China by the international system, maintains that China is not a dissatisfied power and that it largely plays by the "rules of the game."[64] China had to accept these rules in order to join the international economic community. This is precisely the argument Drezner and others have made; a combination of power, interest, and ideas has predisposed China to view their success as bound to the success of the system. Huiyan examines the role of culture and the beliefs of Chinese leaders, stressing that Confucian norms of peace and harmony are more influential for today's generation of Chinese

[63] Huiyun 2009, 313
[64] Pearson 1999

leaders than Alastair Johnston's "parabellum strategic culture."[65] Similarly, some argue that China hasn't disrupted the international system because ideological changes in the views of domestic policymakers led to an embrace of the "Washington Consensus". China, they argue, has not articulated a so-called "Beijing Consensus", because the Chinese in fact have no alternative world view to articulate.[66]

Recent evidence, however, has placed intellectual pressure upon this school. It is to be expected that China would accept rules that they themselves would benefit from. A free, American secured, open economy in which China could sell manufactured goods is undoubtedly a benefit for the Chinese economy, and has spawned perhaps the most miraculous rate of growth in human history. Indeed, China may even tolerate current unfair rules, at least until they are in a better position to act. Intentions are inherently unknowable; all that actors in an international arena can hope to know are capabilities. As capabilities expand (or contract) intentions follow suit. Furthermore, the claim that China has broadly accepted the "Washington Consensus" is more dubious, as the recent financial crisis has exposed cracks in the facade of global acceptance. Both Chinese actions and rhetoric have exposed deep divisions regarding Chinese acceptance of current norms. The post-crisis rise of Chinese-led international economic institutions is the biggest indicator. Existing economic institutions have a decidedly Western "flavor"; the IMF is always headed by a European and the World Bank by an American. Even the Asian Development Bank (ADB) is dominated extensively by Japan; China, despite being the largest economy in Asian, has half the voting shares of Japan, and the bank's president has

[65] Huiyun 2009, 317, 332
[66] Schweller and Pu 2011

always been Japanese.[67] American efforts to accommodate the rise of China have run into political deadlock as members of both parties of Congress have stalled bills to reform the voting allocation of the IMF since 2010.[68] As expected, a China unable to work within the existing system due to entrenched interests would be expected to "pursue its own international arrangements on a parallel track."[69] It is within this context that China has pushed for the creation of four main rivals to Western-lead international institutions: the Asian Infrastructure Investment Bank (AIIB), the New Development Bank (consisting of the rising BRICS nations), the military/political/economic Shanghai Cooperation Organization, and finally a currency reserve fund to provide countries with liquidity in the event of financial crises and shocks. Already, the AIIB has received considerable push-back from American officials, even going so far as to criticize the British government for its desire to become a founding member.[70] Since then, Germany, France, and Italy have all decided to join and (as of this writing) Australia is expected to as well. A measure similar to this (called the Asian Monetary Fund) was tried by the Japanese in the aftermath of the Asian financial crisis, but was met with vehement opposition by the Clinton administration, before eventually failing to take form. Perhaps the Chinese initiative will be longer lasting.

Perhaps realism holds the key to understanding contemporary Chinese actions. (Offensive) Realism maintains that states are fundamentally "power-maximizing" revisionists, who seek to dominate the international order and remake it to their liking.[71] To offensive realists such as Mearsheimer, all states harbor these aggressive tendencies, and will seek to alter the

[67] The Economist 2014
[68] Higgins and Sanger 2015
[69] Kirshner 2014, 109
[70] Higgins and Sanger 2015
[71] Mearsheimer 2001

prevailing balance of power "by acquiring additional increments of power at the expense of potential rivals."[72] This power-maximizing theory could help explain why China has become more revisionist in recent years. In fact, Mearsheimer does argue that the rising relative power of China (due to its rapid economic development, military modernization and assertive behavior over energy procurement, multilateral institutions and Taiwan's future) sentences it to eventual conflict with the United States.[73] One should expect states to fill in power vacuums present in the international system (international relations, like nature, abhors a vacuum). If declining US. power abdicates leadership or influence in a certain arena, scholars should expect Chinese power (or another state's power) to fill in the resulting gap. Indeed, this theory does seem to explain some of the evidence for revisionism I articulated earlier. The rise of the AIIB and RMB currency reserves can be seen as providing services for a growing segment of the global system that is unsatisfied by what a declining American state can provide them

This realization has a dark side, however; interests tend to expand with power. So does fear. A rising state soon finds new places to defend from former allies turned enemies. Since "the measures a state takes to increase its own security usually decreases the security of other states...it is difficult for a state to increase its own chances of survival without threatening the survival of other states."[74] This is the fundamental "Tragedy" of international politics: that even states seeking security in a self-help, anarchic, system will fall into patterns of conflict and strife.[75] This does not bode well for the future of Sino-American relations, especially if power is fluctuating between the two sides.

[72] Mearsheimer 2001, 34
[73] Mearsheimer 2001
[74] Mearsheimer 2001, 36
[75] Mearsheimer 2001, 1-3

However, I do not wish to maintain Mearsheimer's contention that states are strict power-maximizers, always looking for the first sign of weakness to overthrow the system and crown themselves the hegemon. China has expressed a willingness (as of now) to seek a more limited revision of the international system. Pang Sen, a deputy director-general at China's Foreign Ministry said it best: "If the rules are made collectively through agreement and China is a part of it, then China will abide by them. If rules are decided by one or even several countries, China does not have the obligation to abide by that."[76] Therefore, for the purposes of this paper I will treat China as if it is a (limited aims) unsatisfied revisionist power. The magnitude of this assumption, of course, will always be up for debate.

Aggressive vs. Pacific

The difference between an "aggressive" China and a "pacific" China needs clarification, so as not to be erroneously interpreted. "Threatening" and "nonthreatening" behavior is highly context specific, and largely depends on one's point of view.[77] In international relations, context is key. Territorial disputes in the South China Sea between China and Japan are less threatening to the United States than to the Japanese - their close proximity to China heightens their "perceived threat". The West (specifically the United States) sits atop a system largely skewed toward their benefit. The West is so invested in their privileged status-quo that any attempts to reform the system (no matter how legitimate) may be perceived as "threatening". Indeed, many of the calls from the Bush and Obama administrations for China to be a "responsible stakeholder" can be distilled to an unwillingness to give up special privileges that the West

[76] Spetalnick and Palmer 2011
[77] Wendt 1992, 397

enjoys over the rest of the world. But China, like many other rising powers, has legitimate grievances with the current international system. Although they hold a permanent seat on the United Nations Security Council, it is still comprised of Western states. Additionally, both the IMF and the World Bank (the two most important international economic institutions on Earth) are held by a European and an American, respectively. Finally, the global reserve currency, the currency accepted universally all over the globe, is the American dollar. As the rest of the world rises on the world stage they will start to demand prestige that reflects their newfound power, and China will be first in line.

The key distinction between my classification of China as being "aggressive" or "pacific" refers not to its aims, but to its means. As states gain power they will start to demand changes to inequitable systems that conflict with their interests. This is the fundamental rule of power politics: the ones with the power shape politics. Legitimate grievances should be addressed, from both a moral and an economic standpoint (if the costs of maintaining an inequality outweigh the benefits). What I define as "aggressive" is if China, in its pursuit of prestige, begins to utilize means that are outside the widely accepted international political norms. The rejection of international norms regarding diplomacy, or refusing to cooperate with and undermining international organizations comes to mind. Therefore, an aggressive rise for China would see China skirt around international norms, if not rejecting them altogether. Increasingly caustic rhetoric, sabre rattling during territorial disputes, and an unwillingness to work out disputes through diplomatic channels or with international institutions are all warning signs of a state moving outside of the current global system. The most dramatic example would be the illegitimate changing of political borders by force, an outcome relevant to China's East Asian territorial disputes. Conversely, a peaceful rise for China would see them work from within the system, using international institutions and diplomacy in order to resolve conflict, and following most international laws most of the time. Any territorial disputes (and there are many) would be resolved through peaceful, diplomatic channels. China will, in essence, be a supporter of the system, not a spoiler. That is not to say that conflict will not ensue; political disputes still flare up between the United States and Europe (the decision to invade Iraq, for example). The challenges presented by a state's legitimate grievances, however, should not be lumped together and discounted along with the problems posed by a potential "rogue" state. The fundamental lesson here, then, is not to conflate peace with US interests.

Financial Crises and the Future of the Global Economy

Financial crises, far from being the "Black Swan" events many commentators believe them to be, actually tend to be the norm when it comes to sufficiently developed economies. Indeed, economists actually have a pretty firm understanding of how financial bubbles arise and burst. The issue (as this paper's beginning quotes highlight) is fundamentally, a paradox: scholars have an intellectual grasp on the concept of bubbles, their rise and eventual fall, and the resulting panics; however, ex ante it is extremely difficult to identify a bubble and even more so to determine when it will pop.[78] The problem is that when a financial bubble does burst, widespread panic sets in among the populace. Vast amounts of wealth are wiped clean during the panic; many firms trading in, or with close ties to, the bubble can go bust overnight. The unfortunate fact for the economy writ large is that this panic, this contagion, spreads throughout the financial sector. Investors, spooked by the crisis and looking to reduce risk, begin pulling

[78] Former Federal Reserve Chairmen Alan Greenspan and Ben Bernanke sum this paradox up perfectly.

money out of the economy; consumers, afraid of the same risks, flee from troubled financial assets - drying up much needed capital and liquidity in the market. Historically, without proper regulations banking consumers, during a panic, would even engage in "bank runs" - a large mass of customers demanding that their bank return their money, which the bank does not have on hand at that moment.[79] Subsequent regulations by the US government mitigated these runs (for example, up to $100,000 of banking deposits are insured by the FDIC). Many of these regulations put in place after the Great Depression helped reduce or eliminate financial risk for most of the 20th century.

It is the response to past financial crises that I find most important for determining the future of global financial relations. The relative financial stability during the middle of the 20th century was no fluke (sadly, it was the exception, not the norm). Kirshner argues that regulations put in place after the Great Depression had the effect of mitigating financial risk and thus preventing financial crises from ever reaching Depression era levels. Keynesian regulations of the financial sector kept banking safe from the excesses and dangers of unregulated capital. Had these regulations remained in place instead of being dismantled by Republicans and Democrats alike decades later, then future financial crisis would have been muted in their effect, size, and scope. The (temporary) regulatory regime placed upon the US financial sector after the Great Depression stands in stark contrast to the aftermath of the Great Recession, where economic conservatives and Wall Street special interests teamed up to immediately undo many

[79] A great example of this phenomenon is the scene from the classic movie "It's A Wonderful Life", in which Jimmy Stewart's character successfully defuses a run on his bank.

of the regulatory policies enacted by reformed minded politicians and populists in D.C.[80] Kirshner believes that although these initial policies fell short of their marks, they were a good start and could have taken significant steps to limit future crises. Their removal only makes financial crises more prevalent and severe. It would appear now that the very same system that nearly drove the global economy off a cliff is still in the driver seat.

American power, as Kirshner argues, cannot afford to be the cause of yet another global financial meltdown. United States culpability in another global recession would firmly delegitimize the American model in the eyes of the rest. It is this situation that I will examine. In my first world, just this very "worst-case" scenario happens. An unregulated American financial sector, much like the one that wrecked the global economy twice in the last 100 years, yet again falls victim to endemic risk and panic. Billions (if not trillions) of dollars are lost during the crash, the contagion spreads around the world, and the global economy enters another recession. This time, however, the previous supporters of the global economic status-quo pull their support. Support may not be withdrawn all at once, nor explicitly stated by individual nation-states. Instead, the United States will find it harder and harder to persuade states to engage in an American-led global economy. Other states, especially rising powers like China (and the other BRIC's), would be expected to fill in for the declining role of the United States. For example, the World Bank and the IMF could hold less sway over many countries, mainly their consumers in the developing world. Additionally, preferential financial policies promoted by the United States, such as unrestricted capital flows, will most likely be largely abandoned. The financial crisis in this scenario need not be of a higher magnitude than the Great Recession,

[80] Kirshner 2014, 7. Mainly referring here to the repeal of the "Glass-Steagall Act" (which separated investment and commercial banking), and the passage of the "Commodity Futures Modernization Act" (which prevented government regulation of derivatives).

nor even the Asian financial crisis of the 1990's. It just must be sufficient enough to delegitimize the American model of international finance and global economic governance.

The other "optimistic" world, as it may be called, largely avoids these consequences. In this scenario, states by and large bring their financial sectors under control. The dangerous consequences of unrestricted capital flight will be mitigated, as well as the overleveraging tendencies of large banks. Financial risk should be reduced, investment banks and commercial banks will once again be separated, and the "casino mentality" that has defined financial investment since the 1980's will fall out of style. In short, banking will more or less be "safe, reliable, and boring". By all means, this system will still be a free market system; there is a large gap between a well regulated, market based, financial sector, and an "Authoritarian Capitalist" system.

Four Worlds, One Future

I will now look at the impact the preceding sections may have on global economic governance after the financial crisis of 2007-2008. Through careful analysis of Drezner and Kirshner's work, international relations theory, and macroeconomic theory, I plan to "sketch out" four plausible scenarios for the nature of global economic governance in the coming years.

I have crafted a 2x2 payoff matrix representing the main findings of this paper below (Figure 1). On the left side I have placed two projections of the nature of the future economic order: a world in crisis and a world devoid of one. This draws on the works of Kirshner and Drezner this paper has analyzed earlier. A future "world in crisis" reflects Kirshner's argument that a new heterogeneity of thinking about global economic governance will supplant the Washington Consensus in the event of another financial crisis. Kirshner argues that just such a financial crisis will happen, as policymakers in the United States have failed to learn from the previous crisis and have not enacted the proper regulatory policies. Failure to learn from the crisis of today has made a future crisis more likely, which would vaporize the world's support for the American-led economic order. Conversely, a future "no world crisis" reflects Drezner's belief that the US-led economic order is here to stay. Drezner does not see the pessimistic implications that Kirshner uncovers in his work. To Drezner, the Great Recession "provided a severe 'stress test' for global economic governance – and these structures passed."[81] The resiliency of the current set of global economic institutions and the strong status-quo bias present in the system make it exceedingly difficult for any potential challenger to usurp the economic order. This paper then combines these conditions with a financial sector that is sufficiently regulated to avoid the excesses of neoliberal capital flows.

On the top of the matrix I have placed the potential nature of the Chinese state – revisionist or status-quo. Recall that this paper makes a distinction between revisionist and status-quo in relation to China's *means* and not its *aims*. Rising states have legitimate grievances and attempts to push for rectification should not be attributed to moving outside the system. Additionally, I further maintain that any revisionist tendencies that China may have will be strictly limited-aims and risk averse. A revisionist China would thus be unlike the revolutionary states of Napoleonic France and Hilterite Germany, or even Maoist China before it.

The results of the matrix need clarification as well. It may be best, however, to start with what problems in the current literature this model is trying to address. When most scholars discuss the nature of China they tend to do so "backwards". That is, they start from the unit-level of analysis (specific actions by the Chinese state) and then argue that these actions are

[81] Drezner 2014, 15

indicative of a multipolar, bipolar, or unipolar order.[82] For example, a realist may argue that certain actions by China indicate that they are an aggressive revisionist state, using this to argue that the current system resembles one of bipolarity. A liberal might look at the accommodating nature of Chinese institutional integration and the internal constraints on economic growth, and say that China poses little to no threat to American hegemony, which would entail a unipolar system. The problem (as this paper will underscore) is that contemporary China provides a multitude of examples to support both claims. China has indications of strength and weakness, aggression and pacifisms, precipitous growth and sudden decline. To only select a certain set of indicators and provide them as evidence is methodologically flawed.

Therefore, I believe that it is much more effective to set up the structure of the international system first. Examining the nature of the structure in which China, the United States, and the world act goes a long way in determining the implications for global economic governance. Once this paper has laid out the underlying structure of each world it will then be easy to see what implications each system would have for global economic governance. For example, an aggressive China in a crisis world would see more opportunities for revisionism than an aggressive China in a stable one. It is important to clarify that this paper views structure as a permissive cause of action. Indeed, structure will "let" these developments happen, but won't "make" them happen.

Again, it is important to make it very clear that my paper is not an attempt to prognosticate about the future. If my paper is the first shake of the "Magic 8 Ball" to divine what a post-Great Recession global system is going to look like, the best answer will always be

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[82] See (Friedberg 2005) for a refreshing break from this causal logic. However, his work is the exception that proves the rule.

“Ask Again Later”. All I have set out to do is reexamine what scholars before myself have analyzed, and apply what they know to different conditions in the future. *If* these conditions hold, *then* scholars should expect to see outcomes similar to my analysis.

<table>
<tr><th></th><th>Aggressive China</th><th>Pacific China</th></tr>
<tr><td>World in Crisis</td><td><u>World #1</u>
Rise of Chinese alternatives
China wants more from the system
United States unwilling to budge
Intense security dilemma
Breakdown of global economic governance
<u>China will try to rewrite the rules of the system, but will be more reckless</u></td><td><u>World #2</u>
Incentives to demand prestige. commensurate with their power
Offensive Realist theory: should fill power vacuum.
But appears status-quo
Inwardly focused
Global economic governance largely American
<u>China may try to rewrite the rules of the system, but will be more cautious</u></td></tr>
<tr><td>No World Crisis</td><td><u>World #3</u>
New Cold War?
Aggressively try to rewrite system
Fear of China supports status-quo bias
Run into more conflict with West
<u>China will try to aggressively rewrite the rules of the system but will find less support for its alternatives, leading to a new Cold War.</u></td><td><u>World #4</u>
Close cooperation during economic issues
Some minor political and economic disagreements
Will help great economic powers maintain system
Status-quo, supporter not spoiler
<u>China will become a “responsible stakeholder”, acquiesce to the rules and norms of the global economic system</u></td></tr>
</table>

Figure 1: Payoff Matrix

World 1: "Doubly Dangerous"

This, unfortunately, is perhaps the easiest world for many scholars to imagine. In a world defined by an aggressive China increasingly willing to use illegitimate means to get what it wants, and an American economy reeling from another financial crisis, the potential for serious conflict would be severe. This is the pessimistic world that Mearsheimer believe is all too likely given current growth and power trajectories. Kirshner argued that during the last global financial crisis China was, in essence, held hostage to the failing system. China's large dollar holdings and financial stakes forced it (grudgingly) to act in concert with the European Union and United States to take measures to stabilize the system. If Chinese growth has continued and its power risen *relative* to the United States', then by the time the next crisis unfolds an aggressive China will be in a better position to act on its own initiative.[83] An aggressive China in this world would see a disintegrating system and find plenty of opportunities to rewrite the "rules of the game" in favor of itself. However, the transition would probably not go as smoothly as hoped; in fact, global governance structures would most likely collapse during this time period. The existing framework of institutions and agreements predicated on the US-led economic order would be torn between the economic influence of a rising China, and the (declining, yet still substantial) economic power of the United States. Eventually they would be restructured in order to better reflect the new distribution of economic power (with China playing the leading role), but in the meantime the global economy would undergo periods of recession and uncertainty. Still reeling from the previous crisis the economy would be weak and stagnant. The global economic governance structures that saved the economy after the 2007-2008 financial crisis would be in

[83] In essence, the concept is similar to the oft repeated (and linguistically incorrect) saying that the Chinese word for "crisis" (危机) is "danger" + "opportunity".

the process of being remade in the Chinese image, and unable to provide the necessary public goods needed to keep the global economy open. In the worst case "doomsday" scenario, this and the additional Chinese-American security dilemma, push the global economy into a severe period of recession. In the end, the fundamental reason for this is just as much economic as it is political.

Political conflicts between the world's richest country and the world's most populous one would have become more common as time went on, but would finally reach a head in the midst of the next crisis. For example, post-WWII norms against the forceful, unilateral, revision of sovereign borders have been violated (most recently by Russia), and there are concerns that they could be violated again. Nowhere else is this more important than in the struggle over the future of Taiwan (Republic of China). The Chinese Communist Party took control of mainland China at the conclusion of the Chinese Civil War in 1949, forcing the Nationalist government to relocate to Taiwan. Since then, Taiwan has occupied a unique status in international relations: *de facto*, it is its own sovereign country; *de jure*, both China and Taiwan claimed to be the legitimate representatives of the Chinese state.[84] At stake are fundamental US foreign policy ideas: the promotion of democracy, stability in the region as a whole, and the credibility of US commitments.[85] China, as to be expected, sees the situation differently. To them, Taiwan is a "renegade province", one which China has every right (and even a responsibility) to bring back under control. They view American measures to reaffirm a commitment to Taiwan (such as the 1992 sale of F-16 fighter aircraft) as an infringement by the West upon their sovereignty.

[84] A claim which the ROK has since revoked.
[85] Campbell and Mitchell 2001, 14

An aggressive China under these conditions may be willing to resort to the use of force to settle the Taiwan question (if it ever comes to that). Most likely, however, it will not have to. Chinese power will have advanced to such a point where it will be able to significantly shape conditions of the system in which regional actors make decisions. Even now, China's military planning largely revolves around a Taiwan attack scenario.[86] The advancement of the Chinese military machine is only one part of the equation, however; the willingness/ability of a declining United States to engage a rising adversary over a piece of land that has no strategic national interest must be examined. For its part, the United States has stated that it will "consider any effort to determine the future of Taiwan by other than peaceful means...a threat to the peace and security of the Western Pacific area and of grave concern to the United States."[87] Realistically, it is more likely that America will stand by once the bullets start to fly. Regardless, an increasing capacity of the People's Liberation Army to carry out a ground war, and Chinese development of a blue water navy would persuade the Taiwanese leadership to acquiesce to the demands of Beijing. It is important to note here that it is not vitally important that China actually use illegitimate measures to rewrite the status-quo. If it is reasonably expected by relevant parties that Chinese threats and ultimatums are to be taken seriously, then it is highly likely that states will comply with Chinese demands without resulting to war. Empty threats are called as such because, fundamentally, actors know that the aggravating party will not actually follow through. What is important here is that China *would* use them if tested. Power held in reserve can be just as threatening as power actualized.

[86] Campbell and Mitchell 2001, 17
[87] Taiwan Relations Act 1979t, Section 2: Subsection 2: Paragraph 4

In addition to the Taiwan issue, other Asian nations have faced pressure from the Chinese navy over claims to island chains and territory in the East Asian and the South China Sea. Vietnam and the Philippines have made competing claims in the South China Sea against China, and the East Asian Sea's Senkaku/Diaoyu Islands dispute between China and Japan is infamously heated. There are two main reasons behind why China has staked out such revisionist policies, and would risk appearing aggressive toward its neighbors (with all the costs that entails). The South China Sea claims are mainly motivated by economics and national interests (Chinese territorial claims in the region occupy most of that area's potential oil, gas, and mineral resources), while the Senkaku/Diaoyu Islands are more similar to the Taiwan case.[88] These events highlight the revisionist potential of a rising China. China has shown little patience with any state or organization that attempts to compete against its South China claims. In 2012, tense naval standoffs between Chinese, Vietnamese, and Filipino ships lead to multiple collisions and riots in their respective countries. This was preceded in 2012 by the Chinese refusal to work with the Association of Southeast Asian Nations (ASEAN) to formulate a sort of "code of conduct" regarding the South China Sea. Meanwhile, the divide between the Chinese and the Japanese has had serious diplomatic effects, sparking riots and even resulting in Japan recalling its ambassador to China. Both China and Japan are the major economic powers in Asia, and these disputes (indicative of deeper historical animosity) make cooperation on political and economic matters more difficult.

While these political and territorial disputes are interesting topics in and of themselves, it is their relation to global economic governance that this paper focuses on. A rising China more

[88] The Chinese people still consider those islands (located not too far from Taiwan) to be Chinese, even though Japan has conquered and occupied them since the 1890's.

able to pursue its irredentist and expansionary policies runs the risk of overreaching and significantly limiting its economic potential. Much as China's hopes for a greater role for the RMB in East Asia relies on greater demand from others, so too does its nascent global economic institutions. Aggressive, expansionary policies may only serve to threaten and frighten China's weaker neighbors, upon whom Beijing will also rely on to support its global economic vision.[89] Under conditions of anarchy states tend to seek to balance threats, and would thus be less likely to bandwagon or extensively support a threatening state, especially when a counterweight is present. Indeed, China's own aggressive tendencies could play right into the interests of the United States, bolstering the latter's bastion of support at the expense of the former's. At the very least, counterproductive policies will serve to lengthen the transition between the American and Chinese based economic orders, which would prolong the political and economic crisis in question. Until global economic institutions are better able to reflect the underlying power structures, the system will be paralyzed by policy gridlock. For a time, neither the US or China backed coalitions will be able to form enough of a consensus in order to make effective global policy. Global governance, which fundamentally relies on agreements between major powers, will come to a standstill.

World 2: "Inward Development"

At a cursory glance, the nature of World #2 seems to fly in the face of conventional international relations theory. This is a world defined by another systemic economic shock, delegitimizing the American economic order in the eyes of the rest. China would therefore be in the perfect place to expand its power and influence, articulating a new heterogeneity of thinking

[89] Recall Kirshner's observation that expansion relies on politics-regionally, economics-globally.

and revising the system to better accommodate its needs and desires. The second condition, however, maintains that China will *not* do that. In fact, this China would abdicate its role as the next global economic standard bearer, rejecting calls for its leadership and withdrawing within itself. This is a curious position, since Mearsheimer argues that states are fundamentally aggressive "power maximizers", intent on expanding their power and capabilities with the intent of insulating themselves from the dangers present in an anarchic world. If states see an opportunity to take power or balance against a threat, they will aggressively do so in order to ensure survival. This contradiction can be explained by breaking down the offensive realist model of balancing and systemic incentives. First, Chinese power has been substantially overestimated by policymakers and scholars alike. While China is on pace to become the world's largest economy, and the largest domestic market for foreign firms, there are significant problems within the Chinese state that are not just economic, but political as well. Large internal structural problems could severely hamstring China's ability to impose its will on the world stage.[90] Second, internal divisions within the Chinese Communist Party (CCP) may prevent China from adequately responding to systemic incentives it faces on the international stage. International relations scholars tend to treat states as rational, *unitary* actors, able to adequately respond to systemic incentives. This tidy model breaks down if a state does not act in a unitary fashion on the world stage. As this paper will show, that may indeed be the case when the internal constraints and divisions within the CCP are taken into account.

The engine of Chinese growth and power has been the unprecedented rise and development of the Chinese economy. Before the Great Recession, China has made awesome

[90] (Indeed, this has happened to China before: Mongol invaders forced the Ming Dynasty to orientate itself inward, leaving its external commitments (and its Treasury Fleet) to rot.)

strides in opening up its domestic markets and integrating itself into the liberal economic order. This resulted in annual growth rates hovering around 10% for years.[91] This economic growth came mainly from export and investment-driven growth, with China becoming the world's largest exporter and creditor. After the Great Recession, however, China has been trying to move away from this model of export-led economic expansion. The problem with this model is that over time China's economic growth will stall as it begins to experience marginal returns to scale - the same amounts of labor and capital will produce less output, fewer jobs, and less growth. China will need to either use a greater amount of inputs, develop new innovative technologies, or a combination of both. Furthermore, export-fueled growth is vitally dependent upon demand for those goods and services. If external demand for Chinese goods remains muted (because slow recovery from the financial crisis limits the ability of the United States and Japan to increase their consumption), then that would limit the economic growth of China.[92] China has been trying to replace this with a growth model that relies more on expanding domestic consumption, energy savings, and environmental protection.[93] This could be accomplished through four main policy channels: fiscal policy, financial policy, exchange rates, and price policy.[94] Indeed, the central government has enacted numerous fiscal stimulus plans aimed at incentivizing private consumption; and while prices can still be set by the government, it has been allowing market forces to dictate prices in most industries. But China has been wary of liberalizing its financial sector and the RMB is still largely unable to be converted and undervalued.

[91] World Bank: GDP growth
[92] Lardy 2012, 129-130
[93] Lardy 2012, 67
[94] Lardy 2012, 68

These stylized facts, however, belie fundamental issues facing the Chinese economy. One can paint a much darker picture depending on which indicators one choses to examine. China may rank higher than the West on industrial sector growth, but "those measures [emphasize] 'bulk' and industrial output *of a bygone era*."[95] This is in opposition to the West and the United States, which "excel in human capital and technological assets."[96] This is important because the deepening of human capital and technological assets provides a positive feedback loop with technological innovation, and thus long run economic growth. China's difficulties in these areas have been well documented. The best and brightest Chinese families can afford to send their kids to get educated in American universities, where they tend to stay after graduation. Additionally, Chinese copyright laws are significantly less protective than those found in the West, which results in reduced innovation and invention. Rising levels of human capital and innovation is an important component for economic development, and even more so when the state is trying to transition from simple manufacturing to services and complex machinery.

Like the Industrial Revolution in the West, economic development entails social costs as well as benefits. A rapidly urbanizing country sees a rise in urban disamenities (plague, pollution and mortality/morbidity) as its population is crammed into hastily built cities. Waste from industrial factories pollutes the air and poisons the water supply. In fact, China's pollution and smog problems are well known throughout the world. Furthermore, while economic growth tends to make everyone better off, some people end up better off than others. This results in deep structural inequalities within Chinese society, roughly following the rural-urban divide. To

[95] Chan 2005, emphasis added
[96] ibid

be sure, even the urban centers have a significant number of poor or low-wage workers; however they tend to have more opportunities for upward mobility than many in the inland regions. It is important to note that all states that undergo economic development will undergo this process - these costs and externalities are not unique to the Chinese model of growth. The difficulty for China will be if the social strife engendered by sudden societal changes leads to mass protests and political activism.

The flexibility of Chinese leaders on the world stage would be limited by their domestic economic situation. All states' foreign actions are constrained by domestic (as well as systemic) variables; yet China, with its substantial reliance on economic growth, is constrained even more so. If China's leaders fail to transform their system from export/investment based growth, their ability to project power on the world stage will be further curtailed. In fact, "any disruption in China's remarkable record of high annual economic growth...would further complicate such ambitions."[97] China thus would face significant domestic and systemic pressures to undergo internal reforms to make itself more competitive globally. These economic problems will require political solutions by the Communist Party, which would most likely still heavily regulate aspects of Chinese political and economic life. If the Communist Party were unable to successfully implement needed reform packages, then China could find itself in a position of internal underbalancing as divisions within the elites create political gridlock and policy paralysis. These reforms would thus likely be sluggish, costly, and suboptimal, preventing the Chinese state from fully exerting its influence on the world stage.

[97] Kirshner 2014, 14

Indeed, Randall Schweller has identified four factors at the domestic level of analysis that severely limit and constrain the internal balancing behavior of states.[98] First, if elites cannot agree about the nature and extent of the threat or what course of action would be most appropriate, then the state will fail to enact requisite policies. One can see this in the political thought of the Chinese; one camp sees the Americans as potential partners, the other camp as adversaries, and there is an ideological balancing act between the two sides. Second, social cohesion/ethnic fragmentation plays a role in maintaining an "ingroup vs. outgroup" dynamic. Contrary to popular belief, China is a very diverse country, encompassing various ethnicities and religious faiths. While exact numbers are hard to come by from Western sources, Chinese census figures generally paint the population at around 90% Han, with the rest being divided between numerous other ethnic groups.[99] But these ethnic minorities tend to be located inland, far away from the globally connected, prosperous regions. How ethnic divides would constrain Chinese global leadership is beyond the scope of this paper, and an excellent avenue for future research. Next, the stability of a regime is directly related to its ability to project power globally. Weak and unstable regimes with little legitimacy spend more time and resources clinging to survival than engaging in international matters. As China's economy grows and its middle class begins to demand more political and economic freedoms, it would be likely that Chinese leaders would face a crisis of legitimacy that threatens their privileged status-quo. Policymakers and grand-strategists simply would not have time to devise global governance structures when they are facing down mass protest movements calling for their removal. Finally, elite cohesion (or fragmentation) reflects the central government's ability to work together in the event of a crisis.

[98] Schweller 2006, 11-12
[99] 2010 Census

A unified group of actors working in lock-step would be better able to respond to domestic and systemic incentives than a disjointed gathering of independent politicians with their own interests and desires. The fundamental question, therefore, asks "Which Communist Party leads China today?" This is no easy question, as the Chinese Communist Party is one of the murkiest and least open organizations in the world. There are signs of fragmentation; the corruption trial and sentencing of Bo Xilai, the recent indictment of Zhou Yongkang, and Party membership purges indicate a Communist Party with a significant lack of cohesion.[100] It could also be indicative of a Party reforming itself, shedding off corrupt members that would threaten its image and legitimacy. In short, probably not even Chinese leaders know what sort of Party they are leading.

With the American order in shambles and China too inwardly focused to sustain it, global economic governance could find itself without a leader. More likely than not, this would end badly for global openness and international trade. Global hegemons are partly responsible for sustaining the international order and for providing the public goods other states would find too costly to sustain. Without a clear hegemon, there is no set state or group of states that are willing or able to enforce global norms and maintain economic openness. This largely resembles the conditions of the Great Depression. Kindleberger notes that the British were unable to stabilize the system while the Americans were unwilling, and that, "When every country turned to protect its national private interests, the world public interest went down the drain, and with it the private interest of all."[101] Without an American state willing to bear the burdens of the system and with a Chinese state unwilling to accept those costs, global economic governance

[100] Bodeen 2015
[101] Kindleberger 1973, 292

structures would collapse. Conversely, governance structures could "survive", but in name only. Schweller posits a world in a state of "entropy", where, "National and international narratives now become more fractured and incoherent, making...policies calling for costly and intrusive international cooperation far more difficult to achieve."[102] In this interpretation, global governance structures are nothing more than "a spaghetti bowl of clashing agreements" between an ever increasing number of increasingly powerless actors.[103] The system will, over time, begin to break down as additional governance structures will be placed atop one another with abandon. Global governance would thus lose all ordering principles.

World 3: "A New Cold War?"

World #3 postulates a world defined by a China increasingly willing to utilize aggressive tactics to rewrite the status quo, and a global economy largely sheltered from the drastic cycles of boom and bust that have defined the last 20 years. Much like World #1, China will still desire a solution to the Taiwan question and seek territorial expansion in its quest for resources. Like World #2, however, the global economic system would be relatively stable and firmly established. This results in the unique situation whereby a revisionist China, willing to rewrite global economic norms, confronts a system that has been widely accepted by most states most of the time. It would seem that China would see less demand for its economic leadership, severely constraining even its regional ambitions. Additionally, overly aggressive and revisionist actions may in fact scare smaller states into supporting the US status-quo. To be certain, there will always be states that are at least partially unsatisfied with the American system (think Iran, North

[102] Schweller 2010, 33
[103] Schweller 2010, 34

Korea, and sometimes Russia). There may be some minor ideological cooperation between these limited numbers of states and China, but it would be a far-cry from the system wide support a financial crisis would grant alternative ways of thinking. China would likely play the role of "spoiler", as opposed to a supporter of the global economic system.

Interestingly enough, the global stage has already seen these conditions play out once before during the 20th century. This world largely resembles the conditions the United States and the Soviet Union found themselves in after World War II. Then, a rising Soviet Union was attempting to revise the political and economic order set forth by the United States' and her Western allies. Not content with the "American way" (a Western capitalist, imperialist, system imposed upon the world) the USSR underwent rapid advancements in the economic, political, and military spheres. Under the leadership of Joseph Stalin (1924-1953) the USSR underwent a period of state-led rapid industrialization, with drastic (and tragic) results for the Soviet people. Shortly after WWII the Soviet Union, through force of arms, either annexed or set up puppet regimes in most of the land it had occupied during the hostilities. The Soviet Union was expanding militarily, forcefully crushing the Hungarian opposition and undergoing rapid militarization and nuclearization. Within a few years, most of Eastern Europe was placed behind the "Iron Curtain", a successful line of buffer states insulating the Russian heartland from further Western aggression. In short time the USSR had established regional hegemony over Eastern Europe, become economically self-sufficient, and rivaled the United States in terms of military power.

Much like the Soviet Union, the Chinese state is undergoing (or could potentially undergo) similar transitions today. Chinese desires for territorial expansion in Asia have been previously discussed, although outside of Taiwan it would be hard to argue that China would seek permanent ownership of inhabited lands recognized as belonging to others. Nevertheless, the Chinese are expanding their military in order to better reflect their growing economic power. With an increase in economic wealth states are usually able to divert resources to bolster more effective and advanced militaries. Indeed, this has been most notable with the Chinese Navy[104] (People's Liberation Army Navy), which as of 2012 had commissioned its first aircraft carrier, *Liaoning*. This is consistent with the goal of Chinese policymakers to field a robust, "blue water" Navy, which would be able to put pressure on United States' military capabilities in the region. Finally, under Communist Party leadership, the Chinese economy has undergone various periods of state-led development. Some initiatives (such as Mao's "Great Leap Forward") were disastrous, while others (the economic openness under Deng) have been more effective. These initiatives always had the same (implicit) goal: to make the Chinese economy and people more insulated from the dangers of an anarchic global system.

While the above stylized facts highlight the similarities between the Soviet Union's development and China's, it is important to note the differences between these two models. A key difference between the Soviet Union then, and China now, is that the former was much less involved in international economic relations than the latter. Nowhere is this more evident than when looking at international trade data for the Soviet Union then, and China now. In 1985, global exports and imports each accounted for only 4% of Soviet GNP.[105] The Soviet Union was much more closed off and isolated from the world (as the term "Iron Curtain" would suggest). It had little need for foreign trade with the West when it had a robust system of satellite-states upon

[104] Although it should be noted that the Army (at over 1,000,000 men strong), and the Air Force have also undergone advancements as well.
[105] Soviet Union Country Study 1989

which to draw resources. It is important to note, however, that while the USSR was largely self-sufficient, it still relied on grain imports from the West to help feed its population. Foreign trade in China, conversely, constitutes roughly half of their current GDP.[106] The Chinese economy is blessed not only with plentiful mineral resources, but also a cheap supply of labor to exploit them. Thus, China has sustained its awesome growth rates by becoming the industrial manufacturer of the world; its cheap labor supply giving it a comparative advantage. Additionally, the Chinese have been extremely vocal on global economic governance issues.[107] China has increasingly become a major player in economic affairs, making numerous entreaties on the West to reform the current economic order. Chinese compliance with the WTO, involvement with the G-20, and development of its own institutional alternatives shows a significant level of participation not seen with the Soviet Union. In summation, the Soviet Union rose in spite of the global economy - China because of it.

The ramifications for global governance structures have already been partially mapped out. The greater integration of China through international trade and global economic relations would dampen some of its more revolutionary means. China (like the Soviet Union before it) could merely pay lip-service to its revolutionary founding ideologies once it becomes sufficiently adapted to the international system. It is important to note that, over time, systemic pressures can cause a state's revolutionary ideologies to fall by the wayside, as the state instead seeks stability and survival (think the early Soviet Union vs. the Soviet Union left by Stalin, or Khomeini's Iran as opposed to Khamenei's Iran, which has given up its ideology of exporting the Shi'ite revolution throughout the Muslim world). In this world, China is still revisionist but

[106] World Bank: Foreign trade
[107] Recall that both Kirshner and Drezner stressed the active role that China played in saving the current economic order

would be less willing to significantly challenge the global system. To be sure, it would still look to do so if the conditions were right; however, it would simply be more risk-averse. This would largely resemble the hey-day of the Cold War, where both sides sought to expand their power and influence, but tried to avoid direct confrontation. China and the United States would certainly vie for greater influence over the system, but would be severely constrained from taking too drastic of actions.[108] Global economic governance and institutions would thus reflect this power dynamic. The United States (as it had done to the Soviets) would use these institutions, and the legitimacy they confer, as a tool to constrain Chinese influence and power. For example, developing Asian states may find more generous and accommodating loans from the IMF and Asian Development Bank if they aligned themselves with Washington.

Despite residing in a relatively stable, US-led, global economic system designed to constrain it, China would still retain massive amounts of economic power. This power would most likely continue to grow over time, contingent upon economic development. The potential problem for China is that it finds itself with more power (and thus more capability to remake the world in its image) but less demand for its leadership. The status-quo bias to a sufficiently stable system would be too much for the Chinese to overcome. This could be problematic if China takes an overly aggressive posture toward the international community. While China may not have the capabilities or the backing to remake the global system, it will still have the ability to play "spoiler", undercut global governance, and make cooperation among the great powers harder than it would otherwise be. Indeed, it could refuse to sign onto banking and finance

[108] Whether this stability is the result of something inherent in the distribution of power under conditions of bipolarity, or whether nuclear weapons play an outsized role, is beyond the scope of this paper. Refer to Waltz 1964.

accords, ignore calls of action, or even boycott economic summits. For example, China currently loans money to, buys oil from, and sells weapons to, Sudan. In fact, the economic relations between the two are relatively close and strong.[109] Relations between Sudan and the West, however, are not; Sudan is currently sanctioned by the United States for its role in the Darfur genocide. To be sure, the pressure of these biting sanctions is significantly lessened by China's continued involvement in the country. A sufficiently aggressive China could even engender its own economic crisis by enacting policies that put the global economic system under more pressure (whether knowingly or not). Therefore, China may actually be seen not as a partner to work with, but as an obstacle to be overcome - driving down demand for its leadership and pushing states into deeper integration with the US-led order.

World 4: "Pacific Defender"

In this world, the optimism of Drezner overcomes the warnings of Kirshner and the pessimism of Mearsheimer. Liberal institutionalism and engagement prevails over relative gains of power and security dilemmas. Conditions in this world would be defined by their relative peace and stability: well regulated global financial capital markets and a rising, yet status-quo, China. The ruinous boom-bust cycle and bubbles spurred on my hot capital flows would be reduced. China would largely be satisfied with the system they have extensively and miraculously grown and developed in. Chinese policymakers and citizens would begin to view their own success and prosperity in terms of the stability and success of the international system. Surprisingly, China may even take political and diplomatic steps to chastise other rising states that threaten aspects of the status-quo. It would thus become in China's strategic interests to

[109] Goodman 2004

support the system. In short, China would demand a greater seat at the pre-existing table, not that they be allowed to build an entirely new table. After further examination this outcome is not even a surprising one. One could even argue that the system was overdetermined. In fact, international relations liberals would point to three variables that are fundamentally key to the successful integration of China into the global system: economic interdependence, institutional engagement, and democratization. By tying China's economic well-being to the health of the system and giving them greater agency over it, the West can successfully engage China. The fact that the growth of a Chinese middle class with peaceful, democratic ambitions, would also place domestic constraints on aggressive foreign policy actions only strengthens the arguments for peace.

Economic interdependence between the two parties is deep, as both China and the United States are deeply entwined economically. Trade between the People's Republic and the United States has skyrocketed from its initial $1 billion USD, to nearly $245 billion USD by 2005.[110] Not only are both states each other's largest trading partners, but China is the single largest holder of US dollars, at nearly $4 trillion. Liberal institutionalists argue that as the amount of trade and investment between two countries rises, relations tend to improve. The state depends on a robust tax-base, of which a firm's revenues constitute a significant portion. Firms, however, loathe war, conflict, and uncertainty - they are fundamentally pro-peace. The more belligerent, conflictual, and threatening a state is, the more likely it is that firms will divest and move out of the country. Additionally, the profit motive drives firms to globally expand, increasing foreign trade, investment, and interdependence. These bilateral economic relations (along with other factors) create vested domestic interests, which then lobby their respective governments for

[110] U.S.-China Business Council 2005

policies that avoid conflict and preserve peace. It would then be in most firms' interests to avoid war at all costs. As China continues to grow and develop it will likely move even further into the global economy, opening itself up to greater levels of foreign investment, trade, and capital. Since Chinese growth has, and continues to be, dependent on the current economic order, the belief is that China will become so invested in the status-quo that it will support the system. These economic linkages will further bind the United States and China closer together, dampening any aggressive tendencies toward conflict. In short, when goods cross borders, armies don't.

The argument for institutional engagement with China rests on the liberal belief that international institutions serve as "focal points" in coordinating the global rules of the game.[111] First, by increasing the opportunities for states to make credible, binding commitments to one another, institutions can improve communication between states and reduce the uncertainty of intentions. Normal diplomacy can only reassure wary states so much; signals must be more costly for potential aggressors to make than for peaceful states in order to be effective. It is relatively costless for a state to say one thing, and then do the complete opposite (policymakers have excellent practice in this). Therefore, by cooperating with international institutions and shouldering some of the costs of the global system, states can effectively signal to other states the true intent of their actions. Second, the main goal of the backer of the international order (the United States) is to use international institutions and organizations as a tool to "produce a change in a country's behavior to better fit the norms and principles of the global...regime."[112] Institutions are also effective tools to subject potential violators to the pressures by which foreign

[111] Goldsmith and Posner 2005, 38, 86
[112] Pearson 1999, 211

policy commitments are usually sustained. Additionally, being a member of an institutional group tends to orient one towards that group's goal. This "ingroup-outgroup" dynamic can have strong socializing effects on adherence to group goals.[113] While this cannot fully guarantee compliance (for example: the US destruction of the Bretton-Woods financial system) it does significantly predispose states to view their own success in terms of the system and group they reside in. To be sure, some of the rules of this system will need to be rewritten

Liberals note that since the opening of China by Deng, not only has China integrated itself into the global economy, but that it has joined a multitude of international organizations as well. China is now a member of the World Bank, the IMF, the Asian-Pacific Economic Cooperation (APEC) and even the World Trade Organization. By some measures, Chinese membership in international nongovernmental organizations rose from 71 to 1,163 from 1977 to 1997.[114] It is not just that China has increased its membership in international organizations, but that China has also been opening up more to the world in general; sending scientists, scholars, bureaucrats, and students all over the world, and accepting more and more foreign nationals. Compared to the Cultural Revolution and the long periods of isolation during the mid-20th century, China has taken drastic steps to normalize its foreign relations.

All of these organizations are important measures of Chinese integration; however it is their ascension to the World Trade Organization that underscores just how far China has come. While China was more or less warmly welcomed into most international organizations, their acceptance into the WTO was prolonged, difficult, and costly.[115] The WTO puts substantial pressure on its members to liberalize their economies, and extensively scrutinizes members'

[113] Pearson 1999, 212
[114] Lampton 2001, 163
[115] Pearson 1999, 218

trade and economic policies. For China to enter the WTO it thus had to significantly change how it conducted international trade and economic relations. Compliance with WTO restrictions on domestic subsidies and tariffs on imports proved to be very costly, both economically and politically, for China's leaders. State Owned Enterprises were largely propped up by the central government, and there were fears that they would not be able to survive in global competition.[116] The resentment by many Chinese over the costly conditions imposed by the US, and the political ramifications of their Tiananmen Square crackdowns only further strained WTO talks.[117] Nevertheless, China succeeded in attaining membership in 2001.

Finally, democratic states have a stellar track history of avoiding war with one another. Since the advent of the modern state system under Westphalia, wars between democracies have been exceedingly rare. To be sure, this is largely dependent upon how one defines a "democracy". The Russo-Georgian War was fought between two states with democratically elected governments; the argument here would be over quantifying just how democratic Putin's Russia really is. Nevertheless, compared to wars between non-democracies and wars between democracies and non-democracies, wars between democracies are almost unheard of. This is due to a mixture of institutional constraints and cultural reasons. First, citizens in a democracy learn how to solve disputes peacefully. That is fundamentally how civil society is able to function and operate; citizens will try to work out disputes peacefully by themselves, or will take their concerns to a higher (judicial) power. Free markets also play a significant role in promoting civility, and the hope is that China, by transitioning to a free market economy, will see these effects spillover into international relations. Additionally, most citizens are opposed to

[116] ibid
[117] Pearson 1999, 220

war. Indeed, this is probably because they are the ones most likely to fight and die in it. Domestic checks by a well-represented public upon policymakers make war posturing more costly, as elites will pay for flouting the will of the people come election time. Finally, democracies are relatively slow and transparent, with bureaucratic deliberative bodies and posturing politicians. Rallying a political coalition and getting everyone on board with a war thus takes time and political capital. In the meantime, cooler heads can prevail, diplomacy can take effect, and conflicts can work themselves out. Liberals argue that a democratizing China would soon take on all the features of the above model. At the very least they argue that, while democracy may not be sufficient for peace, it most certainly will be necessary.

Global governance structures would fare the best in this world than in any other. This paper has already established that a rising China with very limited aims in a world free from system destabilizing crises would be predisposed to support the system. Its economic interests in the current order would be too high, making conflict less profitable and thus irrational (for both parties). The United States, recognizing the very risk-averse, limited aims of a rising China, would be more willing to accommodate China's legitimate grievances. Issues of contention that are of China's strategic interests and not America's would find a solution that both parties can agree to, and that satisfies China's demand for prestige commensurate with its power. Citizens in both countries would have democratic and representative tools with which to signal their support for, or rejection of, certain policies (the United States more so). Since most citizens benefit from an open global economy that provides them a variety of goods at lower costs, they would be expected to put political pressure on policymakers who attempt to adversely affect the status-quo. Global economic institutions would be strengthened and reformed to give a greater voice to non-Western concerns. While IMF policy would most likely be constrained over different interpretations of financial liberalization and the “new heterogeneity of thinking”, this would not necessarily be a detriment to the system. Some of the countercyclical policies imposed by the IMF can backfire in the midst of a crisis.[118] Finally, not only would the system be reformed and maintained, but it would also add on additional capabilities. As the world (mainly Asia) grows and develops, it will begin to demand more foreign direct investment and capital. The United States, the IMF, World Bank, and indeed China and the AIIB can all step in to meet this demand. Asia will be big enough for both China and the United States.

To be sure, this paper does not intend to paint a utopian future for international relations, whereby all states recognize the awesome power of markets, become fully integrated into the global system, and repudiate war and strife as a means to their aims. Realism is, fundamentally, the study of why things *do not* change over time, why states still struggle for wealth and power, why wars continue, and why conflict always seems inevitable. This is not to say that there would not be political and trade disputes between China and the West, or even China and the rest. After all, even the UK and the US (with their “special relationship”) still spar over disagreements (these disputes are, however, very minor in the grand scheme of global governance structures). Indeed, China and the US may never have the close relationships that the US and others enjoy. Economic interdependence is far from being a ringing endorsement for peace: World War I happened despite the unwillingness to go to war, and the close interdependence between the European states. Institutional engagement is a fine needle to thread; if China asks for too much, engagement fails, and if the United States offers too little it would fail yet again. Liberal democracies may be inherently peace-loving, but *democratizing*

[118] Indeed, this was the condition Argentina found itself in during the 1990’s.

states are vastly more war-prone. As the political process puts domestic pressure on already unstable policymakers, they may respond to these internal pressures through external stimuli. Elites facing political unrest may target an external scapegoat and attempt to "rally around the flag" in order divert from their own failings and to promote unity. The incentives facing leaders of democratizing states to act more aggressive and warlike could potentially aggravate a pre-existing security dilemma with the United States and China. It will thus still be important to both sides that they will be able to resolve these inevitable disputes without needless political and economic costs. Indeed, cooperation between both parties will be critical, since "peaceful rise cannot be accomplished by China alone, but only by China and the rest of international society working together to create the necessary conditions."[119] Under these conditions, it would thus be imperative for both states to formulate global governance structures that would lower the transaction costs of trade and promote a stable, profitable economic system for the whole world.

Back To The Future?

The events of 2007-2008 were a turning point for international relations. They were a turning point because they signaled the end of an era: the Second Post-War US order is dead. The current economic order was established in the immediate aftermath of World War II, when the distribution of power looked dramatically different than it does today. The fact that it lasted nearly 60 years struggling against the differential growth of power between states is a testament to global governance's virility and resilience. However, eventually enough disequilibrium in the system built up and something had to give - the whole global economic order came crashing down. The great economic powers (the United States, the European Union, and China) were

[119] Buzan 2010, 7

able to step in and stabilize the system this time, but that begged the question "What about next time?"

Daniel Drezner, taking an optimistic view of developments, argued that international institutions were able to fully integrate all major actors into supporting the American-led system. Even China, which should have been the most revisionist, acted in concert with the United States on most major issues. He believed that the Chinese did not offer opposition to the American order because they in fact had no alternative world view to articulate. Global governance structures thus were successful in doing their job: they ensured that the system would remain open and that international trade and capital flows would continue to spread. Jonathan Kirshner's pessimistic contention is that that crisis has only set the global economy up for a larger one down the road. It may be that China acted in concert with the United States and acquiesced to the demands of the system, but that was only because its large dollar holdings were holding it hostage. China, he contends, became too integrated with the international system, and almost paid dearly for it. He believes that the financial crisis has not only spurred the Chinese into developing their own systemic capabilities, but also has delegitimized the American economic order in the eyes of the rest of the world. States are wary of following the Washington Consensus blindly, and a new heterogeneity of thinking about finance has developed.

This paper looked to add to that debate. I analyzed the two different worlds postulated by Drezner and Kirshner, and then looked at how they would be affected by another financial meltdown. The meltdown did not have to be of apocalyptic proportions; all that had to happen was that it be sufficiently large enough for legitimate fears of financial contagion to spread, and that the United States would be seen as the main culprit. In one scenario the American order would be delegitimized and in the other it would endure. By applying these conditions together, this paper developed a 2x2 payoff matrix with which to examine this central thesis.

The first world would exhibit a rapid transition of power between the United States and China. China, already more revisionist than not, would see an opening to enhance its prestige to levels commensurate to its power. It would step in relatively quickly to stabilize the system, rewriting global norms to its liking and promoting a greater role for its currency, the renminbi. The second world would be significantly more detrimental to global governance than the others. Here, there are strong incentives for a rising challenger to step in and take control of the system, and yet no state does so. The state in the best position to do so, China, is too busy consolidating its position domestically to respond to external incentives. With a lack of a clear hegemon to provide the global economic public goods, global governance would be weak and ineffective. The third world, with an aggressive China but no tangible crisis to latch onto, would oddly enough resemble a very minor Cold War. Both sides would be locked in ideological conflict (the Washington Consensus vs. a New Heterogeneity of Thinking), but it would pale in comparison to Communism vs. Capitalism. Similarly, any overlyaggressive tendencies would be dampened by the strong economic ties between the two sides. The fourth and final world is the most peaceful and conducive for global economic governance out of all of them. A pacific China, successfully engaged by the status-quo powers, would peacefully rise to their ranks. It would have a greater seat at the table, one more commensurate with its newfound power and prestige.

Once these four worlds are laid out it is intellectually tempting to pick one or two that scholars deem are the most likely to occur. That is not, however, the goal of this paper. I am not attempting to pick one world that I then argue is most likely to happen, based on current growth trajectories. Statistical extrapolations are tricky and the future is inherently unknowable. What I have done in this paper is roughly sketched out which variables would be the most important determining factors in each of these four worlds. What I hope to add to the literature is a greater understanding of how global governance structures simultaneously interact with traditional revisionist-status-quo distinctions and systemic pressures from a global financial crisis. It is my hope that others will continue on my work by deeply examining the fundamental nature of each world, describing the interactions between the variables underlying my assumptions. I wish to make it clear once again that this is not an act of prognostication. This paper is not an attempt to divine the future of international relations - I read no tea leaves within these pages. Regarding the future of global economic institutions, this paper remains more a rough sketch than a finished portrait. Whether the world returns to the pessimism of realist political thought, with cycles of conflict, power, and prestige; or the power of globalization and interdependence makes conflict too costly, remains to be seen.

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