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The People’s Republic of China and the IMF

By

Jue Wang

A thesis submitted in fulfillment of the requirements for the degree of Doctor of Philosophy in Politics and International Studies

University of Warwick
Department of Politics and International Studies (PAIS)
September 2014
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<tbody>
<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
</tr>
<tr>
<td>APEC</td>
<td>Asia-Pacific Economic Cooperation</td>
</tr>
<tr>
<td>ARF</td>
<td>ASEAN Regional Forum</td>
</tr>
<tr>
<td>ASEAN</td>
<td>Association of Southeast Asian Nations</td>
</tr>
<tr>
<td>BRICS</td>
<td>Brazil, Russia, India, China, and South Africa</td>
</tr>
<tr>
<td>CASS</td>
<td>Chinese Academy of Social Sciences</td>
</tr>
<tr>
<td>CBRRC</td>
<td>China Banking Regulatory Commission</td>
</tr>
<tr>
<td>CIC</td>
<td>China Investment Corporation</td>
</tr>
<tr>
<td>CIRC</td>
<td>China Insurance Regulatory Commission</td>
</tr>
<tr>
<td>CMI</td>
<td>Chiang Mai Initiative</td>
</tr>
<tr>
<td>CMIM</td>
<td>Chiang Mai Initiative Multilateralized</td>
</tr>
<tr>
<td>COFER</td>
<td>Composition of foreign exchange</td>
</tr>
<tr>
<td>CSRC</td>
<td>China Securities Regulatory Commission</td>
</tr>
<tr>
<td>CTBT</td>
<td>Comprehensive Test Ban Treaty</td>
</tr>
<tr>
<td>EB</td>
<td>Executive Board</td>
</tr>
<tr>
<td>ECF</td>
<td>Extended Credit Facility</td>
</tr>
<tr>
<td>ECHR</td>
<td>European Convention of Human Rights</td>
</tr>
<tr>
<td>ECJ</td>
<td>European Court of Justice</td>
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<tr>
<td>EFSF</td>
<td>European Financial Stability Facility</td>
</tr>
<tr>
<td>ESM</td>
<td>European Stability Mechanism</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>EURIMF</td>
<td>Group of EU representatives to the IMF</td>
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<tr>
<td>FDI</td>
<td>Foreign direct investment</td>
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<tr>
<td>FSAP</td>
<td>Financial Sector Assessment Program</td>
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<tr>
<td>G11</td>
<td>Group of Eleven</td>
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<tr>
<td>G20</td>
<td>Group of Twenty</td>
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<tr>
<td>G24</td>
<td>Group of Twenty-four</td>
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<tr>
<td>G7</td>
<td>Group of Seven</td>
</tr>
<tr>
<td>G77</td>
<td>Group of Seventy-seven</td>
</tr>
<tr>
<td>GATT</td>
<td>General Agreement on Tariffs and Trade</td>
</tr>
<tr>
<td>GDDS</td>
<td>General Data Dissemination System</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross domestic product</td>
</tr>
<tr>
<td>GEF</td>
<td>Global Environment Facility</td>
</tr>
<tr>
<td>GSE</td>
<td>Government-sponsored enterprises</td>
</tr>
<tr>
<td>HIPC</td>
<td>Heavily Indebted Poor Countries</td>
</tr>
<tr>
<td>IBRD</td>
<td>International Bank for Reconstruction and Development</td>
</tr>
<tr>
<td>ICJ</td>
<td>International Court of Justice</td>
</tr>
<tr>
<td>ILO</td>
<td>International Labour Organization</td>
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<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>IMFC</td>
<td>International Monetary and Financial Committee</td>
</tr>
<tr>
<td>IR</td>
<td>International Relations</td>
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<tr>
<td>ISO</td>
<td>International Organization for Standardization</td>
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<tr>
<td>Abbreviation</td>
<td>Description</td>
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<tr>
<td>--------------</td>
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<tr>
<td>LIC</td>
<td>Low income countries</td>
</tr>
<tr>
<td>MD</td>
<td>Managing Director</td>
</tr>
<tr>
<td>MDRI</td>
<td>Multilateral Debt Relief Initiative</td>
</tr>
<tr>
<td>MOF</td>
<td>Ministry of Finance</td>
</tr>
<tr>
<td>NAB</td>
<td>New Arrangements to Borrow</td>
</tr>
<tr>
<td>NATO</td>
<td>North Atlantic Treaty Organization</td>
</tr>
<tr>
<td>NBS</td>
<td>National Bureau of Statistics of China</td>
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<tr>
<td>NMP</td>
<td>Net material product</td>
</tr>
<tr>
<td>OECD</td>
<td>Organization for Economic Co-operation and Development</td>
</tr>
<tr>
<td>PBC</td>
<td>People’s Bank of China</td>
</tr>
<tr>
<td>PIN</td>
<td>Public Information Notices</td>
</tr>
<tr>
<td>PLL</td>
<td>Precautionary and Liquidity Line</td>
</tr>
<tr>
<td>PPP</td>
<td>Purchasing Power Parity</td>
</tr>
<tr>
<td>PRC</td>
<td>People’ Republic of China</td>
</tr>
<tr>
<td>PSPP</td>
<td>Poverty Reduction Strategy Paper</td>
</tr>
<tr>
<td>RFI</td>
<td>Rapid Financing Instrument</td>
</tr>
<tr>
<td>RMB</td>
<td>Renminbi</td>
</tr>
<tr>
<td>SAFE</td>
<td>State Administration of Foreign Exchange</td>
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<tr>
<td>SBA</td>
<td>Stand-By Arrangements</td>
</tr>
<tr>
<td>SCF</td>
<td>Standby Credit Facility</td>
</tr>
<tr>
<td>SDR</td>
<td>Special Drawing Rights</td>
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<tr>
<td>SWF</td>
<td>Sovereign wealth funds</td>
</tr>
<tr>
<td>UAE</td>
<td>United Arab Emirates</td>
</tr>
<tr>
<td>UK</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>UN</td>
<td>United Nations</td>
</tr>
<tr>
<td>UNDP</td>
<td>United Nations Development Programme</td>
</tr>
<tr>
<td>UNEP</td>
<td>United Nations Environment Programme</td>
</tr>
<tr>
<td>UNSG</td>
<td>United Nations Small Group</td>
</tr>
<tr>
<td>US</td>
<td>United States of America</td>
</tr>
<tr>
<td>WHO</td>
<td>World Health Organization</td>
</tr>
<tr>
<td>WTO</td>
<td>World Trade Organization</td>
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Acknowledgements

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I am deeply grateful for my parents and my grandpa for their continuous support and sacrifice in the past years.

Last but not least, I want to thank my lovely friends Nicola, Zakia and Xiaoxiao for their company and support.
Declarations

I declare that this thesis has been entirely my own work and follows the guidelines provided in the Guide to Examinations for Higher Degrees by Research of the University of Warwick. The dissertation has not been submitted for a degree at another university and any errors within are entirely my own. Some material in the thesis was earlier published in July 2013 in an article co-authored with Dr. Peter Ferdinand- ‘China and the IMF: from Mimicry towards Pragmatic International Institutional Pluralism’- in *International Affairs* 89: 4, pp. 895-910

Jue Wang
Abstract

This thesis looks into the relationship between the People’s Republic of China (PRC) and the International Monetary Fund (IMF) since the PRC regained its IMF membership in 1980. It initially analyzes the China-IMF relationship with socialization theoretical framework, attempting to explore how the IMF has socialized China into accepting neoliberal international economic norms. The research borrows Alastair Johnston’s ‘microprocesses’ of socialization to assess the processes of IMF socialization via financial assistance, technical assistance, and surveillance and policy advice for China. The research shows socialization has taken place to a moderate degree, as IMF programs have had some impacts on China’s domestic economic and financial liberalization. Yet no evidence shows the IMF has convinced China to fully redefine its economic principles and norms. Socialization turns out to be an inadequate analytical approach to analyzing the China-IMF relationship in the long run.

The research continues with a supplementary theoretical framework: principal-agent theory. Principal-agent theory overcomes some of the technical deficiencies in socialization theory, and helps us understand more thoroughly China’s role in the IMF and the governance of international financial economy in general in the long run. China is regarded as the principal, and the IMF as China’s international organization agent. Driven by its objective of acquiring a larger influence in the governance of international financial economy, China delegates several tasks to the IMF so that the Fund can accomplish these tasks more efficiently than if China took other cooperative or unilateral approaches. China-IMF interactions are assessed following a four-stage analytical approach based upon the key concepts of principal-agent theory. China’s and the IMF’s institutional features and functions are examined as important factors of the China-IMF relationship. They include China’s preferences regarding IMF operation, China’s role in IMF governance, and China’s impact among IMF staff. Based on this examination, the consequences of China’s delegation of tasks to the IMF are assessed. This dissertation indicates that the IMF plays a limited role in assisting China to access larger influence in the governance of international financial economy, because of the IMF’s western-dominated staffing rules, unbalanced governance structure, preference deviation from China, inadequate resources, and China’s incapability to facilitate strict controls on the IMF.

The thesis contributes to the so far thin literature on the China-IMF relationship with selected case studies such as IMF Article IV Consultation for China, China’s role in IMF quota and voting share reforms, IMF staff with Chinese nationality, and so on. The research provides a model for analyzing the relationship between China and international organizations with a combination of socialization and principal-agent theoretical frameworks. Last but not least, it extends the research subject of principal-agent theory in international organization Studies to include an emerging market economy state as the principal, which correctly implies the increasing influence of emerging market economies in the governance of international political economy.
Chapter 1 - Introduction

When the Managing Director (MD) of the International Monetary Fund (IMF) Christine Lagarde attended the Boao Forum for Asia Annual Conference in China on April 7, 2013, she started her speech with a passionate response to the Chinese president Xi Jinping’s ambitious proposition of ‘China Dream’. She said, ‘The IMF is your partner in this endeavor. Just as China is changing to fulfill its dream, we are changing too—so that we can be even more effective in our support. We believe that we have a lot to give—our global experience and technical expertise.’\(^1\) (IMF 2013a) This statement proposed an ever growing ‘partnership’ between the IMF and China. It reflected the Fund’s faith in China’s economic growth, and the Fund’s prospect for its own role in the blueprint of China’s future expansion.

In recent years, the IMF has repeatedly emphasized China’s contribution to strengthening the international financial economy; meanwhile, it has also demonstrated a strong intention to consolidate a mutually beneficial relationship with the Chinese government. The IMF’s rhetoric has become increasingly obvious since the global financial crisis that started in 2007 had deepened. The then-IMF MD Dominique Strauss-Kahn said in late 2009 that China was ‘helping to design the global priorities for the future and devise solutions to global problems’, and he added that it was a good opportunity for China and

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\(^1\) She also later extended this concept to ‘Asia’s dream’, and shared her idea about how Asia would maintain growth and fulfill its dream.
Asia to contribute to shaping the post-crisis global economy. (IMF 2009a)

The IMF encouraged China to revalue its currency Renminbi (RMB) and increase domestic demand in order to contribute to rebalancing the global economy. Meanwhile, the Fund was probably even more enthusiastic about convincing China to contribute heavily to IMF financial resources in order to help it through the crisis period. Strauss-Kahn said to China’s Caijing (Finance) Magazine in 2008 that China should answer positively to the proposals of injecting capital into the IMF. (Li 2008) China did not let the IMF down, as it signed with the IMF an agreement on purchasing up to Special Drawing Rights (SDR) 32billion (around US $50 billion) in IMF notes in September 2009. It was the first note purchase agreement in the history of the IMF. (IMF 2009b) When Lagarde took her first official trip to China as the MD of the IMF in 2011, she confirmed China’s leading role in the global economy and especially in the IMF. She also called on the Chinese government to make decisions to help the troubled Europe, because ‘no country and no region can go it alone. We are bound together by our economic success or failure’. (IMF 2011a)

The IMF’s enthusiasm for a stronger partnership did get corresponding answers from the Chinese side. Chinese policymakers, academics and media have also given increasing attention to the IMF. There was a voice in China encouraging reliance on the IMF to help China gain more power in the governance of the international financial economy. The most explicit example was the Chinese Central Bank governor Zhou Xiaochuan’s advocacy of a diversified international monetary system based on the IMF’s SDR to
replace the US dollar dominated system. (Zhou 2009) Zhou’s proposal was backed by the then-Chinese president Hu Jingtao. In his speech at the G20 Cannes Summit, Hu called for reforms of the international monetary system in a steady manner, including expanding the use of the SDR of the IMF, reforming the SDR currency basket, and establishing an international reserve currency system with stable value, rule-based issuance and manageable supply. (Xinhua 2011) Chinese officials also called on the IMF to strengthen surveillance of the financial markets of advanced economies, especially the main international reserve currency issuer countries. Hence China’s policymakers expected the IMF to play the role of a fair referee as well as a stabilizer. They particularly hoped the IMF would take into account of the emerging market economies’ interests and create an international financial environment that is friendlier for these countries.

The policymakers’ propositions received some positive feedbacks from the academics. For example, Qiao and Xu argued for strengthening the IMF’s role as the global central bank that coordinates regulations among all countries. (Qiao and Xu 2011) In 2010, the Renmin University of China hosted a ‘Commemorate 30 Years Anniversary of China’s regaining IMF Membership Discussion Symposium’ and invited China’s leading scholars and current and former policymakers to review China’s IMF membership and more importantly to discuss the current and future significance of the membership.² The most

² Speakers at the Symposium included Cao Tong (Deputy Director of the China CITIC Bank and Director of the International Currency Research Centre of the Renmin University of China), Xiang Songzuo (Deputy director of the International Currency Research Centre of the Renmin University of China and Chief Editor of the Global Finance journal), Zhang Zhixiang (former Chinese Executive Director at the IMF), Guo Qingwang (Head of the School of Finance at the Renmin University), Robert Mundell (Professor at the Columbia University), Chen Yulu (Dean of Beijing Normal University and Professor in the Financial Policy Research Centre at the Renmin University), Wei Benhua (former Deputy Director of the State Administration of Foreign Exchange), Zhao Xijun (Deputy Head of the School of Finance at the Remin
essential topic at the symposium was how the IMF could reform the single currency based international monetary system, and create a favourable environment for internationalization of RMB and for China to play a more significant role in the governance of the international financial economy.

However, some other evidences have showed that the relationship between China and the IMF is far from reaching a strategic partnership. First of all, China has an inadequate quota and voting share in the IMF. In order to be an influential player in the IMF, a member state needs to have a large share of decision-making power in the Fund, which is measured by the member state’s quota and voting share in the Fund. The IMF has an unbalanced internal governance structure where decision-making power is concentrated in the Fund’s advanced economy member states. The US and other advanced economies have the majority of IMF quota and voting shares, while the fast growing emerging market and developing countries are underrepresented. Some scholars argued that the IMF’s western-dominated nature and the consequential legitimacy issue caused its incapability to efficiently look into and solve problems in the emerging market and developing world. The IMF’s poor policy advice failed in several financial crises in the emerging market and developing economies in the 1990s. Hence the emerging market economies and developing countries gradually lost trust in the Fund and chose alternative solutions when they face macroeconomic difficulties. (Chin 2010; Woods 2001; Woods and Lombardi 2006)
The Fund has realized the legitimacy issue and initiated several rounds of governance reforms. The recent rounds of reforms in 2006, 2008 and 2010 respectively included shifts of quota and voting shares from its developed to emerging market and developing country members. However, these reforms have not improved the emerging market and developing economies’ voices sufficiently enough to match their fast increasing real shares of the world economy. The 2010 reform- including quota and voting shares shifts and total increase of quota amounts- was expected to be implemented by January 2013 the latest. Yet while the Fund kept pushing some major states, especially the US, to pass the reform proposal domestically, a US government document showed that by April 2013 the president had not even sent the request for the extra appropriations involved to the Congress by then. (US House of Representatives Committee of Financial Services, 2013)

In addition, even after the 2010 reform is implemented, the US and the EU countries added together still maintain veto power in the Fund. Although China will have approximately 6.39 per cent of total IMF quota and 6.07 per cent of total voting share, which made it the third largest member just after the US and Japan, its total decision-making power in the IMF does not earn it sufficient governance power to challenge the US or other advanced economies together. Chinese officials have urged the IMF to implement the 2010 reforms in almost all Fund meetings and activities since 2012, yet it has not been done by the time this thesis is submitted.3

Neither did the IMF respond with a satisfactory answer to China’s request for an IMF-led reformed international monetary system where the US influence should be greatly

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3 This thesis is submitted in January 2014.
restricted. The IMF did not respond directly to Zhou’s proposal of creating a super sovereign currency based on the SDR. Yet Strauss-Kahn said in 2009 that the current system had proven resilient during the recent crisis and that he expected the dollar to ‘remain the principal reserve currency for some time.’ (IMF 2009a) Not long after Zhou’s proposal, Chinese scholars and policymakers also seemed to have dropped the idea of enlarging the use of SDR and the influence of the IMF; instead, they have been promoting the idea of ‘RMB internationalization’ and attempting to get more market shares without the IMF’s assistance.

With regard to the significance of IMF membership, Chinese scholars and officials have various opinions. These opinions include a few pragmatic thoughts that hope the IMF would enhance China’s economic strength and influence, such as China needs the IMF to maintain international financial stability; participating in the IMF shows China’s capability in governing international economic affairs; the IMF plays an important role in securing China’s financial assistance to the crisis-hit countries (for example some EU countries during the Eurozone crisis); participating in the IMF is one of China’s means to access international cooperation. However those who are less optimistic argue that the IMF needs China more than China needs the IMF because of the increasing capital flows from China to the IMF, rather than the other way around. (Yu 2006; Gao 2011; Interview with a Chinese official in Beijing⁴)

Considering the controversial evidences of China-IMF interactions, despite the rhetoric

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⁴ The interview was conducted in Beijing. The interviewee (Interviewee 1) is a government official who works closely with the IMF in a Chinese Financial Institution.
about a robust China-IMF partnership, what is the actual relationship between the two? If the rhetoric does reveal the true nature of the China-IMF relationship, why did the Fund not confer to China real leadership in Fund governance? If the rhetoric is true, how has China achieved such a prominent influence in a western-led Bretton Woods institution within 30 years? If not, how do we explain the increasing interactions between the two in the past three decades including IMF technical assistance, IMF surveillance and policy advice, multilateral consultations, China’s participation in various IMF programs such as the Financial Sector Assessment Program (FSAP) and the General Data Dissemination System (GDDS), increasing Chinese contribution to IMF financial resources, and so on? What are the consequences of these activities? What does China’s pragmatic government aim for via interactions with the IMF?

In order to solve these puzzles, I intend to analyze comprehensively the relationship between the IMF and China since China regained its IMF membership in April 1980. This is also the main task of this thesis.

1 Research Objective

1.1 Research Scope

This thesis analyzes the relationship between China and the IMF since 1980, when People’s Republic of China regained its IMF membership. It also explores the driving force behind the advancement, and/or decline, of the China-IMF relationship. Although more attention has been given to China-IMF related policy decisions in the recent years
(as introduced above), the acceleration in activity over the previous decades requires academic analysis. A systemic analysis of the relationship between China and the IMF enables us to obtain a thorough understanding of related policy decisions and consequences. It includes examinations of China’s and the IMF’s objectives, functions, structures, institutional rules, and practices that lead to specific interactions that define the relationship between the two. In addition, the contexts of the interactions, in this case the international and regional economic development trends and short-term events such as financial crises, also require appropriate assessment as they largely determine the actors’ intentions and actions.

When China joined the IMF, it did not have much knowledge about how the IMF and the international financial economy were functioning. This was due to Communist China’s decades of isolation from the mainstream international society up till the reformist leadership decided to open the borders and embrace the concept of economic interdependence in the late 1970s (yet in a cautious and incremental style). Since then, China has participated in a growing number of IMF activities, the details of which are analyzed in the thesis. Through participating in these activities, Chinese officials have accumulated experience and expertise in handling Fund-related international economic affairs. More importantly, the Chinese government has further specified its objectives in the governance of international financial economy via its participation in the IMF. For instance, one essential objective was introduced above: becoming a larger shareholder of a reformed international monetary system. The Chinese leadership has had growing
objectives since it joined the IMF in 1980, which will surely be analyzed with details later in the thesis.

1.2 Research Design

Through the analysis of the China-IMF relationship, the thesis intends to illustrate how China attempts to achieve its objectives via participating in IMF programs and the consequences of participation. Since China was previously unfamiliar with the rules and practices of the international financial economy, while the IMF was an influential international organization with well-established rules and firm institutional norms, the analysis naturally starts from exploration of the IMF’s impacts (especially those in the earlier stage of China’s IMF membership) on China’s domestic economy.

The thesis adopts the essence of socialization theory to analyze China’s relationship with the IMF in the early stage since it joined the IMF. It borrows Alastair Johnston’s socialization framework to analyze the IMF’s impacts on China’s domestic economy. Johnston’s three microprocesses of socialization-mimicking, social influence, and persuasion- are used to explain how the IMF socialized China into accepting neo-liberal international economic norms. (Johnston 2008) By using the microprocess approach, we can specify how the IMF exerted influence in China’s domestic economic policy-making via interactive mechanisms such as IMF financial and technical assistance and surveillance and policy advice. It also specifies the extent to which the Chinese authorities change their interests and norms under such influences. The IMF’s impacts on
China’s economic norms contributed to its economic liberalization progress, as well as helped China further its goal in economic development.

However, the limitations of socialization theory prevent the analysis from revealing a full picture of the China-IMF relationship, especially that in the late stage and recent years. For instance, socialization theory undermines the importance of states’ intentions (states are not simple norm takers) and their impacts on the international organizations they participate in; it also overstates the legitimacy of international norms in guiding state policies. Hence, a supplementary theory is brought in: principal-agent theory.

Principal-agent theory focuses on delegation: in this case, states delegate authority to international organizations so that the latter can perform the delegated tasks to benefit the former. (Hawkins et al 2006) In the case of China-IMF relationship, China is regarded as a member of the IMF’s ‘collective principal’, and the IMF is China’s international organization agent. This theoretical framework reveals the essence of the China-IMF relationship: how China could achieve its objectives in the governance of international financial economy via participating in the IMF. Based on the basic features of principal-agent theory, I propose a four-stage approach to analyzing the relationships between states and international organizations. The approach is applied to explain the interactions between China and the IMF in the three following chapters.

Firstly, I will identify China’s principal objectives and related governmental structure, and the IMF’s agent interest and institutional structure. Secondly, I will explore the
motivations for China’s delegation to the IMF. They are based on the IMF’s outstanding functions that enable the Fund to help China achieve its objectives, for example the IMF’s specific expertise and information advance, its agenda setting power and multilateral decision-making mechanisms, and its capability to solve the controversial issues that cannot be solved by China on its own. Based on the IMF’s functions, I will analyze each task China delegates to the IMF, for example technical training, policy analysis and advice, multilateral consultation on global imbalances, lending risks assessment and contract design, and reforming the international monetary system. Thirdly, the factors that have impacts on China’s delegation actions will be examined. They include China’s preferences compared to those of the IMF and other members of the Fund’s collective principal, China’s share of the IMF’s formal and informal governance, and China’s influence among IMF staff. Fourthly, which is also the most important stage of the approach, I will assess the consequences of China’s delegation to the IMF. Based on the analysis undertaken in the first three stages, I will assess if the delegation generates satisfactory consequences that may lead to ‘re-delegation’; or undesired consequences, that is agency slack, which may lead to ‘de-delegate’. The causes of agency slack will also be examined.

Via this four-stage approach, some key issues in the China-IMF relationship will be analyzed. For instance, China’s effort in pushing forward IMF quota and voting share reforms and the unsatisfactory results are analyzed as a consequence of the western-dominant governance rule of the IMF, as well as a cause of undesired delegation consequences for China. Another example is the IMF’s policy advice for China being
rejected, which is analyzed as a consequence of unsuccessful delegation. By revealing the key facts in China-IMF interactions and causal relations among them, principal-agent theory enables us to understand why China gets involved in some IMF programs, but not others; why some IMF activities generate satisfactory consequences for China, but some do not; and why China participates in IMF programs at the same time as it attends other regional and international institutions with similar functions. The analysis eventually leads to the conclusion on whether or not the IMF plays the role of a good agent in assisting China to achieve its objectives in the international financial economy.

It is also worth mentioning that, although principal-agent theory analyzes the China-IMF relationship from a different perspective compared to socialization theory, they do not fundamentally clash in this research. Principal-agent theory usually recognizes the strong influences of international organizations, for example Hawkins and Jacoby argued international organizations use ‘agent strategies’ to influence states’ decisions on delegation. (Hawkins and Jacoby 2006) Hence in the case of the IMF, its strong influences on China’s domestic economy that are emphasized by socialization theory are also approved by principal-agent theory. Moreover, socialization theory focuses on the normative influence of the IMF, which according to principal-agent theorists is based upon the IMF’s ‘organizational culture’ that comprises the staff’s common interests and working principle and the Fund’s institutional rules. While socialization theory analyzes the process of IMF influencing China’s domestic economy, principal-agent theory takes into account the original causes of IMF exerting influences on China- that is China’s
objectives in the governance of international financial economy and examines how the IMF assists China to achieve its objectives.

After all, application of an appropriate theoretical approach to analysing the relationship between China and the IMF is crucial. It should correctly reflect the Chinese government’s intentions including its preferences and objectives, because they significantly guide China’s policy decisions in the international sphere. It should also include careful scrutiny of the IMF’s institutional features including its governance structures and rules, because they largely affect the Fund’s policy orientations. Finally, it should enclose the influences of external environment and third party actors. Hence, using an appropriate theoretical framework to analyse the China-IMF relationship is another research objective of this thesis.

1.3 Research Questions

The thesis has the following major research questions:

1. How does socialization theory explain the IMF’s influences on China’s domestic policy?

2. Why did China get engaged with IMF programs? What are China’s objectives in the governance of international financial economy?

3. How has the interaction between China and the IMF progressed?
4. What is China’s governance role in the IMF? How has it progressed?

5. How does the IMF assist China to achieve its objectives in the governance of international financial economy? How does principal-agent theory explain it?

These questions will be answered in the course of this thesis.

2 Literature Review

2.1 Literature on the IMF and China’s participation in the IMF

Literature on the IMF includes a very limited amount of works that directly focus on the Fund’s interaction with China, mainly because the PRC did not gain its membership until 1980 and not grow into an important Fund member until even later. Therefore the broad literature on the IMF does not tell much about China’s participation in the Fund, yet it provides us with details of the IMF’s structure, functions, norms and evolution along the years, which sheds light on what the IMF can do in influencing member states to change policy in general. It thus provides a contextual background for China-IMF interaction and especially the IMF’s influence in China’s economic policymaking. A large part of literature on the IMF highlights the Fund’s most crucial functions: lending, technical assistance and policy advice, among which discussions on lending are usually undertaken along assessments of procedure and effectiveness of conditionality. Via conditionality, the IMF attempts to generate policy change in borrowing countries, and this illustrates
why the significance of IMF lending is beyond short-term problem solving. Some scholars focus on the complexities of operational issues in the IMF, they explore various IMF programs and the evolving institutional structure of the Fund. Some scholars (especially constructivists) focus on the Fund’s norms that embrace the essence of neoliberalism, or so called ‘Washington Consensus’, and examine the degree to which IMF policies and practices under such norms can effectively solve member countries’ balance of payments difficulties and guide them through financial crises. In addition, due to several major changes in the international financial architecture since the Bretton Woods institutions were established, scholars and policymakers have elaborated the IMF’s evolving role in global financial governance. (Woods 2006; Vreeland 2003; Park and Vetterlein 2010; Moschella 2010; Gould 2006) Among this rich literature, I want to highlight the following works that contribute to the research undertaken for the thesis.

In her book The Globalizer: The IMF, the World Bank, and Their Borrowers, Woods developed a mechanism of how the IMF influences borrower countries’ domestic economic policies, highlighting the three forces that determine the Fund’s performance: the Fund’s most powerful member countries; the Fund’s fundamental economic ideas, fashions, and orthodoxies; and the Fund’s bureaucratic. In this mechanism, powerful states set the boundaries; within which professional economists and staff draw up the contents based on the economic ideas, fashions and orthodoxies. While the staff coerce or persuade borrowing countries to undertake prescribed measures, their work serve the interests of power members as well as the institution itself. However, the results of such ‘coercion’ and ‘persuasion’ depend largely on the ‘configuration of political institutions.
within borrowing countries.’ (Woods 2006: 82) In particular, successful persuasion is achieved upon: 1) the Fund’s strong bargaining leverage in enforcing ‘Washington-prescribed medicine’, 2) sympathetic interlocutors in borrowing countries that share economic ideas, technical expertise, and methodology with IMF staff, 3) less democratic regimes in borrowing countries where economic decision-making is efficiently controlled by a small amount of elites, and 4) supportive interest groups in borrowing countries. (Ibid: 65-83) These conditions of successful persuasion shed lights on the IMF’s influence in China’s domestic economic policymaking.

Woods argued that the IMF’s work is affected by the preferences of their most powerful members (mostly the US), their own bureaucratic motives, and by politics within member countries. (Ibid: 179) Thus the coordination among these three factors are extremely important. After analyzing three case studies of IMF missions in Mexico, Russia and Africa, she pointed out that the IMF focuses too much on politics and interests of the creditor governments and the Fund itself; on the other hand borrowing countries’ needs are often neglected. This explains why the IMF has lost its legitimacy, especially among its developing country members. Woods advocated for radical reforms for the IMF to ‘redirect its research and policy so as to play an advisory and standard-setting role in a way that would better advantage its borrowers’. (Ibid: 185, 188) Woods’ suggestion is compatible with China’s constant advocacy for IMF governance reforms that will be discussed in details in the later chapters.
Vreeland’s book *The IMF and Economic Development* also focused on the IMF’s function and its influence in borrowing countries. In particular it discussed if the IMF should play the role of promoting economic growth in borrowing countries, which was not Fund’s initial goal when it was originally established but became one when the Fund switched its policy focus from regulating currency to managing balance of payments difficulties (mostly in developing countries). (Vreeland 2003: 9) In order to solve this puzzle, Vreeland assessed the effectiveness of IMF programs, by defining the determinants of IMF program participation and examining consequences of such programs for economic growth.

As mentioned above, IMF loans to countries with balance of payments difficulties are often attached with conditionality that entails fiscal austerity, tight monetary policy, and devaluation. (Taylor 1993) Borrowing countries that are required to live up to the conditionality are considered as sacrificing economic sovereignty, and thus they are usually reluctant to do so. Why would they still do it? He used the data that cover 135 countries from 1951 to 1990 to assess the IMF’s impact on member countries’ economic growth. Eventually he found out that governments engaged in IMF programs not just for economic reasons but also for political reasons, and that these programs hurt economic growth and exacerbate income inequality. It is because IMF policies ‘dampen the effects of bad economic performance by redistributing income upward and thus rewarding elites… IMF programs hurt doubly the least well-off in society…’ (Vreeland: 152) Governments of borrowing countries sometimes enter the programs and agree to accept conditionality because they can blame the IMF for such unpopular policies. (Vreeland
Vreeland’s finding further proved that borrowing countries’ political objectives and preferences significantly determine the result of their participation in IMF programs. Although China has not been a borrower, it has been influenced by IMF policies through different channels other than financial assistance—such as technical assistance and policy advice—hence Vreeland’s finding indicates that we should take into account of Chinese government’s political objectives and preferences while examining the IMF’s influence in China’s economic policymaking.

Another prominent work in the literature is Moschella’s book *Governing Risk: The IMF and Global Financial Crises*, in which the author explained how ideas drove policymaking in the IMF, and specifically how different ideas around major financial crisis periods generated policies that advocated different levels of financial liberalization. Similar to Woods, Moschella also pointed out that IMF policies are shaped by various actors, such as state representatives, economist and private actors (Moschella 2010: 26), yet the difference was that she accentuated the significance of ‘ideas’ as the core driving force of Fund policies. She developed an agent-centered constructivist framework, named ‘evolutionary theoretical framework’, to describe the complex procedure of transformation of ideas into policies in the Fund. Ideas of outside (influential member countries and sponsors) and inside (staff) are both important; these ideas are not static but constantly ‘contested and contingent’ according to Katzenstein (1996: 3) and continuously challenged by the changing environments. The ideas need to eventually reach ‘legitimacy’ among involved actors to form effective policies. Hence Moschella’s work explored the complex inner workings of the IMF and especially how staff’s ideas
‘walk their way’ into the Executive Board; most importantly, it highlighted the significance of ‘ideas’ and ‘legitimacy’ in IMF policymaking. (Moschella 2010: 1-34)

Park and Vetterlein’s edited book Owning Development: The Creation of Policy Norms at the IMF and World Bank further emphasized normative factors in IMF policymaking. The authors of this book traced evolution of different norms in the IMF’s policy areas, and examined the degree to what these norms shaped the Fund’s policymaking. (Park and Vetterlein 2010) The authors also identified three stages of policy norm change: emerge, stabilize, and wane, in order to reveal a dynamic development of norm circle; as well as three measures of policy norms’ strength: formal validity, social recognition, and cultural validity, in order to acquire a more nuanced understanding of policy norms’ varying influences. (Ibid: 6) The authors agreed that the IMF (and the World Bank), rather than the borrower countries, ‘owns’ the norms and policy; and that these norms and consequential policies are based on the core neo-liberal economic model, or ‘Washington Consensus’. (Ibid: 9) This norm-based constructivist view of IMF programs supports the core of ‘socialization’ approach to analyzing relations between the Fund and its member countries that will be discussed in the later chapters.

These works have looked into several key issue areas of the IMF. Although they did not specifically focus on the interactions between the IMF and China, they identified various key actors in IMF programs, discussed the complex policymaking procedures within the Fund, assessed the IMF’s impacts on borrowing countries’ domestic economy, examined the importance of neo-liberal ‘ideas’ and ‘norms’ in IMF policies, updated theoretical
frameworks for analyzing various IMF activities, and therefore formed a contextual background for the research undertaken is this thesis. Most of the works in the literature recognized the essential dominant role played by the Fund’s western advanced country members, and they discussed the relations between these countries and the Fund. A large part also examined the implementation of IMF policies in borrowing countries, yet they did not dig deep to look into the political and social environments of the borrowing countries. China is neither a traditional dominant power of the IMF nor a big borrower; hence it is not difficult to understand why the literature on China-IMF relationship is thin. However, due to China’s rapid growth in the international financial economy, and its increasing participation in international financial governance (some examples were already mentioned in the beginning of this introductory chapter), the literature needs to be enriched to include an enhanced systemic analysis of China-IMF relationship, and it is also one important purpose of the research undertaken for this thesis.

Although the existing literature on China-IMF relationship is thin, one significant contribution needs to be highlighted- Jacobson and Oksenberg’s book *China’s Participation in the IMF, the World Bank, and GATT* in 1990. It came out as a pioneering research of China’s participation in international economic organizations in the 1980s. It was also one of the first research works that looked into China’s interactions with international organizations. The book revealed the stories of how the IMF and China initially got connected, and how initial connections developed into a formal negotiation over China’s re-entry into the IMF. It also analyzed the crucial international political and
economic environment in the 1970s that affected both the Chinese government’s and the IMF’s decisions to engage with each other.

The research investigated China’s early participation in IMF programs and the consequential impacts on China’s officials, government departments, and macroeconomic policies. The authors pointed out that IMF (and World Bank) staff’s policy recommendation and advice proved to be influential, yet not the only, source of the Chinese government’s policy reforms toward a market-driven economic system. The IMF and the World Bank had also affected China’s economic policy processes, and led to greater cooperation between the IMF’s functioning departments and China’s financial sector. (Jacobson and Oksenberg 1990: 139-150)

Jacobson and Oksenberg’s research had significant impacts on the later works on China-international organizations relations. Like Jacobson and Oksenberg, later scholars focused on the impacts of international organizations on China’s domestic policy domains. Although Jacobson and Oksenberg also mentioned about some adjustments in international economic organizations due to China’s participation, they were less remarkable compared to international economic organizations’ impacts on China’s domestic regime. It was because China was still an inexperienced member with few skills in handling international affairs and little influence in the international political system in the 1980s. It explains why this research starts the analysis of China-IMF relationship by examining the Fund’s impacts on China’s domestic policymaking, using a socialization theoretical framework. Alastair Johnston highlighted the impact of Jacobson and
Oksenberg’s research in his own work on international security organizations’ socialization of China into accepting their norms. He said ‘…their [Jacobson and Oksenberg’s] book anticipated some of the concepts of interests to constructivists’, especially ‘they described processes of change in Chinese diplomacy that are variants of mimicking, persuasion, and social influence’. (Johnston 2008: xxiii)

However, the comprehensiveness and depth of Jacobson and Oksenberg’s analysis was limited, as the research was undertaken before 1990. Since then, the relationship between China and the IMF has evolved drastically, which requires more updated academic attention.

Some later works have also emphasized the IMF’s impacts on China’s domestic policymaking. Pearson interpreted the interactions between China and the IMF as ‘the IMF engaging China’. She argued the changes in China’s macroeconomic policies were consistent with IMF guidelines, which prove successful ‘engagement’. She argued the Chinese economic leadership had accepted the neo-liberal international economic norms because: these norms had been applied to the domestic economy; China carried out enormous numbers of economic transactions on the global markets; and China had not tried to disrupt the norms of the major international economic organizations they participated in. (Pearson 1999a: 222-223) Feeney (1998) discussed the IMF’s contribution to China’s economic reforms via various channels; especially its influence in China’s foreign exchange regime. He argued the IMF membership had ‘greatly aided China in achieving and managing its new status as a major trading nation and an
emerging superpower in the global economy…” (Feeney 1998: 245) Lardy also emphasized the IMF’s role in advising China on its exchange rate policy. He specifically pointed out that many of the most important Chinese decisions on exchange rate policy had been announced within a few weeks after IMF Article IV Consultations. (Lardy 1999)

Kent emphasized the changes in China’s domestic political sphere due to (or partly due to) interactions with the IMF, for example, various institutional and legislative implementations such as the measures adopted by the People’s Bank of China (PBC) to increase the flexibility and credibility of its monetary policy, and implementation of the Commercial Bank Law, the Law of the PRC on the PBC, the Guarantee Law of the PRC, the Insurance Law of the PRC, and the Price Law etc. (Kent 2007: 134-135) In addition, she also pointed out an issue that was not included in the previous works but has caught increasing attention recently, that is China’s underrepresentation and lack of decision making power in the IMF.

Some of these researches were undertaken in the 1990s, and thus excluded the recently developed China-IMF interactions. In addition, since most of these analyses of China-IMF relationship were a mere fragmentation of the general discussion of China’s relationship with international economic institutions, they often neglected specific interactions between China and the IMF. For example, none of these works revealed the dynamic changes of China’s decision-making power in the IMF. They did not look into the Chinese government’s preferences regarding IMF activities. Neither did they explain
how IMF Article IV Consultation works for China and why the Chinese authorities agreed to submit information to the program. These factors that had been overlooked significantly determined the relationship between China and the IMF. Therefore, again, the thesis aims to provide a more comprehensive investigation of the interactions between China and the IMF to fill in the gap in the literature.

2.2 Literature on Relationships Between China and International Institutions

The literature on relationships between China and international institutions refers to a wide range of international organizations. However, since China did not become an active member of international organizations until recent years, the literature of China’s participation in international institutions is relatively thin compared to those of other countries’ experience in international institutions. 5 Existing literature includes analyses of China’s participation in environmental institutions such as the UN Framework Convention on Climate Change, the Convention on Biodiversity, the United Nations Environment Programme (UNEP)/Global Environment Facility (GEF), a few standards under the International Organization for Standardization (ISO) and so on. (Economy and Oksenberg 2000; Kent 2007; Economy 1998; Ross 1999) Anne Kent conducted some researches on China’s approach to international human rights regimes, among which she specifically investigated China’s relationships with the International Labour Organization (ILO) and the UN Committee against Torture. (Kent 1999, 2002, 2007) There is also a

5 Since China has a rather unique role in the international political society that is different from both western developed and other developing states, I do not compare China’s relationships with international institutions with other countries’ experiences in the thesis.
small number of works on China’s participation in the international security regime, including the Conference on Disarmament, the ARF, the Council on Security Cooperation in the Asia Pacific, and so on. (Johnston 1998, 2008; Kent 2002; Johnston and Evans 1999, Swaine and Johnston 1999) The literature also includes research works on China’s participation in international economic organizations such as the General Agreement on Tariffs and Trade (GATT)/World Trade Organization (WTO), the World Bank and the IMF. (Pearson 1999a, 1999b; Lardy 1999; Feeney 1998; Hempson-Jones 2005; Chou 2006; Kent 2007; Magariños, Long and Sercovich 2002) Among all the works on China’s participation in international economic organizations, a large amount of them focus on the interactions between China and the WTO, because compared to China’s interactions with the IMF and the World Bank, the negotiation for WTO membership was the most complex and long-lasting, and China has been more involved in the international trade rather than financial system. However, it does not mean the relationships between China and the other two institutions are less important, and in fact they have become increasingly important in the post-crisis era.

China is more engaged with some international organizations than others, for example China’s compliance with international economic institutions tends to be easier than with international security institutions due to China’s rigid stance on sovereignty and security issues. Among international economic institutions, the negotiation for WTO membership was the most complex and the longest, as China was required to carry out enormous numbers of reforms in the domestic economic system in order to meet the conditions for entry. Although the works mentioned above showed significantly different forms, causes,
and impacts of China’s participation in different international organizations, most of them evaluated the costs and benefits for China to participate and examined (or attempted to examine) the consequences of China’s participation in international organizations. The thesis is affected by such an analytical approach that focuses on the motivation as well as actual consequences of participating in international institutions. Therefore, the objectives of China’s participation in IMF programs, the effectiveness of the interactions between China and the IMF, and the consequences of such interactions are assessed in the thesis.

Within Chinese academia, the study of international institutions became popular in the late 1980s and early 1990s, under the influence on Western (mostly neo-classical) economic theories. (Su 2006; Pang and Wang 2013) Among China’s early IR and International Studies scholars, Ni Shixiong was the first one that introduced the concept of ‘international regime’ to China in 1992 (Ni 1992), and Wang Yizhou was the first one that brought forward the concept of ‘global governance’, in 1995. (Wang 1995) Pang and Wang pointed out that Chinese scholars had hold different opinions about the role of international institutions. (Pang and Wang 2013) Liberals recognize international institutions’ role in promoting international cooperation, for example they acknowledged the UN’s role in maintaining peace and promoting development (Zhang 1995; Fang 1995), and Asian regional organizations’ role in promoting regionalism and multipolarity. (Gao and Lu 1994; Liu 2004) On the other hand, realists argue international institutions are controlled and manipulated by the most power nations, usually the US and its western allies, to fulfill these nations’ interests. (Jian and Ding 2002; Men 2001) In addition, Pang
and Wang pointed out that a small number of Chinese have adopted critical perspectives on international institutions, for example Li used neo-Gramscian approach and argued that international institutions are part of the global economic class structure, and they fulfill the interests of the center of the global economy at the expense of the periphery. (Pang and Wang 2013; Li 2010) Chinese scholars also question the legitimacy of international institutions, criticizing that in institutions like the IMF and World Bank, emerging market economy and developing countries are severely underrepresented. (Jian and Ding 2002) The imbalanced power distribution within the IMF has threatened its policy effectiveness in emerging market economy and developing countries; therefore a governance reform has been advocated by not only Chinese but also Western IPE scholars. This issue will be addressed with details in later chapters.

In particular, Chinese IPE scholars have paid increasing attention to China’s role in the global financial system, especially since the global financial crisis. Wang and Chin suggested the global financial crisis drove Chinese IPE scholars to focus on four themes:

‘(1) The shortcomings of the existing international monetary system and currency internationalization; (2) the source of global financial instability; (3) variations in the impact of the global financial and monetary systems on different countries; and (4) the rise of new forums for economic decision-making and international governance, such as the G20, the Financial Stability Board and the BRICS grouping’. (Wang and Chin 2013: 1258-9)
Triggered by PBC governor Zhou Xiaochuan’s advocacy in 2009 for enlarging the use of SDR as the world’s super-sovereign currency and strengthening the IMF’s surveillance of major reserve issuing countries, Chinese scholars promoted the idea of diversifying the international monetary system and internationalizing RMB. (Zhou 2009; Zhang 2009; Wang 2009a, 2009b; Qiao and Xu 2011) However, while acknowledging the potential of RMB in the international monetary system, several Chinese IPR scholars also stressed the risks of RMB internationalization and warned that China was not ready for a completely liberalized currency. (Gao and Yu 2010) In general Chinese scholars’ views of China’s participation in the international financial system are rather Sino-centric, self-protective and cautious, which is understandable considering China is relatively inexperienced in the system. (Wang and Chin 2013: 1262) Meanwhile Chinese IPE scholars have stated that China should further engage in the international financial system and play an active role in rebuilding a system that is diversified from US dominance and more tolerant to China’s domestic-focused incremental financial reform policies. (Li 2009; Zhang 2010)

2.3 Literature on socialization theory

Socialization is a central concept in social constructivism. There is a considerable amount of research works on socialization in sociology, such as Peter Berger and Thomas Luckmann’s Sociology and Sheldon Stryker and Ann Statham’s ‘Symbolic Interaction and Role Theory’ in the Handbook of Social Psychology (Berger and Luckmann 1966; Stryker and Statham 1985). International Relations (IR) scholars also adopted the concept of ‘socialization’ to explain the internalization of international norms and values (Ikenberry and Kupchan 1990).
IR scholars used socialization approach to assess if international organizations socialize states into accepting their norms. One prominent sign of successful socialization is that states have fundamentally changed their principles and believes toward the international organizations’ preferences and eventually internalize the international organizations’ norms in the states’ own regime and making policies accordingly. Yet it is sometimes difficult to judge if states have accepted international organizations’ normative values and changed their identities and believes accordingly, or just changed their behaviour temporarily due to short-term pressure from the international community. In the literature of China’s relationship with international regimes, socialization scholars usually focus on how China can be socialized (or not) to be a responsible status quo actor in global governance arenas; whether China will play by the existing international rules, want to modify them, or seek to radically change them and establish new institutions, rules and norms.

In an ADB working paper, Archaya explored socialization effects of Asian regional institutions, taking China, Vietnam and India’s experiences as case studies. He emphasized that socialization refers to peaceful and non-coercive norm transmission and leads to long-term and stable changes in behavior rather than short-term adaptation. (Archaya 2011: 9) He also brought forward five institutional conditions for successful socialization. On China’s case, Archaya argued that ASEAN has socialized China into accepting multilateral approaches to regional security issues, which is evident in China’s participation in multilateral talks with ASEAN on the South China Sea disputes leading
to a Declaration on the Code of Conduct in the South China Sea. He also argued that China’s normative and behavioural shifts are irreversible. (Ibid: 12-13)

Ba’s paper ‘Who’s Socializing Whom?’ assessed the conditions of successful engagement between the ASEAN and China, by which ASEAN could socialize China into accepting its norms. In the paper, Ba pointed out that ASEAN successfully persuaded China to adopt more cooperative and multilateral approach towards neighbouring countries and grow positive expectations and ideas about its ASEAN relations. (Ba 2006: 170) She argued the successful socialization is mostly due to ASEAN’s ‘complex engagement’ strategy, referring to ‘a social, interactive process aimed at transforming how actors conceive themselves in relation to others’. Via ‘complex engagement’, ASEAN and China sought to generate ‘non-coercive and open exchanges at multiple levels and over multiple issue areas’, ‘strategic pursuit of cooperative relations based on common understanding’, and opportunities to find ‘new areas of agreement’. (Ibid: 160- 161) Ba also pointed out that socialization between ASEAN and China was a ‘two-way’ process- while ASEAN socializes China to regional norms, China also sought to influence the way ASEAN views and handles regional matters. Therefore, its open and inclusive style of engagement enabled ASEAN to persuade China to reconsider its views towards regional multilateralism and ASEAN. (Ibid: 168-9)

However, some other socialization scholars are less optimistic about the effectiveness of international organizations’ socialization of China. Han denied China’s engagement in
globalization is a result of socialization, as globalization has not caused a fundamental change in Chinese worldview; moreover, ‘China negated the learning to internalize the principles of multilateralism and precluded the process of socialization from reaching to the substantial level’. (Han 2007: 51) Instead, China’s increasingly engaged in global economy in order to deepen and widen economic interdependence with the outside world, and eventually to promote its own national competitiveness and to ‘buttress the legitimacy and leadership of the Chinese Communist Party’. (Ibid: 53) Han argued three factors determined globalization could not effectively socialize China into accepting the norms of the current international regime: 1 Chinese leaders restrains the impact of globalization within the field of economy; 2 China’s globalization is driven by internal political objectives rather than external pressure; 3 Chinese people, including scholars and policymakers, maintain realpolitik Weltanschauung. (Ibid: 51-57)

Lynch’s book Rising China and Asian Democratization discussed how and to what extent has the global rational-liberal culture socialized China, Thailand and Taiwan. Lynch criticized world-polity theorists’ view that global culture will reconstitute all states as liberal-rational entities, and argued that China ‘while open to some forms of socialization, rigorously macromanages the process to prevent reconstitution at the level of collective identity.’ (Lynch 2006: 13) Being socialized into liberal-rational global culture means China will have to be de-centered from the world political system, which is not accepted by the Chinese Communist Party and other elites. Therefore, the Communist Party ‘makes selective use of such global culture values as rationalism and science to pursue a different kind of re-centering based on massively increasing Chinese comprehensive
national power.’ (Ibid: 17) Instead of being socialized into global culture, Chinese leaders seek to establish an alternative global center based on principles antithetical to American-defined ‘democracy’ and ‘human rights’; and remain committed to ‘world plurality’, ‘rejecting liberal solidarism as a cloak for US hegemony.’ (Ibid: 18)

Johnston’s *Social States: China in International Institutions: 1980-2000* explains how international security organizations such as the UN’s Conference on Disarmament in Geneva, the ASEAN Regional Forum (ARF) and associated regional multilateral security dialogues, the Comprehensive Test Ban Treaty (CTBT), and the anti-personnel landmine regimes ‘socialized’ China into accepting their norms. (Johnston 2008) Most importantly, he introduced three ‘microprocesses’ of socialization- mimicking, social influence, and persuasion- that provided a good approach to analyzing how international organizations and states practice socialization. (Johnston 2008) Compared to the other works in the literature that focus on the conditions of socialization, Johnston’s work offered a distinctly useful mechanism by which one can analyze the actual processes of socialization and its consequences in the China’s domestic regime. Therefore, in this thesis, I will borrow Johnston’s ‘microprocesses’ of socialization to analyze the China’s participation in the IMF and the IMF’s impacts on China’s domestic economic policymaking in the early stage. Johnston’s concept of socialization is reviewed with more details in the first half of Chapter 2. The second half of the chapter discusses the limitation of socialization approach, especially when it is applied to analyze the interactions between China and the IMF.
On the other hand, Chinese IR and IPE scholars have mostly adopted Marxist and liberal approaches in their studies of international affairs; and the development of constructivism has merely started around a decade ago in China. (Wang and Blyth 2013) Chinese scholars have different views on the debate of whether or not China has been socialized into the international rules and norms of the existing world order. Just to give a few examples, Qin argued China has been socialized into and willingly complied with international rules and norms through increasing interaction with other states. (Qin 2003) Similarly, Meng argued that via frequent interaction with the international community, China has increasingly recognized the importance of having a positive image within international institutions (in order to further its national interests) and acquired more positive perception of international institutions. (Meng 2005) Wang stressed Chinese socialization into Western neo-classical economic theories, especially via international economic organizations like the WTO, has largely shaped (or liberalized) its foreign trade policy. (Wang 2011) However, these works did not indicate how ‘socialization’ worked and most importantly how China modified its identity and interests and accept international norms.

2.4 Literature on Principal-Agent Theory

Principal-agent theory was derived from agency theory in the field of microeconomics. (Spence and Zeckerhauser 1971; Holmstrom 1979; Shavell 1979) It further developed in the studies of American and comparative politics. (Shepsle 1979, 1986, 1989; Weingast and Moran 1983; Weingast 1984; McCubbins and Schwartz 1984; Miller 2005; Downs and Rocke 1994) When it is applied in the studies of international organizations, the basic
framework of the theory refers to member states (as the principal) hiring an international organization (as the agent) to perform some functions that will benefit the members. (Nielson and Tierney 2003; Hawkins et. al 2006)

In this thesis, principal-agent theory is applied as the primary theoretical framework to analyze the interactions between China and the IMF in the later and recent years. The review of the literature on principal-agent theory is combined with the discussion of crucial definitions, concepts and causal relations in principal-agent theory in the first half of Chapter 4; hence I will not expand the details of the literature here. The discussion will focuses on the concept of delegation, reasons for delegation, and features of the main actors in the framework: principal, agent and third party actors. It also includes the concepts of a few important terms in the principal-agent framework, such as agent autonomy, agency slack, principal control, and so on. The discussion aims to help develop a systemic analytical tool to assess the interactions between China and the IMF in the principal-agent theoretical framework.

In addition, I should stress here that the theoretical framework adopted in this thesis is a combination of socialization and principal-agent theory. Socialization explains China’s relationship with the IMF in the early stage, where the IMF sought to convince the Chinese officials to liberalize its economic policies and policymaking processes. However, due to both China’s domestic political obstacle and the Fund’s inadequate surveillance, socialization is proved to have taken place moderately in the early stage via technical assistance and policy advice. Later, as China became a strong economic power
and an increasingly proactive member of the Fund, it not only showed dissatisfaction with the IMF’s neo-liberal policy advice that ignored China’s domestic economic factors but also gradually developed its own economic developmental strategy as well as objectives in the global financial system. Therefore, instead of being socialized into accepting the IMF’s existing norms, China became more prone to utilizing interactions with the IMF to achieve its own objectives. Hence the relationship between China and the IMF is not only about the IMF’s influences in China’s domestic economy but also the other way around- that is China’s influences in Fund organization and programs.

Chin interpreted this kind of reciprocate influences as ‘two-way socialization’ (Chin 2013), in particular, he used the case study of China successfully persuaded the Bank to agree to new procedures that recognize China as co-donor as opposed to its established rule of having bilateral donors accustomed to following the lead of the Bank. In addition, Chin pointed out that from the Memorandum⁶ (MOU) signed between China’s Eximbank and the World Bank, we could see the compromise between the two banks on their distinct lending principles. The Eximbank aims to establish economic profit-based strategic partnership with loan receiver countries, while the World Bank usually attaches more political conditions to its loans. However, the compromises made by the both banks show that China has been ‘reshaping the norms, rules and principles of the international institutions, and perhaps, gradually, reshaping the system more broadly.’ (Ibid: 215) Ba also argued that ASEAN’s socialization of China is a two-way process: while ASEAN

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⁶ Memorandum of Understanding (MOU) on Cooperation between the Export-Import Bank of China and the International Bank for Reconstruction and Development
persuades China to accept its norms, China also influences the way ASEAN deals with regional matters. (Ba 2006)

In the case of China-IMF relationship, I am rather skeptical about China’s intention as well as capacity in ‘socializing’ the IMF into accepting China’s values and norms, because there is no evidence showing that China has changed the Fund’s deeply embedded neo-liberal norms and way the Fund implements its norms. However, I do recognize China’s unique objectives in the governance of international financial economy and its intention to use the IMF to achieve its objectives in the recent years. Therefore, here, principal-agent theory is the most suitable approach to analyzing the China-IMF relationship in the later stage, especially in the post-crisis era, when China became a more proactive participant of not only the IMF but also the governance of the whole international financial economy.

Socialization and principal-agent theory do not necessarily contrast with each other. In fact, some scholars have previously argued for the commensurability of rationalist and sociological frameworks. For example, Nielson et al. suggested an approach to analyzing the effectiveness of institutional reforms, a combination of ‘top-down’ rationalist Principal-agent model with the ‘bottom-up’ sociological constructivism. (Nielson et al. 2006) They argued that institutional reforms are more effective when the information asymmetries between the principal (management team) and the agent (staff) are minimized, in other words when the principal has better quantity and quality of information about agent actions. In this case, the organization reformers can manipulate
the incentive structures to redefine staff expectations and thus direct changes in the institution. (Ibid: 111-112) However, this is not a sufficiently condition to successful institutional reforms, and the other condition focuses on the sociological aspect of the institution, because institutional reform refers to ‘transformation in ideologies, norms and appropriate standards of behaviour’. (Ibid; Barnett and Finnemore 2004) Therefore, Nielson et al. argued that institutional reforms are more effective when the organization reformers propose changes that are adjacent to the prevailing organizational cultural (including norms, ideas and values). (Nielson et al. 2006: 112-115) The incentive-based and norm-based conditions are both crucial, without either of the two, institutional reforms cannot undertake effectively. In addition, Jupille et al. identified the gaps between ‘rationalist’ and ‘constructivist’ institutionalisms: ‘the starting point for (many) rational institutionalists is self-interested agents engaged in strategic choices; for (many) constructivists, it is other-regarding agents engaged in deliberative dynamics’. (Jupille et al. 2003: 1) However, they attempted to develop middle-range social scientific approaches, in particular, four models of theoretical dialogue between two theories.

3 Research Method

The research is based upon a combination of qualitative methods: document research, other secondary data collection, tertiary material reading, and elite interviews.
3.1 Document Research

Documentary evidence provides first-hand information about the issuer institutions, and thus provides significant research materials in this thesis. As argued by Burnham et. al, official documents offer the political researcher ‘a much more reliable starting point than biographies, published diaries and memoirs’. (Burnham et. al 2008: 94) The documents consulted for the thesis include official publications issued by the Asian Development Bank (ADB), the International Bank for Reconstruction and Development (IBRD), the PBC, the International Monetary and Financial Committee (IMFC) (of the IMF), and the IMF. Among them, the documents from the IMFC and IMF are most frequently referenced. As mentioned before, the literature on the China-IMF relationship is rather thin, thus the IMF’s China-related documents significantly enriched the empirical evidences of the interactions between China and the Fund. IMFC documents include the Chinese representatives’ (usually either Governor or Deputy Governor of the PBC) statements at both spring and autumn IMFC meetings in the time period from 2000 to 2011. The statements included the Chinese government’s opinions on IMF operation, which directly reflected its perceptions and preferences regarding IMF policy decisions and practices.

IMF documents consulted in the research contain various categories, including IMF Staff Reports, Press Releases, News Briefs, Speeches of IMF Senior Officials, Reports of Resident Representative Office, Staff Paper, IMF data (for example, quota tables), Online Reports (made by the external department), IMF Country Reports on financial stability, Article IV Consultation Country Reports, Public Information Notices (PIN) for Article IV
Consultation, and IMF Diversity Council Reports (made by the Diversity Council). Most of the documents are available on the IMF’s official website (http://www.imf.org/external/index.htm). Some documents such as the Article IV Consultation reports for China are available at the IMF Resident Representative Office in the People’s Republic of China in Beijing. I paid two visits to the Resident Representative Office in Beijing in summer and winter 2011, respectively, for interviews and reading documents.

3.2 Other Secondary Sources

Other secondary sources include Chinese and international newspapers and periodicals, for example, the Xinhua News Agency (Xinhua) the official press agency of the Chinese government. Xinhua is subordinate to the State Council and it reports to the Propaganda and Public Information Departments of China, hence the news articles published by Xinhua are consistent with the government’s opinion. The other important newspaper is the People’s Daily; since it is a part of the Central Committee of the Communist Party of China, the news articles published by People’s Daily could be regarded as a form of party voice. Other Chinese newspapers and periodicals include the Shanghai Daily, Chinese Economic Weekly, Diyi caijing ribao (First Finance Daily), Jingrong shi bao (Financial Times), Caijing (Finance) Magazine, Shijie Zhishi (World Knowledge), and the 21 shiji jingji baodao (The 21st Century Economic Reports). The Foreign newspapers and periodicals referenced in the thesis include Financial Times, Bloomberg, Wall Street

\footnote{It is not the same as the ‘Financial Times’ issued in the UK.}
Journal, Lianhe Zaobao\textsuperscript{8}, Reuters China, and Wall Street Journal. The news articles and comments consulted are both in Chinese and English languages; the information obtained from the articles in Chinese is translated into English when it is referenced.

A large amount of the secondary sources could be accessed on the Internet, the convenience of which significantly helped pushing forward the pace of the research. In addition, I have also obtained important information from the official websites of the National Bureau of Statistics of China (NBS), the PBC, the State Council Development Research Centre, and the Chinese Academy of Social Sciences (CASS) (especially its Institute of Economics and Politics). The former two are government departments, and they usually publish their external annual reports, important data, policy changes and other related information on their websites; the later two are research centres and they publish selective research results on their websites.

3.3 Tertiary Sources

Tertiary sources include books, academic journal articles, published and unpublished conference papers and talks. They contain the literature on socialization theory and principal-agent theory in IR and other disciplines including microeconomics, comparative politics, and sociology. The also contain research works on international organizations, China’s domestic political economy, China’s relationships with international and regional institutions, China’s bilateral relationships with other states, and the IMF including its history, institutional structures and programs. The consulted works are in English and

\textsuperscript{8} Lianhua Zaobao is the largest Singapore-based newspaper in Chinese language.
Chinese languages; the information acquired from the works in Chinese language is translated to English when it is referenced.

Most of the Chinese scholars whose works are consulted in the thesis are conducting research in China’s leading universities, research centres and think tanks. Their arguments represent China’s top-level intellectual opinions and expertise on the country’s economic policies. Their research products and policy advice have also become an increasingly important part of the policymakers’ considerations when they make critical policy decisions. Hence, consulting the works written by China’s leading scholars significantly contribute to the comprehensiveness and depth of the analysis in the thesis.

3.4 Elite Interview

Semi-structured elite interview were conducted between September 2011 and October 2012. Elite interview is an effective way to obtain information about decision makers and decision-making processes. Elite interview refers to the situation in which the balance of knowledge and expertise is usually in favour of the respondents because of their high levels of knowledge of the subject matter. (Burnham et al 2008: 231) According to Leech, elite interviewing ‘can be used whenever it is appropriate to treat a respondent as an expert about the topic in hand’. (Leech 2002: 63)

During this research, twelve separate interviews were conducted in Beijing and Washington, D.C. All respondents were promised that their names would be kept confidential. The interviewees include one Chinese financial government official, four
Chinese scholars of international and domestic political economy, four IMF staff members, and one Chinese economy expert and one IMF expert in a US think tank. Questions to the interviewees focused on China’s interactions with the IMF, its currency policy, and its regional governance role. The interviews were conducted in Chinese and English languages (all were in the interviewee’s working language).

3.5 Importance of using a mixture of research methods

No single research method could sufficiently support a comprehensive and in-depth research project. Every single research method has its deficiencies. For instance, newspapers reports are time-specific; while they offer a specific view from the past based on the then-lifestyles, preoccupations, consumption and worldviews, they may suffer adaptability problem with regard to the current issues. (Wilkinson 1994) Since the media are never truly neutral, researchers should also consider the political preferences of the newspaper owners while consulting their reports. Scott questioned the documentary sources in general, especially their authenticity, credibility, representativeness and meaning. Regarding the first two issues, the sincerity and accuracy of the author of the documents are questioned; hence the researchers need to consider the conditions under which the documents were produced. The other two issues refer to the problem that the available (and prevailing) documents may not be the most representative ones. (Scott 1990: 19-24) Hence researchers are encouraged to use a wide range of documents from different sources.
Elite interview is not problem free either. The interviewees may reveal some inside stories or offer some distinguished opinions that may lead to interesting and incisive writing; yet they could be highly biased or reserved to express their real opinions at the same time, which may lead to incorrect research results (especially when the number of interviewees is small). Hence, multiple research methods are applied in this thesis.

4 Contribution of the Thesis

The thesis has three major contributions.

1. It enriches the so far (very) thin literature on the China-IMF relationship. It is done by investigations of a wide range of historical events between China and the IMF and assessments of current policy issues regarding the two. The empirical research looks into the IMF’s assistance programs for China, especially in the technical aspect. A distinguished case study applied in the thesis is IMF Statistical Department’s training programs for the Chinese officials from a wide range of domestic financial government departments. It also looks into IMF Article IV Consultation for China, especially the effectiveness of the Consultation vis-à-vis the sensitive and rigid Chinese authorities. The empirical research also contains investigation of China’s participation in IMF Multilateral Consultation on Global Imbalances and China’s recent contribution to IMF financial resources. Moreover, the research explores the reasons why China expects the IMF to reform the US-dominated international monetary system; and the concerns of many Chinese policymakers and scholars are taken into account in this part of the research. The
Chinese representatives’ statements at IMFC meetings (2001-2011), which reveal the Chinese government’s propositions, are also analyzed in the thesis. In addition, the efforts China made and the consequences China faces during several rounds of IMF quota and voting share reforms are examined in the research; as well as China’s relatively weak influences in IMF informal governance (forums and negotiations outside the Executive Board (EB)). Finally, the proportion of IMF staff with Chinese nationality, and the problem of underrepresentation are examined. Through empirical research of these events, the thesis provides an analysis of the China-IMF relationship that is more comprehensive than the previous ones in terms of both time frame and range of issue areas.

2. The thesis extends the research subjects of principal-agent theory to include an emerging market economy state as the principal. Principal-agent theory has previously been used to analyze the relationships between advanced developed countries and international organizations. It is because advanced developed countries are usually the most powerful members in international organizations, and in many cases they even participated in designing and founding these organizations. However, since the emerging market economy states are becoming more influential in the international political society with clear goals and policy preferences, they should not be excluded from the ‘principal group’. In fact they are usually counted in the collective principals of international organizations, although they may not be as influential as those advanced developed state members. Regarding emerging market economy states as principals help us better understand their objectives and actions in international organizations and related issue
areas. Regarding emerging market economy states as eligible and legitimate principals is also consistent with the advocacy of improving their representations in international organizations in order to improve the latters’ legitimacy. The analysis conducted in the thesis could (hopefully) motivate academic interests in studying emerging market economies as principals of international (and regional) organizations. By recognizing the emerging market economies’ increasing controlling power in the global governance scholars can effectively adjust (or correct) the traditional western-dominated international political theories and establish an updated theoretical framework that responds to the rising capacity of emerging market economies. Accordingly, it can enable the scholars to provide appropriate advice for the policymakers on global governance issues.

3. Undoubtedly, China is an eligible principal whose principal features and role have yet not been analyzed previously. Hence the research framework developed in the thesis has a high level of originality. Compared to the US and some western developed states, China is a less influential principal, yet its influence in the Fund has already significantly grown. China would become a stronger principal, if IMF governance reforms moved faster, if the preference differences between China and the IMF got smaller, and if China obtained more efficient controlling tools. Therefore principal-agent theory provides a dynamic approach to analyzing the relationship between China and the IMF. Similar frameworks could be applied to analyze the relationships between China and other international (and regional) organizations, which will lead to a new definition of China’s role in the international political society that is consistent with its objectives of expanding international influences in the global governance.
5 Thesis Outline

The thesis has eight chapters. The introductory chapter indicates the research context, research structure and main questions to be answered in the research, a review of the literature, and methods of analysis.

Chapter 2 is the first theory chapter, in which socialization theory is discussed in the context of the China-IMF interactions. The first half of Chapter 2 reviews the main concepts of socialization theory in international organization studies. It firstly introduces two themes in the relationships between states and international organizations that fulfill the conditions for the socialization framework. It then illustrates the concepts of processes of socialization based on Alastair Johnston’s three microprocesses of international organization socialization: mimicking, social influence and persuasion. The second part of Chapter 2 discusses the limitation of socialization theory, concluding with a proposal of using socialization theory to analyze the relationship between China and the IMF since 1980.

Chapter 3 implements the socialization theoretical framework in analyzing the relationship between China and the IMF, combined with an extensive investigation of the interactions between the two in the selected crucial IMF programs. It firstly assesses the historical and institutional contexts of the early engagement between China and the IMF, and whether they fulfill the two themes introduced in Chapter 2. Then, it examines
whether mimicking, social influence, and persuasion took place in three major interactions between China and the IMF: financial assistance, technical assistance, and surveillance and policy advice. The limitations of socialization theory are further specified in the context of China-IMF interactions, which led to the need for a supplementary theoretical framework.

Chapter 4 introduces principal-agent theory in IR studies. It starts from reviewing the most crucial concept and causal relations in the theory: delegation and reasons for delegation. It also illustrates the features of the main actors in the theory: principal, agent and third party actors, including their preferences and institutional structures. Based on the basic features of principal-agent theory, an analytical approach is proposed to analyze the relationships between states (as principals) and international organizations (as agents). Finally being emphasized in the chapter are 6 distinguishing characteristics in the China-IMF relationship, illustrating the originality of applying principal-agent theory in analyzing the relationship between China and the IMF.

The three following chapters apply principal-agent theory in analyzing the relationship between China and the IMF. Chapter 5 explores China’s features as a principal and the IMF’s features as China’s international institution agent. Based on the IMF’s outstanding functions, the chapter explains why China delegates authority to the IMF. According to each reason for delegation, the analysis explores the tasks delegated from China to the IMF.
Chapter 6 explores three important factors that affect China’s delegation to the IMF: China’s principal preferences, which are demonstrated through Chinese representatives’ statements at each year’s IMFC meetings; China’s decision-making power in IMF governance and activities including both formal and informal governance power; and China’s influence through IMF staff. Chapter 7 links together the analyzes of China-IMF interactions conducted in Chapter 3, 5 and 6 and examines the consequences of China’s delegation of multiple tasks to the IMF, and reveals the reasons for ‘agency slack’. It concludes with the IMF’s role in assisting China to achieve its objectives in the international financial economy.

Chapter 8 concludes the thesis and briefly proposes possibilities for further research.
Chapter 2 - Theoretical Approach (I): Socialization

1 Introduction

Socialization is used in IR to describe one of the most important processes of disseminating norms, customs and ideologies in the international political society. It refers to the powerful hegemons and established international institutions with authoritative influence disseminating their norms, customs and ideologies to the new members of the international political society. Via socialization, the hegemons and international institutions hope to lead the new members to accept and internalize the existing norms, customs and ideologies and become their consistent allies or members. (Ikenberry and Kupchan 1990: 289-290) The Socialization approach focuses on the normative impacts of international organizations, reflected in the changes in the states’ principles and norms rather than superficial modifications in the states’ practices.

In this thesis, I intend to explore the relationship between China and the IMF from the period dating back to 1980, when the PRC regained China’s legal IMF membership that was previously held by Taiwan. Both China and the IMF went through a significant transitional period in the 1970s, marked by the switch of the policy focus from its developed to developing country members in the IMF and the leadership transformation and a series of political and economic reforms in China. By the time China was
negotiating with the IMF about the potential membership in the late 1970s, it was getting ready to enter an unfamiliar international economic sphere where the Chinese officials were exposed to new tasks and challenges. It is marked by an economic regime that was established and developed to promote liberal markets and trade and investment activities under minimum administrative controls. It was a regime where the prevailing norms, customs and ideologies started to drift away from China’s communist economic principles. These conditions put China into a situation where it needed to learn the new techniques, practices and ways of thinking to handle international affairs, as well as to push forward the domestic reforms in a liberalization style. This learning process is explicitly explained by the concept of socialization. Hence, I start to examine the relationship between China and the IMF from the very beginning (when China regained IMF membership in 1980) by using the socialization approach, aiming to find out how the IMF has affected China’s domestic economy via various ‘channels of socialization’. As the analysis deepens, it will gradually reveal whether the socialization approach performs as a suitable framework in the long run based on which the China-IMF relationship could be comprehensively assessed.

Before they are applied to the analysis of the China-IMF relationship, the essential concepts and conditions of socialization theory are reviewed and discussed in this chapter in order to provide the readers with a clear image of the socialization theoretical framework. The following two sections examine two crucial aspects of the socialization theoretical framework: conditions in the state-international organization interactions that
fulfill the socialization theoretical framework (in Section 2), and the processes of international organizations socializing states into accepting their norms (in Section 3).

The conditions comprise the international organization’s institutional and normative superiority that enables it to disseminate its norms, and the state’s unfamiliarity with the environment of the new international organization that encourages it to learn. They help define a research scope where processes of socialization can take place and thus where socialization theory can be used to examine the relationships between states and international organizations.

Exploration of the actual process of socialization is the most important part of the socialization approach. Accurate assessment of socialization processes distinguishes the socialization approach from general social constructivist approaches, by bringing in significant empirical evidence to prove the interactions between states and international organizations. As mentioned in the first chapter, several scholars previously adopted socialization theory to analyze the relationship between states (China) and international regimes, yet their works mostly focused on the ex ante conditions of socialization and causes and/or consequences of successful or unsuccessful socialization, while the actual processes of socialization were not accentuated. (Han 2002; Ba 2006; Chin 2012; Acharya 2011; Lynch 2006). However, Alastair Johnston introduced three ‘microprocesses’ of socialization: mimicking, social influence, and persuasion, which in order reveal a sequence of international organization socialization. (Johnston 2008) Mimicking is the simplest process of socialization, since it requires merely ‘doing what
others do’. Social influence refers to the process by which states change their behavior because of the pressure of social reward or punishment. Persuasion indicates the process by which states are ‘persuaded to’ redefine their norms and values toward those of the international organizations’. Johnston analyzed these three microprocesses of the social interaction between the Chinese government and a number of international and regional security organizations. Obviously China’s interaction with the IMF is distinct from those with security organizations, yet the social interaction processes of which are rather similar. Therefore, I will borrow Johnston’s ‘microprocesses’ of socialization to analyze the interaction between China and the IMF. Each of these microprocesses is examined in this chapter; and in the next chapter, they are applied to examine the extent to which socialization takes place between the IMF and China.9

However, the socialization approach suffers a number of limitations that weaken its capability to explain the interactions between some specific states and international organizations. The limitations include difficulties in measuring the consequences of socialization, those in separating normative impacts of IOs from the material ones, interference from the impacts of domestic institutions and other international institutions rather than the targeted ones during research, and the incorrect assumption of states as simple norm takers. These limitations may prevent the socialization approach from accurately explaining the interactions between China and the IMF in the long run, and they will be assessed in the next chapter. In this chapter, we focus on socialization theory

9 It also reveals whether or not the socialization approach can accurately and comprehensively analyze the relationship between China and the IMF.
itself, and how it interprets the relationships between influential international organizations and their relatively inexperienced state members.

2 Socialization Approach and Relationships Between States and International Organizations

‘Socialization’ is a central concept in social constructivism. Based on the general social constructivist analysis of the normative structures of institutions, ‘socialization’ further emphasizes the processes by which norms are transmitted to, and internalized by the agents of the institutions. In the studies of international organizations, ‘socialization’ is used to explain the process by which social interactions between the staff and participants of the international organizations lead the participants to endorse the organizations’ predominated norms. The participants vary among different international organizations; and they include individuals, corporations, public sector agencies, state governments, and other regional and international institutions. Before the study of ‘socialization’ was developed in the International Relations field, it was applied in a broad range of social science studies.

In Berger and Luckmann’s 1966 work on Sociology, they defined socialization as ‘the comprehensive and consistent induction of an individual into the objective world of a society or sector of it.’ Based on this definition, they emphasized that socialization is

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10 ‘Agents’ refer to the actors who participate in the international institutions including state governments and other governmental and non-governmental entities. They are different from the ‘agents’ in principal-agent theory that will be discussed in later chapters, which specifically refer to international organizations.
aimed at creating membership in a society where the inter-subjective understandings of the society become ‘objective facticity’ that is taken for granted. (Berger and Luckmann 1966: 44, 129) In Lindzey and Aronson’s book about Social Psychology (Lindzey and Aronson 1985), Stryker and Statham defined socialization as ‘the generic term used to refer to the process by which the newcomers- for example, the infant, rookie, and trainee - become incorporated into organized patterns of interaction.’ (Stryker and Statham 1985:325) These works particularly emphasized the characteristics of the ‘newcomers’ who were unfamiliar with the existing rules.

Political scientists accepted the basic definition of socialization and further refined it in various contexts. Ichilov described political socialization as ‘the universal processes of induction into any type of regime.’ (Ichilov 1990:1) Beck and Jennings refer to political socialization as a process by which adolescents acquire political orientations from their families and from major socio-political forces and events in formative periods (Beck and Jennings 1991: 743) IR theorists also adopted the concept of socialization to explain the internalization of international norms and values. Ikenberry and Kupchan pointed out ‘hegemons’ in the international political society, together with their norms and values, accelerate proliferation of international norms and emergence of international regimes. They defined socialization as the process of ‘learning in which norms and ideas are transmitted by one party to another,’ by which states ‘internalize the norms and value orientations espoused by the hegemon and, as a consequence, become socialized into the community formed by the hegemon and other nations accepting its leadership position.’ (Ikenberry and Kupchan 1990: 289-290) Acharya added that socialization should be
pacific and non-coercive; and it should lead to long-term and stable changes in behavior rather short-term adaptation. (Acharya 2011: 8-9)

2.1 Conditions of Socialization

In the studies of international organizations, socialization explains the relationships between international organizations and their participants, especially the newly joined members and organizations’ policy targeting members. Two specific characteristics of such relationships enable the application of socialization approach in analyzing international organizations.

International Organizations with Prevailing Norms

First of all, international organizations have unique founding principles and goals. These principles and goals are initially determined by the founding members of the international organization- either a single superpower state (the US in most of the cases) or the superpower state together with its allies. In the latter case, the founders usually believe in the same norms and values that guide the international organization’s founding principles and goals from the beginning; if they initially have dissimilar beliefs, their beliefs converge via negotiations at the preliminary stage of the establishment of the organization. The evolving principles and goals of the international organization contribute to the international norms of the related field. For example, the international human rights organizations, such as UN Human Rights Commission and UN Convention Against Torture, call for recognition and respect of the inherent dignity, equal rights and
fundamental freedom of all humans. The international economic organizations such as the IMF, World Bank, and WTO promote international neoliberal economic norms that are based on free trade and investment without political interference. Meanwhile, under the guidance of these principles and goals, the management team gradually develop their working rules, mechanisms, and environments into an ‘organizational culture’, which becomes a part of the international norms.

International norms are diffused in the international political society via various channels, among which the social interactions between international organizations and their participating members are the most direct and effective ones. Intergovernmental organizations require their potential member states to agree to accept the organizational rules prior to accession and to follow the organizational regulations afterwards. The enlarging international membership of the organization further consolidates its legitimacy, authority and the prevailing international norms. Pro-norm behaviour is usually deeply internalized to the point where it becomes automatic, unquestioned, and taken for granted. Anti-norm behaviour may incur severe punishment from the international organization, and cost member states a degraded international reputation, and in the worst case, isolation and exclusion from international society. Therefore, most member states would choose to comply with the regulations of the international organizations once joined.

With their influence, international organizations facilitate the creation and diffusion of international norms. International organizations socialize states into accepting the
international norms via various mechanisms. Robert Keohane hypothesized that participation in international organizations leads states to change their interests in terms that correspond with treaty norms. (Keohane 1998: 470) According to Finnemore, international organizations teach values and construct domestic institutions and procedures inside states that reflect existing and emerging international norms and practices. States then are expected to adhere to these norms and practices even when these seem inconsistent with their material welfare or security interests at the time.\(^{11}\) (Finnemore 1996) Abram and Antonia Chayes explored the ‘great contributions’ made by international organizations to the socialization of participating states. They argued that international organizations and their treaties not only ensure transparency, cut transaction costs, build capacity, and enhance dispute settlement, but also persuade states to “explore, redefine and sometimes discover” their own, and mutual interests. (Chayes and Chayes 1995: 1-33) Ann Kent further extended the role of international organizations to subjecting states to a process of interaction and mutual pressure for consensus that helps regulate their conduct. By doing so, international organizations could lead states to redefine their actual interests, renegotiate sovereignty and accept costs of participation. (Kent 2002: 343) Due to the different functions of international organizations, interactions between international organizations and member states take place in various forms. Consequently, international norms are internalized by the states to different degrees.

\(^{11}\) However, I do not intend to assume that pro-normative behaviour prevail without exogenous incentive (or disincentive), especially when the member states have clear intentions and goals. While emphasizing the role of institutional ‘socialization’ in influencing and changing state domestic policy-making, I do not exclude the impacts of other domestic and international actors.
New State Members

Secondly, international organizations often have new members joining them. The new members are usually states that were previously ‘outsiders’ of the relevant international system. They maintained political principles and policy practices that were different from the ones advocated by the international organizations in the relevant fields. The new members were initially unfamiliar with the rules and regulations of the international organizations before joining them. In order to maintain the current international order, international organizations approach potential member states, aiming to include them into the normative ‘inner circle’, or at least the effective policy range.

Although the new members had different political principles and policy practices before joining, they are neither completely ignorant nor heavily opposed to the international norms advocated by the international organizations. New members are very rarely forced to join the international organizations; in fact, they sometimes, although not always, take the initiative to approach the international organizations. They usually have done some research about the international organizations that they would potentially engage with, and developed a considerable amount of knowledge about the organizations’ principles and goals. Their decisions to engage with international organizations are based on the basic understanding of the international norms; while their own political principles and goals must have converged with those of the international organizations to a certain, at least minimum level, before joining. Such convergence is established upon the appreciation of both material and non-material benefits of the memberships of
international organizations. The level of convergence increases during the initial contacts and membership negotiations between states and international organizations, which eventually leads to successful joining.

Once the new members have joined, international organizations start to socialize them into accepting the international norms via various interactive mechanisms designed by the organizations. (Acharya 2011) Mechanisms vary among different international organization-state interactions; and the degree to which international norms are internalized by the states depends on the effectiveness of the interactive mechanisms and the states’ willingness and capability to approve and implement the norms. States may fully approve the norms that were previously alien to them and implement them in domestic and foreign policy practices; or they may hold doubts about the norms yet still implement them in domestic and foreign policy practices. In both cases, socialization is proved to have taken place successfully. On the other hand, if states refuse to approve and implement the international norms in policy practices, socialization has failed. However, one circumstance could make the assessment of socialization difficult: when the state agrees on the correctness of the international norms yet fails to implement them in policy practices. In this case, the state government is often constrained by other, usually domestic political concerns that are regarded more important than obeying the international norms. Hence even if the state admits the general correctness of the

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12 Classic studies of socialization think pro-social norm behaviour under the impact of material incentive (dis-incentive) should be strictly separated from that under the impact of socialization. However, in practice, it is usually difficult to separate the impacts in this way. (Johnston 2008: 22)

13 This happens because the states learned that the international norms are approved by the majority of the international system; and failing to apply them to policy practices would incur severe punishment from international organizations and/or their dominant members.
international advice, as long as implementing it violates the interests of powerful domestic political actors, the international norms cannot be adopted internally.

3 Processes of Socialization

Several scholars have discussed the processes of socialization in different contexts. Beck and Jennings discussed three socialization processes whereby adolescents acquire the political orientations of their parents: parents provide social identities that bring with them political interests; power and affect relationships establish certain communication patterns in the family such that parents influence the political personalities of adolescents; or the political features of parents are transmitted through a process of inheritance or mimicking (Beck and Jennings 1991: 744). Ikenberry and Kupchan argued that socialization between the hegemonic power and secondary states can occur through three mechanisms: 1, *internal construction*, taking place as exogenous influences lead to elite transformation in a state; 2, *external inducement*, taking place as external material inducements lead to the internalization of norms that were once adopted for instrumental reasons; and 3, *normative persuasion*, or transnational learning through direct inter-elitue contact. (Ikenberry and Kupchan 1990: 290-292)

Alastair Johnston discussed three processes of socialization to explain why and how member states of international organizations change their behaviour in pro-normative or pro-social ways: mimicking, social influence, and persuasion. He argued that the speed, uniformity, and effectiveness of norm diffusion depend on what kind of institutional
social environment leads to what kind of ‘socialization microprocess.’ (Johnston 2008: 23) He mainly used these three microprocesses to explain how international security organizations—such as UN’s Conference on Disarmament in Geneva, the ARF and associated regional multilateral security dialogues, the Comprehensive Test Ban Treaty, and the anti-personnel landmine regimes—socialized China into accepting their norms. These three microprocesses explicitly illustrated the interactions between important international security organizations and the Chinese state. They could be further applied to explain the socialization process between other international organizations and the Chinese state government.

3.1 Mimicking

Johnston defined mimicking as ‘a microprocess whereby a novice initially copies the behavioural norms of the group in order to navigate through an uncertain environment.’ (Johnston 2008) It is a relatively simple and straightforward process compared to the other two. Via mimicking, pro-group behaviour is merely a function of the desire to survive in a novel social environment. When a novice enters new social environments, especially where the prescriptive norms are unknown or uncertain to the novice, it is natural (and safe) to mimic what others do. By mimicking the novice gradually gets locked into procedures, behaviour, norms, and language characteristic of the social environment, of which the cost of violation becomes increasingly high. To apply such logic in the studies of international organizations, it explains why and how a new member state simply mimics what the organization staff and other member states do when it has just joined an international organization; and later it is gradually locked into the
procedures, models, behavioural norms, and languages of the international organization. The lock-in takes place in three ways.

3.2 Social Influence

Social influence is ‘a microprocess whereby a novice’s behaviour is judged by the in-group and rewarded with back-patting or status markers or punished by opprobrium and status devaluation.’ Rewards include psychological well being, a sense of belonging, a sense of well-being derived from conformity with role expectation, status and so on. Punishments include shaming, shunning, exclusion and demeaning, or dissonance derived from actions inconsistent with role and identity. (Johnston 2008: 24-25) To apply the concept of ‘social influence’ in the studies of international organizations, it refers to a process that embodies positive feedback loops, where approved behaviour leads to back-patting from other member states of the international organization, which reinforces the likelihood of further approved behaviour in the future. (Ferdinand and Wang 2013: 896) However, conformity achieved via social influence is not necessarily accompanied by private acceptance of the rightness of a particular action: Johnston cites with approval Festinger’s phrase about ‘public conformity without private acceptance’. (Johnston 2008: 25) Conformity achieved via social influence is motivated by the member state’s interests in maximization of status and image (through the accumulation of back-patting benefits) in the international organization and the wider international political society. Pro-social behaviour motivated by status maximization reflects the member state’s egoistic pursuit of social rewards and avoidance of social sanction. (Baston 1987: 35) However, it does not mean the member state is ignorant of the value and meaning of the
norms being placed on the social status; the understanding of such norms is shared- yet to different levels- by both the international organization and the member state.

Different institutional designs of international organizations lead to differences in the likelihood and degree of social influence. Johnston expanded Rogowski’s research of domestic institutions, and suggested four conditions for effective back-patting and opprobrium in the microprocess of social influence. (Johnston 2008: 94) To apply the conditions to the social environments of international organizations: (1) larger international organization memberships usually enable maximized accumulation of back-patting/shaming markers, and therefore generate effective social influence. (2) International organization decision rules are majoritarian or where reasons for supporting or opposing consensus are on record, as the consistency effects are stronger in this case. (3) The mandate is negotiation. (4) Member states have low autonomy, since persuasion effects are less likely to work in this case, and they are more likely to transmit the back-patting and opprobrium messages directly back to the international organization.

In addition, effectiveness of social influence also depends on the political traits of the member state. Effective social influence usually happens when the member state cares about their status in the international organizations and the international political society; and when the related domestic political institutions and/or policymakers have homogenous political preferences toward the state government’s international reputation. On the other hand, if the member state, or the majority of its powerful domestic policy-
making institutions do not care about the state’s international reputation, effective social influence is unlikely to function.

3.3 Persuasion

Persuasion is ‘a microprocess whereby novices are convinced through a process of cognition that particular norms, values, and causal understandings are correct and ought to be operative in their own behaviour.’ It refers to a process in which agents are convinced to change minds, opinions, and attitudes about causality and affect in the absence of overtly material or mental coercion. (Johnston 2008: 25-26) Persuasion is regarded as the ultimate political strategy, as it involves ‘mind-controlling’ power. Mutz et al refer persuasion to the core of politics, and the ‘central aim of political interaction’. (Mutz, Sniderman, and Brody 1996:1) Gibson even argued that politics is all about persuasion, as ‘real politics involves arguments; it involves people drawing a conclusion, being exposed to countervailing ideas, changing views, drawing new conclusions’. (Gibson 1998: 821) To apply this concept in the studies of international organizations, it refers to the process by which the member state does not only adopt pro-norm behaviour, but also genuinely agrees with the international norms and implements them in other related policy practices and activities. The member state eventually adopts the international organization’s ideology, identity, culture, values, and norms as its own.

Different institutional designs of international organizations and features of member states lead to differences in the likelihood and degree of persuasion. Besides Johnston, several other scholars discussed the conditions that are conducive to persuasion, which
could be applied in the discussion of international organizations’ socialization of state members. (Johnston 2008: 159-160) (1) The member state is highly cognitively motivated to analyze counter-attitudinal information (for example, a very novel organizational environment). 2. The international organization is highly authoritative and it involves a small, intimate and high-affect membership. 3. The state has few prior ingrained attitudes that are inconsistent with the international norms; and it perceives few threats from the international organization. 4. The member state is relatively autonomous from the international organization. 5. The social environment is less politicized or more insulated from public opinion and pressure. (Johnston 2008; Checkel 2005; Zurn and Checkel 2005)

4 Limitation of Socialization Approach

The socialization framework proves to respond to two essential themes of the relationships between international organizations and their state members: authoritative international organizations create and diffuse international norms among their members via interactive mechanisms; and member states that are initially unfamiliar with the international norms are socialized into accepting such norms via participating in the interactive mechanisms designed by international organizations. The study of socialization processes in the international organizations further enables us to understand how international norms are transmitted to states.
However, the socialization approach reveals merely one, yet not all aspects of the relationships between international organizations and states. The socialization approach suffers some deficiencies that prevent it from generating a comprehensive analysis of the relationships between international organizations and states. Just to give some examples, it simply assumes international organizations are the providers of the international norms, and states are the takers, which underestimates the influence of states in international organizations. It inadequately explains the importance of the states’ preferences and intentions, which underestimates the states’ impact on international organizations. The socialization approach tends to take international norms as given, which overestimates the appropriateness, universality, and adaptability of the norms. Such ‘underestimation’ and ‘overestimation’ indicate there are some aspects of the relationships between international organizations and states that cannot be accurately assessed by the socialization approach. Here, I want to point out four deficiencies in the socialization approach when it is applied in the studies of international organization-state relationships.

First of all, the consequences of socialization are difficult to observe and assess. This is because the socialization approach focuses on the changes in the states’ values and norms, which are mostly concealed and ambiguous. This problem has been brought up many times in the criticism of constructivist theories, yet not solved in the socialization approach. Kent attempted to solve the measurement of international socialization. In her paper ‘China’s International Socialization: the Role of International Organizations’, she proposed three indices to measure the international socialization for China. They are
China’s readiness to redefine its actual interests; China’s preparedness to renegotiate its sovereignty in response to organizational and treaty pressure; and the degree to which China shows a readiness to shoulder the costs, as well as enjoy the benefits, of organizational participation. (Kent 2002: 349-358) However, while leaving the terms such as ‘actual interests’, ‘sovereignty’ and ‘costs/benefits’ undefined, the proposed qualitative measures were too generic and vague to assess the precise normative impact of international organizations. Among Johnston’s three microprocesses of socialization, the consequence of mimicking is relatively obvious to observe, but those of social influence and persuasion are more opaque. It is particularly difficult to assess the consequence of persuasion, because we cannot easily tell if the state has adopted the international organization’s values and norms as its own. One way to do it is to investigate if the state’s participation in all the other related activities reflects the same values and norms, which is practically difficult.

Secondly, the socialization approach focuses on the international organizations’ nonmaterial impacts on the states including the changes in their political principles, values, and norms that are reflected in the later practices. In practice, it is highly unrealistic to separate nonmaterial from material impacts on the states’ policy practices, especially in the cases of international economic organization programs, where some member states receive continuous financial assistance. Take the IMF as an example, it provides the member states that have balance of payments difficulties with loans. These loans are attached with conditionality, which require the loan beneficiaries to carry out domestic political and economic reforms under the guidance of economic liberalization in
order to secure the succeeding issuance of loans. The socialization theorists argue that the international neoliberal economic norms are transmitted to the member states via IMF lending conditionality. I agree with this incremental process of norm transmission; however, I want to point out that material incentive, that is the financial benefit, is the primary motivation for the state’s engagement in IMF lending mechanisms. The norm transmission process would likely be cut off if the state found a lending source that is more tolerant toward its domestic political environment. Therefore, in some, if not the most cases, the nonmaterial impacts are built upon the material impacts.

Thirdly, international organization socialization is not the only- may not even be the primary- influence of the changes in the member states’ political principles, interest, values and norms. The consequences of international organization socialization are often reflected through the state’s institutional changes and policy practices. However, we cannot easily judge if a certain domestic change is due to the socialization of a specific international organization that the state participates in, because the state’s institutional changes and policy practices respond to various internal and external factors.

Internally, policy-making in one area could be influenced by several different individuals and governmental departments. Therefore if the individual/department that collaborates with one specific international organization has less influence in the domestic political system than those who hold opposite preferences\textsuperscript{14}, the international organization may fail to convince the state to make policy decisions in a way that is preferred by the organization. In this case, although the international organizations may have socialized

\textsuperscript{14} They may, or may not, be influenced by the socialization of other international organizations.
their correspondent individual/department in the state into accepting its advocated norms, it likely fail to have effective influences on the state’s final policy decisions. Therefore international organization socialization may have mixed and complex impacts on the states.

Externally, one state could be a member of several international organizations that maintain different norms. Although these international organizations may not have fundamentally contrasted norms, they could sometimes become competitors, for example, the international development banks/funds versus regional development banks/funds. In this case, the impacts of socialization by different international organizations vary according to the exogenous environment. For example, many countries in the Asian region are not closely tied up with the IMF especially because of the disastrous Asian financial crisis and the lame IMF rescue plan, thus their participation in Asian financial cooperative institutions has diverted them away from IMF socialization. In this case, their inactive engagement with IMF programs is caused not only by doomed unsuccessful socialization, but also by their participation in regional financial integration as a substitute solution. In addition, the state’s institutional changes and policy practices may also be influenced by bilateral interactions with other states, the general political environment, the market (in the cases of economic issues), and so on, which would also lead the state to redefine their norms; or simply by some unexpected factors, which does not usually lead to norm redefinition.
Fourthly, the socialization approach simply assumes the international organizations are the providers of the international norms, and states are the takers. It works in the short and medium terms, but not in the long term. According to the studies of socialization processes, the new member state joins the international organization without having comprehensive knowledge of the organization’s rules and regulations in practice; therefore it just follows the organization’s instructions step by step. It may copy the behaviour of the international organization and other members, simply because ‘this is what everyone else does’. The first-step practice is explained by the microprocess ‘mimicking’ by Johnston. It may also do what as it is told to in order to gain approvals and avoid punishments from the authoritative international organization and other members in the system. This is explained by the microprocess ‘social influence’. Later on, further participation in the international organization may lead the state to redefine its interests toward the norms that are advocated by the organization. It is described as ‘persuasion’. All these microprocesses focus on whether the state accepts, or does not accept, the norms from the international organization.

In the short and medium terms, the socialization approach explains the social interactions between the international organization and the new member state, and their consequences, because the state is unfamiliar with the organizational environment and thus more easily to be influenced by the international organization. Nevertheless, even in the short and medium term, it underestimates (or ignores) the member state’s intentions and preferences that drove them to engage with the international organization. Member states are not simple norm takers in many cases, especially when they have relatively
strong influences in the international political society, because in this case they would be able to promote their own norms in the international community. Moreover, states are not simple norm takers when they have explicit goals to achieve via participating in international organizations, because in this case their determined goals will guide them through the interactions. Last but not least, states are not simple norm takers when they have uncompromising political interests and values, because in this case international organizations are less capable of convincing states to redefine their interests and values.

In the longer run, it is even less likely that these member states would be easily convinced to accept and implement international norms. Acharya argued that socialization should lead to long-term and stable change instead of short-term adaption (Acharya 2011: 9); therefore it is doubtful if the socialization approach could be applied to fully explain the relationships between international organizations and their member states in the long run. In particular, for the following reasons:

(1) As the member state gets more familiar with the organizational environment, it develops specific strategies to handle the international organization, and hence not just does what it is told to. Such strategies include a better assessment of the cost/benefit of cooperating with the organization, alignment with other members who hold similar preferences, and a better use of the voices in the organization’s decision-making committee. On the other hand, rather than being socialized into accepting the international organization’s norms, the state’s participation in the international
organization may lead the organization to redefine some parts of its own interests and values.

(2) When a state develops its strength in various aspects, its status and controlling power in the international political society increases. As a result, it is less subjected to the threats of punishment from the international organization and other states in the international political society. It may also gradually develop other options rather than participating in the international organization, either by engaging with other international and/or regional organizations, or by bilateral cooperation, or even by taking the domestic/unilateral approach.

(3) Norms of an international organization are not static. They may grow to universal norms; and in this case, it is difficult to tell if the later changes in the state are due to the socialization from the international organization or the general environment. They may also fall behind the development of the political environment and become unsuitable for guiding states’ policy practices over time; and in this case, it is not appropriate for the international organization to continue to socialize its member states into accepting its norms.
5 Conclusion: Using Socialization Approach to Analyze the China-IMF Relationship

The socialization approach has been used to assess the relationships between international organizations and China. It was mentioned briefly earlier that Alastair Johnston explored three ‘microprocesses’ of socialization—mimicking, social influence and persuasion—and examined how these microprocesses illustrate China’s participation in a selection of international/regional security institutions.

He discovered that the Chinese diplomats’ participation in some of the first major international arms control institutions, such as the Conference on Disarmament, led China to adopt certain habits, language, and even organizational models of arms controllers in these institutions. He argued that the Chinese government realized that it needed to adopt some of the common forms of participation (in these institutions) before it developed a specific security ‘interest’ and further purposeful participation in the international security regime. China’s participation thus reflects Johnston’s proposition of ‘mimicking’ process of socialization.

Moreover, he found out that when China signed the Comprehensive Nuclear-Test-Ban Treaty and Protocol II of the Conventional Weapons Convention, it was not induced by material (dis)-incentives. He reckoned the Chinese leadership weighed heavily the benefit from minimizing opprobrium costs by making these agreements. It thus proved Johnston’s proposition of ‘social influence’ microprocess.
In addition, Johnston argued that the participation of Chinese diplomats, scholars and analysts in the ARF and related Track II security dialogues helped create a constituency of protomultilateralists who internalized a view of security that placed less stress on unilateral security and more on cooperative security strategies. It consequently proved the ‘persuasion’ microprocess. Finally, he came to the conclusion that ‘there is considerable, if subtle, evidence of the socialization of Chinese diplomats, strategists, and analysts in certain counter-realpolitik norms and practices as a result of participation in these institutions’. (Johnston 2008: xiv)

Kent also used the case studies of China’s interaction with many international and regional organizations to test the consequences of socialization. She used the examples of China’s participation in the Conference on Disarmament, the International Labour Organization (ILO) and the United Nations Environment Programme (UNEP) to explain some moderate changes in the related domestic practices. She further described China’s participation in some international organizational activities, such as supporting the deployment of the International Force in East Timor, cooperating with the ASEAN in drafting a Regional Code of Conduct in the South China Sea, joining several human rights organizations and ratifying treaties, and removing a large degree of state control over domestic economic activities in order to meet WTO entrance requirement. These examples proved that the Chinese government was prepared to renegotiate the boundaries of its sovereignty. In addition, she also used the examples of China’s acceptance of costs in its interaction with the Conference on Disarmament and in its negotiations to join the
WTO. These facts proved three consequences of international organization socialization: redefinition of interests, renegotiation of sovereignty, and acceptance of costs. (Kent 2002)

The socialization framework proves to be a valid approach to analyzing the relationship between international organizations and China. The communist Chinese government has gradually joined an increasing number of international organizations since the 1970s, mainly due to regime and leadership reforms in the domestic political system. Up till then, China had been isolated from the international political society for decades. Therefore, when China joined the international organizations— that were mostly dominated by the western developed countries— it was unfamiliar with the environment and policy practices of most of these international organizations. It created a possible condition for the international organizations to teach the policy practices and related implementation methods and techniques to the new member China. There were some doubts in mainstream western society then worrying that China’s communist propositions and values might ‘pollute’ western norms in these international organizations. The international organizations themselves were also quite wary about this problem, and therefore they often cautiously ran their programs with China to make sure China would follow their regulations and rules. They also consciously included China into their activities, hoping the involved Chinese representative officials would gradually accept the international norms and pass them to their authorities, so that the Chinese government would eventually implement these norms in the domestic policy practices. This process is defined as ‘socialization’ according to the theoretical framework analyzed in this chapter.
China’s relationship with the IMF, especially the early engagement, falls into this category. Hence, I intend to explore the China-IMF relationship in the socialization theoretical framework. I shall firstly look into the context of China’s engagement with the IMF and see if it fulfills the two themes of the conditions for the socialization approach: 1. Based upon their authoritative influence, international organizations legitimately seek to diffuse international norms via various interactive mechanisms with participating members. 2. States with the political principles and policy practices that are different from those of international organizations’ join international organizations because of material and nonmaterial (dis)-incentives; and later they are socialized into accepting international norms via various interactive mechanisms with international organizations.

I will then investigate the interactions between China and the IMF, mainly focusing on IMF financial and technical assistance, and policy advice for China. Via these interactivities, I intend to find out whether, and how, the three microprocesses (borrowed from Johnston)- mimicking, social influence, and persuasion- have evolved. This investigation is based on a considerable amount of empirical materials from IMF and Chinese government documents. Various case studies of IMF programs, such as IMF Statistics Department trainings for Chinese officials and IMF Article IV Consultation for China, will be discussed in order to examine the processes of socialization.

Finally, the analysis of the relationship between China and the IMF with socialization approach may reflect some of the limitations of the socialization theoretical framework.
To recall such limitations, the consequences of socialization are difficult to observe and assess; it is difficult to separate the international organization’s non-material and material impacts; international organizations may not be the primary cause of changes in the states’ political principles, interest, values and norms; and the socialization approach simply assumes international organizations are the providers of norms, and that states are the takers, which is a less valid assumption in the long run. Based on these limitations, I will assess the extent to which the socialization theoretical framework explains the relationship between the IMF and China.
Chapter 3 - China joins the IMF: Socialization or Else

1 Introduction

China regained its IMF membership in April 1980. Initial contacts between IMF staff and China’s central government officials started in 1973. The preparation for China’s access to IMF membership developed in the second half of the 1970s; and before that China was resistant to the idea of joining the international organizations that were led by the western capitalist states. The whole decade between 1970 and 1980 was crucial for both the IMF and China. Triggered by the Nixon administration’s decision of unpegging the US dollar from gold in 1971 and the following transformations in the international monetary regime, the IMF’s role dropped significantly among western economies. The Fund later switched the focus of its lending mechanisms from the western developed country members to the developing country members in the rest of the world. During the same period of time, China experienced the first major change of central leaders since 1949 due to Mao’s death in 1976; and the new leaders initiated a whole series of domestic economic and political reforms. The reformist leadership initially focused state policies on economic development in the post-Mao era, later as they accumulated more experience and administrative skills, they were determined to transform China’s economy from a centrally planned regime to a free market-based one. Since then, China’s long-closed border has been gradually opened up to the world economy.
The context of China regaining IMF membership and the general international political environment in the 1970s and 1980s satisfy the conditions for international ‘socialization’ to take place. In the case of China joining the IMF, the IMF saw the possibility of enlarging its influence by including China in its programs, such as financial and technical assistances and policy advising. Via these programs, the IMF could guide China to adopt the technical approaches and policy practices that meet the international standard, and to eventually accept the neoliberal economic norms and internalize them in its domestic policy-making. On the other hand, China carried out a series of dramatic domestic policy changes in the 1970s, including eliminating the Cultural Revolution leadership, pushing forward liberalizing domestic reform, ending decades of isolation and self-reliance, and legitimizing the concept of economic interdependence. China was motivated to join international economic organizations in order to get international resources for its domestic economic development, as well as to improve its international image and reputation.

Both the IMF and China conceived potential benefits for cooperation with each other. This convergence of preference for international cooperation created a favourable context for the IMF to ‘engage China’. Pearson used the word ‘engage’ to explain how the major international economic organizations brought China into the core of international economic society and encouraged it to play by the ‘rules of the game’. (Pearson 1999: 207-234) The concept of ‘engagement’ is similar to what ‘socialization’ indicates; yet the latter implies more hierarchical relationship between international organizations and
China. Socialization also puts more emphasis on the normative impact of international organizations: how and to what extent international organizations transfer the international norms to states and whether these states internalize the norms. In other words, participating in IMF programs would possibly lead China to change its political interests and adopt the political principles and policy practices that were fundamentally different from the communist orientations yet consistent with neo-liberal international economic norms.

Based on such contexts, this chapter uses the socialization approach to analyze the interactions between China and the IMF. It investigates three main IMF programs that China participates in: financial assistance, technical assistance, and surveillance and policy advice. These interactive programs can be regarded as mechanisms of IMF socialization, via which the Fund’s neo-liberal economic norms are transferred to China. China has never been a major borrower of the IMF, yet it has become one of the Fund’s largest technical assistance receivers. IMF technical assistance takes various forms including training courses in IMF institutes, IMF experts’ and lecturers’ visits in China, and periodical posts in IMF headquarters for the Chinese officials sent by the state’s financial institutions. IMF technical assistance programs provided China with significant information in formatting and processing financial data and policies with internationally formalized methods. IMF surveillance and policy advice for China is mostly carried out via the Fund’s annual Article IV Consultation. This has tackled some critical issues in China’s financial economy, such as the measures of the exchange rate of RMB, the
problem of under-valued RMB, lack of transparency in China’s financial management, the urge for more fundamental reforms in China’s financial system, and so on.

Through investigation of the interactions between Chinese officials and IMF staff in the activities of financial assistance, technical assistance and surveillance and policy advice, the research intends to find out whether or not the processes of socialization, that is mimicking, social influence, and/or persuasion, took place and the extent to which they were accomplished. Frequency and depth of socialization between China and the IMF indicates the effectiveness of socialization theory as an approach to the China-IMF relationship. If socialization is proved to have increasingly and continuously taken place via IMF programs for China in the long run, it means socialization theory can effectively explain the relationship between China and the IMF. If socialization between China and the IMF is limited by some permanent obstacles, it means socialization theory as an analytical approach may lose its explanatory power in the long run.

The research result shows that the sequence of socialization processes has not been accomplished due to some fundamental elements in China’s and the IMF’s political and institutional factors that may stay unchanged in the long run. Hence, while admitting that socialization theory explains China’s relationship with the IMF in the early stage, I also argue that socialization theory cannot support the analysis of the China-IMF interaction in the long run. The investigation of China-IMF interaction in this chapter reflects the limitations of the socialization approach in analyzing the China-IMF relationship that corresponds to the last part of the previous chapter. It specifically points out that the
socialization approach pays little attention to China’s initiatives and intentions in participating in IMF programs, and thus overlooks China’s objectives in the governance of international political economy. It also overestimates the accountability of the neoliberal economic norms and ignores the fact that China may actually want to participate in the international financial economy in a different way. The chapter finally calls for a supplementary theoretical approach that better reflects China’s objectives and the relationship between China and the IMF in the later years: principal-agent theory.

2 Initial Contact and Engagement

The context of the international political economy and China’s domestic political changes largely stimulated the early engagement between China and the IMF. They also help us understand how the China-IMF interactions fulfill the conditions for IMF socialization.

2.1 The IMF

The IMF was established in 1944, together with the World Bank, comprising the functioning institutions of the Bretton Woods System. It was founded under the initiative of the US and UK, aiming to bring back international economic order after World War II. The Fund’s original purpose was to promote institutionalized international monetary cooperation, to facilitate growth of fair international trade, to maintain exchange rate stability, to assist in the establishment of a free multilateral payment system with no foreign exchange restrictions, and to assist the member states with balance of payment
difficulties (IMF Article I, Section iii of IMF’s Articles of Agreement). In the first two decades after its establishment, and together with other international economic organizations such as the World Bank and the General Agreement on Tariffs and Trade (GATT), the IMF was mainly involved in policy-making and practices of the countries with market economies. The IMF’s influence in the international financial economy reached its highest level in the late 1950s and throughout the 1960s, during which period the Fund made a large amount of loans to both developed and developing countries to help them resolve balance of payments difficulties. This situation started to change in the late 1960s when some of the Eastern European countries with communist governments entered the major international economic organizations.

The IMF’s role further changed in the 1970s. The US went off the gold standard in 1971 and the fixed exchange system collapsed. (Gowa 1983) Since then, the values of the major economies’ currencies have been mainly determined by market forces, with a limited degree of government intervention in order to prevent abrupt fluctuations. The IMF thus changed its policy focus from regulating currency to managing balance of payments difficulties; and it also become more involved in borrower countries’ domestic policies via conditionality attached to its loans. (Vreeland 2003) The borrower countries were mostly in developing areas.

2.2 China

In the 1950s and 1960s, China was mostly isolated from the outside, especially the western world. In the 1970s, the Chinese government leaders started to gradually open
the country to the world, although with a high level of wariness and cautiousness. The limited opening started from improving diplomatic relations with international organizations and foreign governments, marked by regaining the seat in the United Nations in 1971, and restoring diplomatic relations with the US and Japan in 1972. The diplomatic opening was followed by gradually increasing economic and intellectual exchanges with foreign countries, which paved the way for China’s entry into the international economic sphere. After suffering decades of wars and isolation, China had been left far behind in terms of capital, technology, expertise and other resources that were needed for economic reforms. Therefore, in the 1970s, China became more and more eager for international capital and expertise to facilitate its reforms, and sought acceptance and general approval from other members of the international community.

Deng Xiaoping and his allies, who later became the key reformist leaders of the Chinese government in the post-Mao era, perceived some serious structural problems in China’s economic development in the 1970s. However, as his relatively liberal economic views were in contrast with the radical political environment in the 1970s, he was demoted several times and he didn’t have the opportunity to promote economic liberalization till 1978, two years after Mao’s death and elimination of political radicals. (Naughton 2007; Lin at al. 1996) Deng and his allies were determined to set economic growth as the priority goal and sought to solve China’s problems in a more liberal fashion. The remarkable reforms initiated during the Third Plenary Session included introduction of a market economy through the personal responsibility system, radical reforms in the agricultural sector, and expansion of international trade and foreign exchange earnings.
The Third Plenary Session also significantly shifted China’s trade policy from autarky to a more outwardly oriented one. (IBRD 1988: 1-6) Many principles formulated at the Third Plenary Session have since guided the Chinese government through further economic liberalization and opening in the following years.

China was standing at a critical crossroads at the end of the 1970s. The reformist leaders deeply believed that the domestic reforms in an economic liberalization fashion would boost China’s economy and fundamentally improve citizens’ welfare and the state’s strength. They were determined to end China’s isolation and let China join the world. Yet they understood it was not easy to convince skeptical conservative officials to accept the idea of economic interdependence.

2.3 Initial Contact and Engagement\textsuperscript{15}

Triggered by its UN membership, the Chinese government became more familiar with, as well as more approved by, the international economic organizations in the early 1970s. In 1972, a United Nations Small Group (UNSG) was established within the Bank of China to assess membership in all UN financial agencies, including the World Bank and the IMF. The UNSG was following developments in the World Bank and the IMF closely and submitting its reports to the top leaders, yet with highly cautious and reserved views due to the intense domestic political complexion.

\footnotetext[15]{Jacobson and Oksenberg’s (1990) book included some good details of China’s early engagement with the IMF, and I will show some in this section.}
The World Bank President at the time - Robert McNamara - thought the World Bank needed China’s participation to enhance the Bank’s legitimacy and increase its resources. Therefore, McNamara took the first move in 1973 to invite China to join the Bank. The Chinese authorities rejected McNamara’s first invitation because they thought the Bretton Woods institutions could not bring China opportunities to further its foreign policy objectives, and that IMF Articles of Agreement were contradictory to the socialist monetary system. China particularly did not want the restrictions on the determination of its foreign exchange rate and control over the administration of its foreign exchange imposed by the IMF. (Jacobson and Oksenberg 1990: 60-65) In addition, China’s strict ‘self-reliance’ policy would not approve any external borrowing at the time, so it was not worth paying the quota without borrowing from the IMF.

However, in order to protect its economic benefits from IMF gold sale in 1976 from being taken away by the Taiwanese government (which was registered as the legal member that represented ‘China’), the Chinese government eventually took the first step toward the IMF. (De Viries 1985: 31-34) The president of the People’s Bank of China sent a telegraph to the IMF on this note, claiming that all properties and rights in the IMF belonged to the Chinese people and that the representatives of Taiwan should be expelled from the Fund. (Jacobson and Oksenberg 1990: 65) Zhang Zhixiang, a former Chinese IMF executive director recalled China’s premier Zhou Enlai who was also the foreign minister at the time phoned the IMF to claim the PRC should be only legal member that represents China. (Zhang 2010) Since then, the question of China’s resumption of membership in the IMF and the World Bank had been put on the State Council’s agenda.
In January 1979, the PBC together with the Ministry of Finance, and the Ministry of Foreign Affairs sent a report to the State Council, containing the results of the USNG’s and other specialists’ observation of major international economic institutions. The report showed the conditions in the international political environment were conducive to China’s accession to the IMF and the World Bank, including the Taiwan complexion and the attitude of the US and Third World countries toward China. The report also stated the benefits of joining the IMF and the World Bank, including entailing withdrawal or expulsion of Taiwan, enhancing China’s bilateral relations with many foreign countries, yielding China more information about the international financial economy that was needed in its domestic development programs, and of course China’s access to IMF and World Bank loans. Meanwhile, the Chinese leaders were also aware of the costs of joining the IMF and the World Bank, including submission of highly confidential data, dealing with the Fund’s and the Bank’s frequent missions to China, and the financial contribution to meet its quota in the Fund and subscription in the Bank.

Informal contacts and visits between China and the IMF and the World Bank started in 1979 and 1980, which significantly contributed to China’s eventual accession to both institutions. Meanwhile, the IMF, the World Bank and China all had started to undertake the final preparation for China’s accession. In March 1980, the IMF sent to China a delegation to negotiate on China’s IMF membership. The negotiation was a great success. During two weeks of intense mission, the delegation generated a document of agreements that referred to a few official arrangements regarding China’s IMF membership. (Ibid:
On April 17, 1980, less than two weeks after the delegation’s return, the IMF Executive Board made a decision that the People’s Republic would represent China in the Fund. The decision was followed by further negotiations about China’s quota and the disposition of the gold reserve.

China settled with the ninth largest IMF quota 1.2 billion when it joined, which was increased to SDR 1.8 billion by the end of the year. China also became a single constituency of the IMF; therefore the size of the executive board expanded from 21 to 22. The Chinese government sent its first board governor to the IMF, the president of the People’s Bank of China Li Baohua, and Zhang Zicun became China’s first executive director in the IMF. Similar appointments were also made for the World Bank. With these appointments, the Chinese government began to set up its internal bureaucratic counterparts for the IMF and World Bank. (Zhang 2010)

2.4 Context for Socialization

Understanding the historical, political, and institutional contexts of China regaining IMF membership and the transformations in the international political economy in the 1970s and 1980s enables us to examine if the China-IMF relationship fulfills the conditions for international organization socialization. In this subsection, I am going to assess if the contexts of the establishment of China-IMF relationship satisfied the conditions for IMF socialization to take place. First of all, let us recall the two themes of conditions for international organization socialization:
1. Based upon their authoritative influences, international organizations legitimately seek to diffuse international norms via various interactive mechanisms with participating members.

2. States with political principles and policy practices that are different from those of international organizations join international organizations because of material and nonmaterial (dis)incentives; and later they are socialized into accepting international norms via various interactive mechanisms with international organizations.

With regard to the first condition, the IMF proved to have the desire to transfer the international neoliberal economic norms to its newly joined members such as China and some other developing countries. The IMF gradually switched policy focuses from its developed to developing country members in the 1970s and 1980s, while more and more developing countries approached and joined the Fund. The enlarging IMF membership—especially by including China in the Fund—further consolidated its legitimacy and authority in international economic governance. However, these new member states included some Eastern European countries, some former communist countries and the countries that were still running communist economic regimes while—and after they had—joined the IMF. These states had maintained very different economic policy practices and political interests and values from those of the IMF and its main western advanced economy state member states.
Take China as an example, it was still running the centrally planned economic regime when it approached the IMF. Although the new leaders initiated some prior domestic reforms in economic liberalization in the late 1970s, the most crucial economic policy decisions, such as distribution of resources, price levels of crucial goods, central banking, and foreign exchange, etc. were controlled by the central communist government. In order to keep the international economic order that was based on the liberal international economy with little restrictions on trade, investment and foreign exchange, the IMF sought to make the new state members learn and accept the international neoliberal economic norms. It would also consolidate the IMF’s role among the developing world by socializing them into accepting the Fund’s prevailing norms.

With regard to the second condition, China was eager for international capital and expertise to support its domestic reforms, as well as to develop its international links and improve its international reputation. After decades of isolation, China was lagging far behind in terms of technology and expertise. The domestic scholars and experts were mostly educated in China or the Soviet Union, and thus their knowledge about building modern economic and social systems was limited within the (Chinese version of) Marxist communist framework. The government leaders with reformist minds realized they should adopt a more liberal development strategy. (Naughton 2007) They also supported the idea of international economic interdependence. Joining international economic organizations was one way to obtain international capital and expertise, as well as to establish the reputation of a friendly member of the international political society. However, the domestic political pressure and the disturbances in the central leadership
throughout the 1970s created some obstacles for China’s access to the IMF. In addition, it was not easy for Chinese government officials and the society in general to accept the ideological switch caused by China’s access to the international economic organizations. After a whole decade of internal research\(^\text{16}\) on the international economic organizations and incremental opening to the outside world, China eventually decided to join the IMF in 1980. By then, China was more familiar with the rules and regulations of the international regime, yet it still lacked substantial experience in dealing with international organizations; and the international neoliberal economic norms pointed toward a complete different direction for China’s economic development from what the communist orientations would lead China to.

The initial engagement was a success, without any major technical disputes or ideological conflicts occurring. The early part of China-IMF interactions that will be included in the analysis of China’s participation in IMF programs in the next section displays a mostly harmonious relationship between the two. Although China was unfamiliar with the rules and regulations of the IMF, it knew what to expect from the membership of an international economic organization that was led by the US and its western advanced economic allies. In fact China was in need of the international capital, expertise and approval that only a legitimate multilateral institution like the IMF was able to provide.

These conditions created a favourable context for ‘socialization’ to take place. To recall the definition of socialization, it refers to the process by which social interactions

\(^{16}\) The research carried out by the UNSG was entirely based on the researchers’ limited knowledge about the international economic organizations.
between the staff and participants of the international organizations lead the participants to endorse the organization’s predominated norms. According to Finnemore, international organizations teach values and construct domestic institutions and procedures inside states that reflect emergent international norms and practices. States then adhere to these norms and practices even when these seem inconsistent with their material welfare or security interests at the time. (Finnemore 1996) Abram and Antonia Chayes argued that international organizations and their treaties not only ensure transparency, cut transaction costs, build capacity, and enhance dispute settlement, but also persuade states to ‘explore, redefine and sometimes discover’ their own, and mutual interests. (Chayes and Chayes 1995: 1-33)

So did China’s participation in IMF programs actually lead it to redefine its interests and values? Did the IMF socialize China into accepting and internalizing the neoliberal economic norms in the later domestic policy practices? Could we use ‘socialization’ to explain the IMF’s impact on China since 1980? The key approach to these questions is to assess the actual processes of socialization, via which the IMF could transfer international norms to China. Therefore, the next section will analyze the IMF programs that China participated in, which are divided into three types: financial assistance, technical assistance, and policy advice. It attempts to find out how and the extent to which the IMF has socialized China into accepting these international norms. Johnston’s framework of three ‘microprocesses of socialization’ will be applied to assess the IMF’s approaches to socialize China, and their consequences.
3 China-IMF Interactions: Did Socialization Happen?

Interactions between the IMF and its member states focus on three main Fund-designed mechanisms: financial assistance, technical assistance, and surveillance and policy advice, which are also the IMF’s three major functions. China has participated in all three mechanisms, although it has participated in the latter two much more frequently. Via these mechanisms, the IMF attempts to diffuse its norms and values to the member states. Johnston’s microprocesses of socialization—mimicking, social influence and persuasion—can be traced in these mechanisms, yet to different degrees. Hence, examination of these interactive mechanisms also enables us to understand whether socialization took place and the extent to which they have affected China’s domestic economy policies.

3.1 Financial Assistance

The financial assistance mechanism aims to provide the member countries having short-term balance of payments difficulties with emergency funds. The mechanism could be divided into three types of lending: the main lending facilities, lending to low-income countries, and debt relief; each of these types of lending includes several different programs. (IMF official website\textsuperscript{17}) The main lending facilities include Stand-By Arrangements (SBA) for emerging market economies, the Flexible Credit Line (FCL) and Precautionary and Liquidity Line (PLL) for countries with very strong policies, the Rapid Financing Instrument (RFI) for countries with urgent balance of payments needs,

\textsuperscript{17} IMF official website, the section about ‘Lending by the IMF’, access via http://www.imf.org/external/about/lending.htm
the Extended Fund Facility for countries whose balance of payments difficulties are related to structural problems, and the Trade Integration Mechanism for countries whose balance of payments difficulties are caused by multilateral trade liberalization. The lending to low-income countries includes the Extended Credit Facility (ECF) for low-income countries (LICs) with protracted balance of payments problems, the Rapid Credit Facility for LICs with urgent balance of payment needs, and the Standby Credit Facility (SCF) for LICs with short-term balance of payments needs. The debt relief program includes the Heavily Indebted Poor Countries (HIPC) and the Multilateral Debt Relief Initiative (MDRI).

Most of the financial assistance programs are attached with conditionality. Conditionality is divided into hard and soft ones. Hard conditionality refers to the measures a borrower country has to meet to access any loans. Soft conditionality refers to the a wider range of other elements that the IMF takes into account in making decisions on completing (or not) the reviews in order to permit the disbursement of each installment of loans. Soft conditionality includes structural benchmarks, indicative triggers, and general undertakings in the country’s letter on intent. (Independent Evaluation Office 2002; Woods 2006: 70-71) Although conditionality is decided through discussions among borrow countries and the Fund’s specialist teams, the latter make most of the decisions on the details of conditionality. Once the loan is made, IMF staff also monitor the borrower countries in order to evaluate if they live up to the agreed program and project, and make the decision on whether or not releasing the next installment of loans accordingly. (Woods 2006) According to the Fund’s own words, conditionality enables the funds to
‘…evolve from helping countries deal with short-term trade fluctuations to supporting adjustment and addressing a wide range of balance of payments problems resulting from terms of trade shocks, natural disasters, post-conflict situations, broad economic transition, poverty reduction and economic development, sovereign debt restructuring, and confidence-driven banking and currency crises.’ (IMF official website)\textsuperscript{18}

Via conditionality, the IMF indirectly influences the borrower countries’ domestic policy-making and policy practices. The borrower countries are required to meet IMF policy requirements in order to get the next installment of loans. Hence, during the borrowing period, these countries ought to do what they are told by the IMF and/or follow what other borrower countries do in order to get the loans. Hence, the process of ‘mimicking’ may be witnessed via IMF lending. However, social influence is unlikely to happen, since the motivation behind IMF lending program is material-in fact, purely financial- rather than reputational. Neither is persuasion likely to take place via lending, as the effective period for conditionality is usually too short for the borrower countries to redefine their interests and values. If countries were required to implement policy changes according to IMF guidance for a longer period of time, they might start to absorb IMF neo-liberal economic norms.

However, unlike many other IMF developing country members, China never became a large borrower from the Fund. China received a drawing from the Fund in the first credit

\textsuperscript{18} IMF official website, the section about ‘Lending by the IMF’, access via http://www.imf.org/external/about/lending.htm
tranche of SDR 450 million and a Trust Fund loan of SDR 309 million in 1981, and repaid the loan by the end of 1984. It received another drawing of SDR 598 million in 1986, and repaid the loan after one year. China has not borrowed from the IMF since then. (Zhang 2010) The IMF Managing Director Michel Camdessus said in 1997 that he did not believe that China would need IMF support in the years to come, other than technical assistance in macroeconomic matters. (Reuters China News 1997)

Hence, China is exempted from the usual impacts of socialization via IMF financial assistance. It also proves that the IMF has little leverage over China’s policy decisions via financial assistance.

### 3.2 Technical Assistance

Technical assistance is another core mechanism of the IMF. It links the Fund with its member states via expertise sharing. IMF technical assistance covers a wide range of issue areas including central banking, monetary and exchange rate policy, tax policy and administration, and official statistics. It takes various forms including Fund staff’s visits to member countries to advise government and central bank officials on specific issues, Fund provision of resident specialists on a short- or a long-term basis, and training courses for member country financial government officials. The technical assistance mostly targets the IMF’s low- and lower-middle-income countries, in particular in sub-Saharan Africa and Asia. The core products of IMF technical assistance are internationally standardized policy process methods and techniques. (IMF 2009c; IMF
Via taking a part in IMF technical assistance, member countries learn to adopt the methods and techniques that are widely used in the most advanced financial economies, as well as promoted by the IMF.

China has received continuous technical assistance from the IMF since the 1980s via training courses in IMF institutes, IMF experts’ and lecturers’ visits to China, and periodical posts in IMF headquarter for the Chinese officials sent by the state’s financial institutions. IMF technical assistance programs provided China with significant information in formatting and processing financial data and policies with internationally formalized methods. For example, the IMF’s early efforts encouraged China to use gross domestic product (GDP) data instead of net material product (NMP) data, which indirectly made Chinese officials recognize the importance of the service sector that was excluded from NMP measurements. (IBRD 1983: 1: 244-254, IBRD 1985)

The most remarkable example is IMF Statistics Department’s training programs for China. The programs provide training courses for the staff from China’s crucial financial institutions (both at central and provincial level) such as the PBC, the China Banking Regulatory Commission (CBRC), the Ministry of Finance (MOF), the State Administration of Foreign Exchange (SAFE), and the National Bureau of Statistics (NBS). The training programs mostly cover macroeconomic statistics, fiscal reform, taxation, balance of payments, budgetary, and monetary operations. Most of the programs are initiated in response to Chinese requests for specific information and training in

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techniques. They take the forms of (1) hands-on, issue-oriented short-term missions designed to address specific areas of weakness in statistics; (2) short seminars for high-level officials on the use of macroeconomic statistics for the purposes of analysis and policy formulation based upon internationally accepted methodologies; (3) tailored training combined with on-the-job training relating to specific practical topics; (4) participation in general training activities in Washington D. C, at the Joint China-IMF Training Program in Dalian, the Joint Vienna Institute, and the IMF-Singapore Regional Training Institute; and (5) training course/study visits to IMF headquarters on methodology and compilation procedures for Chinese officials. (IMF 2009c: 7-17)

The IMF Statistic Department has delivered a substantial amount of valuable technical assistance to help China’s financial institutions produce data using internationally acceptable methodologies and practices, both for authority use and for the IMF’s operational purposes. (IMF 2009c: 5) For example, they have assisted the PBC in addressing methodological issues arising from the recent developments in the financial sector, and implementing standardized reporting forms. They have helped the CBRC learn the technical methods on how to compile financial soundness indicators and how to analyze these data, thereby improving the effectiveness of its regulatory services. In addition, the training helped the MOF officials understand the government finance statistics methodology, improve data quality and facilitate international comparison of fiscal data, thus helping them achieve the goal of more closely aligning China’s fiscal data with international standards. The training course provided by IMF Statistics Department for the MOF in 2008 helped it address several outstanding data classification
and compilation issues. With the assistance of the IMF, the MOF implemented a new classification system of government revenues and expenditures in 2007 and increased transparency and dissemination of fiscal data. (IMF 2009c: 7-17)

Last but not least, the Statistics Department conducted several activities in cooperation with the NBS. The most remarkable one was to help coordinate General Data Dissemination System initiatives in China. The Statistics Department sent a technical assistance mission on GDDS in 2003, and co-hosted an international meeting on technical cooperation in statistics with the NBS in 2004, followed by organization of several training seminars on the quarterly national accounts in 2004 and on the use of macroeconomic statistics in 2005. The department also hosted visits to IMF headquarter by several NBS delegations, to discuss issues relating to the GDDS and data dissemination and exchanges. Since China joined in 2002, the GDDS has provided a framework to further develop China’s statistical systems and helped identify technical assistance needs and coordination with IMF technical assistance providers. The evaluation report on IMF Statistics Department’s technical assistance to China in 2009 concluded that since China joined the GDDS, its agencies had made considerable progress in improving the production and dissemination of macroeconomic data, most notably in the introduction of more features of internationally agreed methodologies and datasets; improvement in data dissemination following GDDS recommendations, such as dissemination of advance release calendars on several agencies’ websites; wider dissemination of statistical products, including through websites; and faster and more frequent release of several sets of data. In addition, the establishment of a GDDS office
within the NBS helped coordinate the work on the GDDS with all the other agencies involved at the senior level. (IMF 2009c: 7-17)

When China started to receive technical assistance from the IMF, it learned standard statistical and other technical methods via mimicking because Chinese leaders had almost no understanding of the basic reporting conventions and obligations of a modern market economy, let alone of the institutions needed to make it function. In this way, the IMF membership prompted China to adopt the international standards of measurement, by which the Chinese learned how to better evaluate itself and present itself to the outside world. The example of China replacing NMP data with GDP data was a good example of mimicking. Later, mimicking gradually transformed into social influence. Especially by joining the GDDS, the approved behavior such as adopting internationally agreed methodologies and datasets, disseminating data on the institutions’ websites, and more frequent release of datasets have earned China some approval and ‘back-patting’ in the IMF. As said by Mr Zheng Jingping, the General Director of the Department of Comprehensive Statistics of the NBS:

‘Looking back the whole process of China’s joining the GDDS, once more we realize that, actively participating in international statistical activities and conducting international collaborations are an important, non-substitutable way to promote statistical development. With reference to the good experiences of advanced countries, it will be faster, better and get-twice-the-result-with-half-the-effort to reach the development goals. In addition, introducing the internationally accepted standards and
practices not only optimizes statistical system, but also is convenient for international comparisons and beneficial for China to heighten its international status.’ (Zhang 2004)

However, there is little evidence to show that IMF technical assistance has led to persuasion. The process of technical assistance does not require ‘private acceptance’ and therefore it is difficult to tell if the Chinese authorities have accepted and internalized the international norms embedded in the technical procedures. This is also why IMF technical assistance has generally been welcomed by the Chinese authorities: firstly, most of the programs are initiated from the authorities’ request for specific information and techniques; and then the IMF responds with appropriate technical assistance programs after discussions with the national authorities. In this way, the Chinese authorities take the control of the contents of the training courses and the extent to which they reach the Chinese officials. Secondly, IMF technical assistance focuses on methodological issues such as reporting forms, data collection and process methods, which does not directly impinge upon China’s domestic economic policies.

3.3 Policy Advice

IMF policy advice is a part of its surveillance mechanism. IMF surveillance mechanism could be divided into three categories: country surveillance, regional surveillance, and global surveillance. The country surveillance refers to the Article IV Consultation, which is a regular (annual) consultation for individual member states with interactive discussion included. (Moschella 2012) It is the most direct surveillance among all three categories. The regional surveillance involves examination by the IMF of policies pursued under
currency unions—including the euro area, the West African Economic and Monetary Union, the Central African Economic and Monetary Community, and the Eastern Caribbean Currency Union. In addition, the Fund also issues Regional Economic Outlook Reports in which economic developments and key policy issues in Asia Pacific, Europe, Middle East and Central Asia, Sub-Saharan Africa, and the Western Hemisphere are discussed. The global surveillance refers to reviews by the IMF’s Executive Board of global economic trends and developments. The results of reviews are published twice a year in the World Economic Outlook reports, the Global Financial Stability Report and the Fiscal Monitor Global surveillance entail reviews by the IMF's Executive Board of global economic trends and developments. (IMF official website²⁰)

Unlike the previous two types of interactions, IMF policy advice for the Chinese authorities has tackled some essential domestic economic policy issues that are related to the fundamental economic and political interests and values, such as the measure of the exchange rate of China’s currency Renminbi, under-valued Chinese currency, transparency (or lack of it) in China’s financial management, and the urge for more fundamental reforms in China’s financial system, just to give a few examples. The IMF offers policy advice by sending its staff to China for both ad hoc and regular missions. Special missions are sent to deal with specific policy issues. Regular missions are sent for IMF country surveillance facility, Article IV Consultation, via which much IMF policy advice is offered to the Chinese authorities on the regular basis. The Article IV Consultation usually takes place annually, during which an IMF team of around 10 Fund

²⁰ IMF website, section of ‘Surveillance’, access via http://www.imf.org/external/about/econsurv.htm
economists visits 3-4 Chinese cities in a period of about 2 weeks to gather information and discuss China’s economic and financial policies with the government and central bank officials.\(^{21}\) (IMF 2006; 2010a; 2011a) The team reports its findings back to Fund management on its return and then presents them for discussion to the Executive Board. The Board’s view is subsequently transmitted to the Chinese government; and summaries of most discussions are released in Public Information Notices (PIN) and staff reports to be posted on the IMF’s website.

The Consultations usually refer to several issue areas including general growth trends, macroeconomic policies, financial sector reforms, and domestic and external risks. More importantly, they also include the updated policy focus of the year the Consultation is undertaken. For example, in the early 2000s, the Consultations discussed issues such as rural-urban and regional income disparity that were exacerbated during China’s economic growth. In the period after the global financial crisis between 2008-2010, the Consultations focused on China’s responses to the crisis such as the stimulus packages, the decline in China’s current account surplus, and measures vis-à-vis local governments’ fiscal positions. In the most recent years, the Consultations have focused on the transformation of China’s growth model, the internationalization of the Renminbi, and the advancement of a social safety net. In particular, the flexibility issue in China’s exchange rate policy and reforms in China’s financial sector toward further liberalization have always been on the agenda in the past years. As showed in the staff reports, the Consultations usually take into account the Chinese authorities’ views, and provide them

\(^{21}\) The number of IMF staff in the team, the cities to be visited and the period of the mission vary each year.
with moderate advice toward the detected problems and risks. (IMF 2010a; 2011a; 2012a)

IMF surveillance and policy advice could potentially lead to a larger degree of socialization compared to the previous two interaction mechanisms. This is because via surveillance and policy advice, the IMF could potentially affect China’s interests in and ability to pursue national economic strategy. The main objective of IMF surveillance and policy advice mechanism is to lead the member states to commit to ‘pursue policies that are conducive to orderly economic growth and reasonable price stability, to avoid manipulating exchange rates for unfair competitive advantage, and to provide the IMF with data about its economy.’ (IMF website)\textsuperscript{22} This objective displayed on the IMF’s website indicates the IMF’s own neo-liberal interests and norms. The IMF’s policy advice for China and other member states is consistent with its own interest and norms. Hence, while China accepts IMF policy advice and internalizes it in its domestic political system, it is gradually socialized into accepting the Fund’s neo-liberal economic norms.

However, the extent to which China is socialized into accepting the international norms via IMF surveillance and policy advice is contentious. Though China has since 1978 pursued a general strategy of market liberalization that is mostly compatible with IMF norms, the extent of the reforms and their consequences are controversial. It is not straightforward to determine how IMF surveillance and policy advice, by taking socialization means, have caused China’s domestic economic reforms. The Chinese economic leadership has gone through phases of mimicking and of social influence, yet

\textsuperscript{22} IMF website, section of ‘Surveillance’, access via [http://www.imf.org/external/about/econsurv.htm](http://www.imf.org/external/about/econsurv.htm)
not necessarily reaching the stage of persuasion. The following examples indicate that the processes of mimicking and social influence took place to different degrees, respectively, in the China-IMF interactions via surveillance and policy advice.

In November 1986, the IMF stated its concerns about China’s incapacity to manage foreign loans. The Fund recommended the State Council should set up greater coordination and control over the foreign debt and foreign reserves. Some officials in the Supreme People’s Court, Ministry of Finance, and State Council shared these concerns. Later on, the IMF held a number of seminars on this topic, and introduced to the Chinese officials various institutional models, including those of France, Sweden, Brazil, and so on. Later in the year, eventually, the State Administration of Exchange Control was given responsibility for gathering comprehensive statistics on China’s foreign debt and approving all uses of foreign exchange. (Jacobson and Oksenberg 1990: 148-9)

Several movements in China’s exchange rate policy were proved as related to IMF policy advice. In the mid-1980s, when China suffered balance of payments problems, the IMF suggested China should devalue the RMB by nearly 30 per cent. China initially resisted the Fund’s pressure, arguing that the resulting sharp rise in the cost of imported materials and components would have a disruptive impact on the domestic price level. However, China eventually decided to devalue the RMB by 15.8 per cent against major currencies just after the IMF consultation mission departed from China. (Lardy 1992: 20)
IMF policy advice also affected China’s policy on currency convertibility. China started to introduce a more market-oriented foreign exchange swap market system in 1985, whereby foreign-funded companies could convert their RMB earnings to foreign exchange at a more favourable rate and more efficiently allocate scarce foreign exchange among domestic users. However, the eventual result over time was to encourage foreign exchange hoarding, which drove up the RMB swap rate, especially in response to speculative rumours of fuller RMB convertibility, thus taxing exports and indirectly subsidizing imports. Although the authorities tried to address the problem with five subsequent RMB devaluations, China ultimately concluded in 1993 with strong IMF backing that in January 1994 the official and swap market exchange rates would be unified at a higher managed floating exchange rate. (Feeney 1998: 244)

Based on that, the IMF further encouraged China to move more rapidly to fulfil the obligation of Article VIII of IMF Articles of Agreement, which limits the ability of members to ‘impose restrictions on the making of payments and transfers for current international transactions.’ On June 21, 1996, China announced it would allow foreign-invested enterprises full access to the interbank market for foreign exchange, beginning on July 1, 1996. (PBC 1996: 2) Later on in the year, the Chinese government made a significant step its foreign exchange policy, as well as in the China-IMF relationship. China decided to comply with Article VIII of IMF Articles of Agreement to make its currency freely convertible on the current account as of December 1, 1996. (Sylvester 1997; IMF1996a) Michel Camdessus said on this note,

'This marks yet another milestone in China’s historic transformation and decisive progress toward further integration in the world market economy. The achievement of current account convertibility will further strengthen domestic and international confidence in a very promising reform process.’ (IMF 1996b)

By accepting the obligations of Articles VIII, China gave confidence to the international community that it would pursue sound economic policies that would obviate the need to use restrictions on the making of payments and transfers for current international transactions. (IMF 1996a) Meanwhile, the Chinese government realized that the advice from the IMF on China’s foreign exchange policy could offer significant help to China’s financial reforms, which was also why China was willing to further open its policy area for IMF advice in the following years.

IMF policy advice prompted the Chinese government to reform its financial system so that its activities are closer to the standard international economic and financial practices. The IMF also provided China with a platform on which it could learn from the financial institutions of western developed economies. The reforms in China’s financial sector through the 1980s and 1990s proved the success of this connection provided by the IMF. In the mid 1980s, China set up a central banking system under the People’s Bank of China, which adopted measures to increase the credibility and flexibility of its monetary policy. These included measures diversifying monetary policy instruments, adjusting credit policy, stabilizing the balance of payments and the RMB exchange rate, restructuring nonbanking financial institutions, accelerating financial reform and
restructuring of state-owned enterprises, reorganizing management; undertaking commercial bank reform, and further opening financial markets. In 1998, China recapitalized state commercial banks. In 1999 and 2000, China transferred nonperforming loans totaling 15.5 per cent of its GDP to asset management companies that resolved bad debts through asset sales and debt equity swaps. Reforms were also undertaken in China’s state-owned enterprise sector, focusing on reducing excess capacity, improving efficiency, and transforming ownership structures. Based on that, a modern enterprise system including independent Boards of Directors and Supervisors, government functions separated from enterprise management, and improved incentive and internal control mechanism was introduced. (Kent 2007: 134-35; Naughton 2007; Lardy 1998)

Moreover, the Chinese government has also enhanced legislative implementation in the financial sector, in order to construct a financial system that is compatible with those of the western developed economies’. One significant legislative implementation was the Central Bank Law, which became effective in March 1995, provided the legal authority for the People’s Bank of China to implement monetary policy and to exercise financial supervision over other domestic financial institutions. (Lardy 1999: 214) Other legislative implementations included the Commercial Bank Law, the Law of the People’s Republic of China on the People’s Bank of China, the Guarantee Law of the People’s Republic of China, the Insurance Law of the People’s republic of China, the Price Law of the People’s Republic of China, regulations on foreign exchange, and twenty-six laws and regulations on foreign investment. (Kent 2007: 135) These laws bring China’s
financial system into closer alignment with the principles and practices of central banks in industrialized countries with advanced monetary regime, and standard international financial practice. The People’s Bank of China also issued new regulations that adopted standards from international banking accords, such as the Basle Accord standard of capital adequacy. (Lardy 1999: 214)

3.4 Inadequate Policy Advice and Unsuccessful Socialization

Through the above examples, we could see the Chinese economic leadership has gone through phases of mimicking and social influence in the early stage since it joined the IMF; yet we could not witness full persuasion. Persuasion is proved to have happened when clear evidences show that specific IMF policy advice led the Chinese authorities to change the values and norms in the financial regime. According to the definition of persuasion, when it happens, China not only carries out the practices that meet IMF requirements, but also genuinely agrees with the norms backing IMF requirements and policy advocates and internalizes these norms in its own policy-making in other related issue areas too. (Checkel 2001; Johnston 2008) However, the recent example of IMF policy advice to China has turned out to be a negative proof. The IMF’s recent policy advice to China has faced some difficulties, especially that on China’s exchange rate regime. (IMF 2010a and 2011a) The Chinese authorities continuously refused to take IMF Article IV Consultation advice to further revalue its currency. China’s policy on exchange rate regime (and other financial policies such as interest rate policy) has reflected the Chinese government’s distinct economic norms that differ from those of the IMF.
The deficiencies in the Article IV Consultation hindered the staff’s capability to provide adequate advice to the Chinese authorities and convince them to accept the IMF’s advocated economic norms. Yet among all IMF policy advice mechanisms, the Article IV Consultation is the most thorough and frequent one toward China, and thus it should work more effectively than any other type of policy advice. In other words, the policy advice in general has a limited impact on China’s domestic economic policymaking. The inadequacies in IMF Article IV Consultations, such as ‘poor accuracy and depth of IMF analysis’ and ‘weak IMF advice’, will be analyzed in the following paragraphs. They explain why the IMF cannot persuade China to accept its advice. In addition, the unsuccessful IMF policy advice is also due to ‘the priority of China’s domestic concerns’ and China’s complex ‘domestic policy processes’. These two factors further illustrate why China is reluctant to accept IMF advice on some essential policy issues and why China refuses to adopt the IMF’s neo-liberal economic norms. These causes of unsuccessful IMF policy advice shed light on the question of whether and the extent to which persuasion happens in the China-IMF interactions; and they make us wonder if the socialization approach tells the full story between China and the IMF.

**Poor Accuracy and Depth of IMF Analysis**

The accuracy and depth of the analysis carried out by IMF economists for the annual Article IV Consultation are not guaranteed. In China’s case, the Fund mission team
usually visits Beijing, Shanghai and one other large industrial city\textsuperscript{24} for a rather short period time of around two weeks each summer for the Consultation. In a brief trip like this, the mission team could not see a full picture of China’s economic development trend of the year. Members of the mission team varied every year, for example, to compare the team members in 2006 with those of 2010, only one Fund staff member was in the both teams; which means the economists and experts sent by the Fund to analyze China’s economic policies and discuss with the Chinese officials were replaced by different ones almost completely within 4 years. (IMF 2006: 3; IMF 2010a: 2) The frequent rotation of bureaucrats and economists among IMF departments therefore caused a concern that the mission teams sent to China may not have a thorough understanding of China’s social and political affairs and thus are unable to carry out an accurate analysis of China’s economic policies. They simply do not have sufficient time to explore China’s economic development in the medium run, as once they get to understand certain patterns of China’s economic development, they are transferred to a different post. In addition, much of the data and information used for the analysis are secondary sources from companies such as Bloomberg and CEIC Data Company, and other economic institutions such as the OECD, IFS and INS; or is provided by the Chinese authorities. The accuracy of these materials is not guaranteed by the Fund.

On the other hand, the Chinese authorities have not become more frank about their financial data and information for IMF surveillance until the most recent years, which affected the accuracy of IMF analysis based on the data provided by the authorities. For

\textsuperscript{24} According to the published staff reports in 2004, 2006, 2010, 2011, and 2012, apart from in 2004 the team only visited Beijing, in all the other years the team visited Beijing, Shanghai and one other industrial city each year, which was Chongqing (2006), Lanzhou (2010), Chengdu (2011), and Wuhan (2012).
instance, the Chinese authorities did not allow the IMF to publish the full staff report of
the Article IV Consultation until 2004, and before then only PINs with much less details
were open to the public.

Weak IMF Advice

IMF surveillance via Article IV Consultation does not have much strength when
contfronted with China’s strong self-protective stance. As the most important bilateral
IMF surveillance tool guiding China’s economic policies, the Article IV Consultation
generates merely generic assessment of China’s economic development trend in each
year. Although it does focus on the most critical policy issue according to both the
internal and external economic environments of the year, the investigation on such policy
issues is not well followed up and deepened over time. The advice made by the staff
accordingly is thus too general. Even if when it comes to a highly controversial issue like
the undervaluation of the RMB, the IMF prefers to avoid direct disputes with the Chinese
authorities.

In the past decade, as showed in the PINs and staff reports, the Chinese authorities’ views
were mostly consistent with Fund staff analysis and advice, apart from the disagreement
on the irreconcilable issue of the RMB’s exchange rate. The PINs and staff reports
indicated that the Fund staff were generally pleased with the Chinese government’s
commitment to macroeconomic management and structural reforms which were
compatible with Fund norms. The reports also approved China’s contribution to the
rebalance of world economy in the post-crisis era. For instance, the 2011 Consultation specifically pointed out the significance of China’s Twelfth Five-year Plan. The Plan is highlighted by further financial liberalization and the shift toward a consumer-based growth model through a range of reforms that intend to strengthen the social safety net, raise household income, enhance productivity and invest in human capital. (IMF 2011b: 5-6) Nevertheless, the Consultations did point out the problems in China’s economic policies and reforms throughout the past years, such as lack of flexibility in the exchange rate policy, the question of China’s transparency and its observance of standards, the over-heated real estate market, the excess inefficient investment and productivity issues in bank lending, and so on. (IMF 2002, 2006, 2010a, 2012a) However, with regard to these problems, Fund staff rarely made harsh comments or vigorous criticisms on China’s policy decisions in the Consultations; and the reports were mostly encouraging rather than condemnatory. The IMF’s weak stance in surveillance and consultations is due to the voluntary, instead of mandatory feature of the implementation of IMF advice.

One exception is the controversial case of the RMB’s exchange rate. The advanced economies especially the US accused the undervalued RMB of being one of the major causes of China’s current account surplus and the consequent unbalanced world economy. The Consultations directly pointed out that China’s reserve accumulation was significantly above the level needed for precautionary purposes, and that the RMB was undervalued. They also found that the undervalued RMB reduced the scope for running a more proactive and independent monetary policy with higher real interest rates, as well as creating distortions in relative prices that undermined the government’s efforts to raise
household income and to develop the service sector. (IMF 2006: 28, 2010a: 63, 2011b: 18-19, 2012a: 20, 2013b: 27-28) Based on such assessment, the Fund has constantly suggested China should accelerate the RMB appreciation; but even in this case, Fund staff did not persuade China to implement their advice.

On the other hand, the Chinese authorities held a consistent and strong standpoint to deny the Fund’s claim of the RMB being undervalued every time it was discussed in the Consultations. The Chinese authorities stated that the RMB was found undervalued partly because the IMF *incorrectly* based its assessment of the degree of undervaluation upon an uncertain forecast of the future current account, and failed to take a broader view on the path of the real exchange rate. The false assessment was also due to the balance of payment statistics underscoring current account outflows from non-remitted income on non-residents’ investment in China. The Chinese authorities insisted that the RMB and the foreign exchange market were actually close to equilibrium. (IMF 2011b: 19) In the end, although the IMF clearly made their point on China’s exchange rate issue, it failed to persuade China to accept the policy advice and revalue the RMB.

The IMF’s relatively feeble advice facing China’s strong stance on the exchange rate issue incurred some criticisms from the West. The strongest criticism was from Goldstein, who for a long time accused the Fund of being ‘very timid and purposely noncommittal’ on the appropriate level of the RMB and the Chinese government’s ‘manipulation’ of the current and recent levels of the exchange rate. (Goldstein 2005: 150-151) He also argued that the Fund failed to detect and correct the Chinese
government’s ‘currency manipulation’ problem because it was ‘intimidated by the extreme sensitivity of the Chinese authorities to external criticism of their exchange rate policy’ and thus failed its role of the only umpire of the international financial sector.\(^\text{25}\)

He has also called for IMF ad hoc consultations on China’s exchange rate policies and strengthening the rules on exchange rate policies. (Goldstein 2011: 18-23) However, Goldstein’s criticism did not provoke a reform in terms of an increase of strength in IMF surveillance on China. The suggestion of ad hoc consultation on China’s exchange rate policies did not have a substantial impact, because firstly the Fund very rarely initiates ad hoc consultations on countries’ exchange rate policies\(^\text{26}\). Secondly, even the Fund’s institutionalized official Article IV Consultation failed to correct China’s exchange rate policy problems as argued by Goldstein, why would an ad hoc consultation that is much less thorough and comprehensive do the job?

More importantly, the Chinese authorities and scholars do not accept the criticism of ‘currency manipulation’. Professor Yu Yongding of CASS- while admitting that the Chinese government did intervene in the exchange rate market for more than two years-refuted Goldstein’s accusation of ‘currency manipulation’, since none of the IMF rules indicated such matter. (Yu 2006: 524) As a matter of fact, the Chinese authorities and economists prefer an IMF that sticks to its basic roles- such as providing temporary financial assistance, assisting countries to formulate the right macroeconomic policies,

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\(^{25}\) Goldstein’s criticism of the Fund surveillance was, ‘it offers no guide to what is and what is not internationally acceptable exchange rate policy, it finds no country guilty of misbehaving when the evidence to the contrary is by now overwhelming, it offers no incentive and/or penalties designed to change errant behaviour, and it removes the one institution (the IMF) that could plausibly serve as a credible international umpire from a policy arena that is rife with opportunities for breaking the rules and gaining market share at your neighbour’s expense.’

\(^{26}\) The IMF only initiated ad hoc consultations on countries’ exchange rate policies twice in the history: for Sweden in 1982 and for South Korea in 1987.
and providing a forum for multilateral economic cooperation and policy coordination—rather than a nosy and harsh watchdog that imposes its opinions on China. The Chinese authorities think the IMF should be careful not to go beyond its mandate, for example, the conditionality attached with IMF loans should be country-sensitive and compatible with the countries’ potential economic prosperity; and IMF technical assistance and policy advice ought not to invasively disturb the countries’ domestic policy decisions.

The Chinese authorities and economists do not find it necessary for the IMF to intensify its surveillance on emerging market economies; and neither do they find it appropriate to change the Fund’s mandate. Instead, if there is any need for the IMF to be tougher on its surveillance, it should be directed towards the policy gaps in advanced economies. (IMF 2012a: 22-23) It does not mean that China prefers a weak and ignorant IMF than an effective safeguard that oversees the global economic policies, but for the moment China would rather support an IMF with gradualist approaches which leaves China much time and space to advance its domestic economic stability first.

**Priority of Domestic Interests**

The doubt about the effectiveness of IMF Article IV Consultation on China’s economic policy-making also refers to the superiority of domestic concerns and China’s complex domestic policy processes. They also explain why other forms of IMF policy advice do not have explicit impacts on China’s policy decisions either. IMF Article IV Consultation teams and other officials, together with their policy advice are mostly welcomed by the
Chinese authorities every year. They have continuously encouraged China to speed up financial liberalization, including the use of more price-based tools of monetary policy, to further open the capital account, to broaden the range of alternative investment vehicles for savers, to remove the government restrictions on bank lending and allow lending decisions to be based on commercial goals, to improve the financial infrastructure and relevant legal frameworks, and so on. (IMF 2011b; IMF 2011c: 5-7; IMF 2012b: 5-6, IMF 2012c: 9, IMF 2011d) The Chinese authorities’ reaction to such advocacies has always been ambiguous, cautious and reserved. The standard rhetoric usually sounds something like the progress of reforms is determined by various economic and social factors that are preconditioned on a stable and supportive macroeconomic environment. Nevertheless the precise explanations of the relevant ‘factors’ and ‘preconditions’ are missing.

However, it would be unfair to neglect China’s efforts in the financial reforms in the past years. The fact is China has made impressive achievements in the banking reforms and financial market liberalization. The reason why the IMF and other international institutions sometimes feel their opinions are being ignored is that the Chinese authorities’ decisions on domestic reforms are purely based on the comparative benefits and influences of China’s domestic industries and financial institutions. When the Chinese authorities make highly crucial policy decisions they always take the domestic concerns as the only priority; and the impacts of advice from the intergovernmental organizations such as the IMF are at most secondary, in other words, there is little space for ‘social influence’ and/or ‘persuasion’ to work.
Take the exchange rate policy as an example, although criticisms from the advanced economies and pressure from the IMF are increasing, the Chinese policymakers have not tended to make a hasty decision to revalue the RMB. Chinese officials and economists have strongly demonstrated that the exchange rate of the RMB is a matter for China. In 2009 and 2010, Premier Wen Jiabao stated in several national and international conferences that a sharp RMB appreciation would destroy China’s export industry while it was still at the low end of the global value added chain and thus generate high unemployment and social instability. (Xinhua 2010; Renminwang 2009) While stressing the Chinese government would not make such a decision notwithstanding the massive international pressure, he also called upon international society, especially the US and Europe, not to force RMB appreciation. Although the Chinese economy is transforming from a export-driven to a consumption-driven growth model as part of the 12th Five-Year Plan, the government will not let the RMB revalue greatly as the export industry remains one of the most important contributors to China’s GDP.

Moreover, most of the Chinese economists do not consider China’s exchange rate issues amount to causing the global trade imbalance, and that neither could RMB revaluation correct such imbalance. (Yu 2006: 521) Xu Qiyuan of the CASS argued that while China carries on its exchange rate regime reforms, it should preclude overseas political interference and hold on its own standpoint, and carry out effective counter-containment toward potential threats. (Xu 2011) In his book Renminbi can say no: Exchange rate of Renminbi, China decides! Yan Xingfang defended China’s exchange rate policies and
accused the US of starting a ‘currency war’ to contain China. (Yan 2010) Although some arguments in the book sound overly defensive, they reflect some Chinese economists’ explicit antipathy toward international criticisms over China’s exchange rate policies, as well as their will to protect China’s domestic industries and market stability. Therefore, the strong objection against a sharp RMB revaluation among the domestic concerns prevented the IMF and any other outsiders to impose their advice on China’s exchange rate policies.

When there are differences among domestic voices on one policy issue, the authorities usually choose to secure the benefits of the most influential party. For instance, marketization of interest rates was proposed in 1993, yet the discussions of advantages and disadvantages of such a reform have remained controversial. Both the saving and debit interest rates are still under central control today. The most important reason for the reform being delayed is that the marketization of interest rates would harm the core benefits of China’s four largest state-owned commercial banks. Once the interest rate is liberalized, the four big banks’ interest margins from which most of the profits are generated will decline, and competition from smaller and local banks will increase rapidly. (Tan 2011) Meanwhile the central bank worries the marketization of interest rates will cause ‘price wars’ among banks and thus push up the debit interest rates and consequently make borrowing even more difficult for the companies. In spite of the increasing voices protesting against the over-protection of the four big banks and calling for a fairer market condition for smaller and/or private financial institutions, savers and corporations, the authorities chose the conservative route to maintain policies that favour
the four big banks. Therefore, the authorities continued to keep the interest rate controlled, at least till the whole financial sector is better self-regulated. Interest rate marketization is just one example of the policy issues upon which China’s reforms lagged behind the IMF’s standard economic liberalization. In some other similar cases referring to the economic reforms, the Chinese authorities have chosen to preserve the state-owned sectors’ benefits. Such policy decisions clearly violated the IMF’s classic neo-liberal norms.

After all, China has a unique development model that is distinguished from the rest of the world. The Chinese authorities think only a certain part of IMF advice is suitable for China’s domestic situation, and the rest is less relevant with regard to China’s unique developmental model. China has socialized into some of the IMF guiding norms, to the extent that China’s economic reforms in the past 30 years have mostly followed the liberal economic principles. However, Chinese policymakers and economists are challenged by multiple tasks that require them to adopt a very different approach toward economic liberalization because of China’s own unique political regime and social environment.

China does not tend to minimize public ownership in the country’s crucial industrial sectors, instead it keeps exploring better ways to manage the dynamics between the public and private sectors under the ruling party-state. The scholars working on the so called ‘Beijing Consensus’ and ‘China model’ – such as Barry Naughton, Giovanni Arrighi, and Zhao Suisheng- pointed out the significance of the state government in
China’s economic development. (Naughton 2010, Arrighi 2007, Zhao 2010) Barry Naughton argued that China is so unique that its model is not applicable to other developing countries; nevertheless he concluded 6 aspects of China’s economic development that were crucial to the success and could possibly inspire other developing countries.27 (Naughton 2010: 437-453)

These aspects emphasized the significance of public ownership and the state sector in China’s industrial development. Since the Chinese authorities want to make sure the financial sector has sufficient capital available for the public and state owned sectors, they prefer to keep the financial sector under controlled reforms to protect it from the wild market. Approaches like this are not compatible with the neo-liberal norms advocated by the Fund. Nevertheless, even when China is engaged in the reforms that are compatible with Fund norms, all the specific decisions on the issues like the extent, the time period, and the range of affected institutions or individuals are made according to the authorities’ own cost/benefit analysis. China’s reforms are not guided by the IMF and/or any other international organizations, but mostly by its own governments.

27 These 6 aspects are described as: 1 public ownership can be reasonably efficient, and the ‘mixed economy’ is a decent model of industrial organization; 2, competition is encouraged in all sectors except those designed as strategic and remains more important than ownership; 3, public ownership can be used to exploit market power and generate revenues for investment and public goods’ creation; 4, a strategy of investment-led growth is essential; 5, for a growth-oriented polity, the state sector may be used aggressively to create growth (and revenue) opportunities outside the state sector; 6, managers of publicly-owned corporations can be motivated by tying their compensation to their company’s performance in maximizing asset value.
China’s Political System

The institutional features of China’s financial sector further explained why IMF advice failed to exert large influences on China’s economic policy-making. The IMF’s direct corresponding institution in China is the People’s Bank of China. In the PBC, there is an ‘IMF Division’ under the management of the International Department, which takes charge of the interactions with the IMF. Their major duties are coordinating with the IMF on the affairs such as dispatching Chinese officials to the IMF for temporary posts, receiving delegations from the Fund, managing the schedules of Chinese delegations to IMF meetings, and other administrative matters. (Interview with a Chinese official28) They are separated from the PBC’s core decision-making sectors. In simple words, PBC staff who align with the IMF do not have much influence on the Bank’s policy decisions. Therefore, IMF advice may not be taken into account in the Central Bank’s essential policy decisions. As argued by Woods, if the IMF wants to successfully ‘persuade’ the a state government to accept its policy advice, it needs to find ‘sympathetic interlocutors’ in the state that share the Fund’s ‘technical expertise, methodology, and an orthodox economist’s understanding of problems and solutions’. She also added that what’s equally important is the ‘sympathetic interlocutors’” position in the government structure and the bureaucratic and political incentives they face. If they do not have large influence in the government, the Fund lacks ‘a degree of leverage and influence’; and this is the case in China. (Woods 2006: 72-80)

28 The interview was conducted in Beijing. The interviewee (Interviewee 1) is a government official who works closely with the IMF in a Chinese Financial Institution.
The State Council usually assigns the directors or deputy directors of the PBC’s International Department to the IMF as executive directors. These officials have a relatively low political status in the domestic bureaucratic system, and thus very little voice in China’s political society. On their return, their working experience in the Fund may have very limited contribution toward China’s economic policymaking. One example further reflected that the IMF-related affairs are not on the top list of the Chinese government’s political agenda. The Chinese government usually sent the governor of the PBC and the Minister of Finance to World Bank-IMF Annual Meetings; however, it only sent some lower level officials to the 2012 Annual Meetings held in Tokyo because of the on-going island dispute with Japan. In this case, China’s representation in the IMF was simply compromised facing the political dispute that was regarded as more critical to the country’s sovereignty and dignity.

As the IMF’s main corresponding institution in China, the PBC’s lack independent decision-making power further prevented the IMF advice from exerting substantial influence on China’s economic policy decisions. Although the PBC formulates some of the country’s crucial monetary policies, it is subordinated to the executive orders of the State Council. PBC policy decisions are also heavily influenced by other economic institutions, such as the Ministry of Finance, the Ministry of Commerce, the State Administration of Foreign Exchange, and the China Banking Regulatory Commission. Although the PBC is an important component of the State Council, it does not have adequate political power to overturn decisions of the local provincial governments. Considering that some of China’s most wealthy and powerful provinces on the east,
southeast, and south coast—such as Shandong, Jiangsu, Zhejiang, Fujian and Guangdong—rely their economic development on the export industries, it is almost impossible for the PBC to decide to revalue the RMB as advocated by the IMF and advanced economies but harmful to China’s own exports.

4 Is Socialization a Good Approach to Analyzing the China-IMF Relationship?

Although the context of China joining the IMF and their earlier engagement created favourable conditions for socialization to take place, the sequence of socialization processes—mimicking, social influence, and persuasion—has not (fully) taken place. China’s economic leadership has gone through the phases of ‘mimicking’ and ‘social influence’ in the early stage since joined the IMF, yet not full persuasion. Achievement of persuasion would be China’s real acceptance of the IMF’s advocated neo-liberal economic norms; and the rejection of it shows that the Chinese government makes its economic policy decisions based upon more influential factors other than IMF propositions. 30 years into China’s IMF membership, the Fund has not successfully convinced the Chinese authorities to deeply change its minds, values, and attitudes to further liberalize its economy. Although China has undertaken domestic economic reforms in the style of liberalization that complies with IMF norms, it has refused to take into account IMF advice on the policy issues that are fundamental to the state’s domestic economic development, such as liberalization of interest rates and foreign exchange rates.
The reasons for China’s resistance to IMF policy advice are both political and institutional.

As previously mentioned, the lack of accuracy and depth in IMF Article IV Consultation is caused by the limited IMF personnel and expertise resources. On top that, the advisory, instead of mandatory, characteristic of IMF Article IV Consultation makes IMF advice rather pale and unconvincing facing the strong stance of the stubborn Chinese authorities. More importantly, the protection of the benefits of strong domestic industrial and financial groups further prevents IMF neo-liberal economic norms from intruding China’s domestic policy-making. China has a unique development model in which the government does not intend to minimize public and state ownership in the country’s crucial industrial sectors. In order to ensure the financial resources for the public and state owned sectors, as well as for the financial stability, the government prefers to liberalize its financial sector incrementally. The Chinese government would like to control the exact speed and pace of its financial liberalization, rather than letting the IMF make the decision. China prefers the IMF as a moderate and advisory coordinator rather than a watchdog that imposes its opinions on China. In addition, the fact that the PBC – as the IMF’s directly corresponding institution in China- does not have independent policy-making power makes IMF policy more difficult from shaping China’s financial policies.

These political and institutional obstacles to IMF socialization are fundamental and structural. It is not likely that the Chinese government will start to accept and internalize
the IMF’s neo-liberal norms to a much larger degree at the expense of the balance (or imbalance) of China’s domestic economic interests. Therefore it is not likely that the effectiveness of IMF socialization, especially those of persuasion will increase within a short period of time. These fundamental and structural obstacles have revealed some limitations in the ‘socialization’ explanation of the China-IMF relationship.

4.1 Measure of Normative Factors

First of all, the consequences of IMF socialization vis-à-vis China are difficult to observe and assess. The socialization approach focuses on the changes in China’s values and norms, which are mostly concealed and ambiguous. As mentioned in an earlier chapter, Kent tried to solve the measure of international socialization. In her paper ‘China’s International Socialization: the Role of International Organizations’, she proposed three indices to measure the international socialization for China. They are China’s readiness to redefine its actual interests, including its implementation of international norms in domestic law and practices; China’s preparedness to renegotiate its sovereignty in response to organizational and treaty pressure; and the degree to which China shows a readiness to shoulder the costs, as well as enjoy the benefits, of organizational participation. (Kent 2002: 349-358) Yet the terms such as ‘actual interests’, ‘sovereignty’ and ‘costs/benefits’ require for more specific explanations.

In the case of China-IMF interaction, IMF advice has provided China with some guidance for reshaping China’s financial policies and establishing new financial institutions and laws, yet it is unknown to what extent such guidance has influenced
China’s domestic reforms. China has increasingly participated in more IMF programs such as the GDDS in 2002 and the Financial Sector Assessment Program (FSAP) in 2009, which reflected China’s willingness to renegotiate its economic sovereignty by submitting more financial data and information to the Fund. However, the Chinese government blocked the publication of its Article IV Consultation staff reports in the period of 2007-09 for unknown reasons, which showed it was not completely prepared to ‘renegotiate its sovereignty’ with the IMF. In this case, we cannot judge whether the IMF has successfully socialized China into accepting its norms.

4.2 Material and Non-material Impacts

Secondly, the socialization approach focuses on the international organization’s nonmaterial impacts on the state including the changes in its political principles, values, and norms that are reflected in the later practices. In practice, it is highly unrealistic to separate nonmaterial from material impacts on the state policy practices, especially in the cases of IMF financial assistances. The IMF provides the member states that have balance of payments difficulties with loans. These loans are attached with conditionality, which require the loan beneficiaries to carry out domestic political and economic reforms under the guidance of economic liberalization in order to secure the succeeding issuance of loans. The socialization theorists argue that the international neoliberal economic norms are transmitted to the member states via IMF lending conditionality. I agree with this increment process of norm transmission; however, I want to point out that the material incentive (financial benefits) is the primary motivation for state engagement in the IMF lending mechanisms. The norm transmission process would be cut off if the state
finds a lending source that is more tolerant toward its domestic political environment. Therefore, in some, if not the most cases, the nonmaterial impacts are built upon the material impacts.

Although China does not receive much financial assistance from the IMF, it does take into account the concerns of material benefits/costs when it makes the decisions of whether to compromise more sovereignty and invite more IMF technical assistance and policy advice in domestic affairs. The more benefits of engaging in the IMF are reflected in the measurable material terms, the more attractive IMF programs seem to be to the China authorities.

4.3 Other Factors than IMF Socialization

Thirdly, international organization socialization is not the only- may not even be the primary- influence of the changes in the member state’s political principles, interest, values and norms. The consequences of international socialization are often reflected through the state’s institutional changes and policy practices. However, we cannot easily judge if a certain domestic change is due to the socialization of the specific international organization that the state participates in, because the state’s institutional changes and policy practices respond to various internal and external factors.

Internally, as mentioned in the earlier text, China’s domestic financial policy-making is influenced by several domestic governmental departments, such as the PBC, CBRC, MOF, SAFE, and the NBS. Therefore if the PBC that interacts with the IMF has less
influence in the domestic political system (which is true in many cases) than those of others\textsuperscript{29}, the IMF may fail to socialize China into accepting and implementing its advocated norms. In this case, even if the IMF has successfully convinced the PBC to accept its norms, it still has limited influence on the final decisions of the Chinese government. The multiple sources of institutional and power influences make it difficult to distinguish in the impact of IMF socialization.

Externally, China participates in various economic institutions and programs. China has undertaken its domestic reforms in the past three decades in the style of liberalization, which matches the advocated IMF neoliberal economic norms. However, it does not mean the interaction with the IMF is the only reason behind China’s economic liberalization. China has engaged with various international and regional institutions in the past three decades, such as the World Bank, the WTO, the G20, the BRICS and so on. Each of these institutions may lead China to change its existing interests and values; and therefore it is difficult to tell which of these institutions (and to what degree) socializes China into accepting their specific norms. The neoliberal economic norms exist in a certain political environment rather than a single institution, and each institution in the environment interprets the norms in a unique way. If China is proved to be socialized into accepting the neoliberal economic norms, it is usually the consequence of China’s engagement with a mixture of international and regional organizations rather than any single one of them on its own.

\textsuperscript{29} They may, or may not, be influenced by the socialization of other international organizations.
In addition, China’s increasing participation in the international financial market has probably ‘socialized’ China into accepting more liberal economic norms than in international economic organizations. The market imposes penalties automatically when the behaviour of Chinese financial institutions and firms deviates from its expectations and from those of other market players. Market forces also promote transparency and efficiency, and encourage China to improve self-regulation in the financial sector. Exploiting the public international capital market required that Chinese listing entities—including the Ministry of Finance and non-sovereign borrowers such as the Bank of China, the Construction Bank of China, the China International Trust and Investment Company, and regional trust and investment companies—divulge more information in the 1990s than in the past. China’s entry into the international equity markets also raised requests for more information and increased transparency. In the early 1990s, the Chinese regulatory authorities spurned an initial information suggestion that it offers its equity shares on a to-be-created second-tier Hong Kong market where the listing requirements would be less rigorous. Alternatively, the Chinese authorities chose to meet the normal listing requirements. Therefore, a large amount of work was required to restate the accounts of Chinese firms in the standard Western format; and a much greater degree of financial disclosure was required. (Lardy 1999: 212-14)

4.4 State as a Strong-minded and Self-determined Member

Fourthly, the socialization approach simply assumes the international organizations are the providers of the international norms, and states are the takers. It does not fully apply to the China-IMF case. It explains better the China-IMF relationship in the period when
China just joined the IMF than that of later periods when China got more familiar with IMF practices and more confident with its own development model. After decades of isolation, China was lacking the capital and expertise when it regained IMF membership in 1980. China had very little knowledge of the methods used in financial practices and the rules and regulations in the international financial system. China was also unfamiliar with the practices of the IMF and other international economic organizations. Since China was willing to learn all the methods and rules from the IMF while the Fund was seeking to diffuse the neoliberal internal economic norms among developing countries, it created a suitable environment for socialization in the early period.

Even then, we ought not to ignore China’s intention to cooperate with the IMF. China was clear about its willingness to learn the financial practices and earn international approval from the IMF, as much as its unwillingness to have the IMF overly intervene its domestic policy-making. China has always had a unique domestic political and social system, backed by very strong self-consciousness and culture. China did not join the IMF by chance; instead, it had a clear goal of what it wanted to achieve and how the IMF could help it achieve the goal. This goal also grew over time. For example, in the 1980s and 1990s the Chinese authorities mainly hoped the IMF would teach standardized financial practices and rules to the Chinese officials who were taking charge of domestic financial reforms. Since the 2007/08 global financial crisis, China has urged the IMF to maintain stability of the international financial system in which China now has a bigger share of. (Eichengreen 2009; Baston 2009: A10; Xiang 2010)
Later when China got more involved in IMF and other international economic activities, it learned to develop a strategy to handle the IMF-related issues, and hence not just did what it was told to do. The strategy includes a better assessment of the cost/benefit of signing up for IMF programs, alignment with other emerging market and developing country members in order to build a stronger community within the Fund, and seeking to have a stronger voice in IMF formal and informal governance. Therefore, while learning the internationally formalized financial practices and being socialized into accepting the international neoliberal economic norms to the extent that is controlled by the authorities themselves, China’s participation may also lead the IMF to modify its institutional structure and policy practices. As described by Chin, it is a ‘two-way socialization’. (Chin 2012) The socialization approach drives us to focus on the IMF’s impacts on China, which may lead to ignorance of China’s impact on the IMF. For example, China’s participation further legitimated the IMF’s status as genuine global organization, and blunted the charge that it was merely the instrument of Western imperialism and exploitation. (Jacobson and Oksenberg 1990: 131) The IMF also gained important information and knowledge about China’s political and economic development via its interaction with various Chinese government officials and experts, because an increasing amount of data became available to the IMF, and through that to other international institutions. China’s participation in the IMF also broadened the IMF’s view on economic development of some transition economies such as the Eastern European countries and developing countries such as Vietnam and Tanzania in the early years, and other emerging market economies in the later years. (Jacobson and Oksenberg 1990) In addition, China has been endeavouring to push forward IMF quota and voting share
reforms that mean to strengthen the decision making power of the emerging market and
developing country members.

As China grew stronger in general in the past three decades, its role in the international
political society has largely increased. As a result, China is less threatened by the
sanctions from international organizations. As China gets more familiar with the rules in
the international political society, it has also joined more international and regional
organizations. These outside options have made China even less restricted by the Fund.
Apart from engaging with other international organizations, China sometimes prefers to
take the bilateral cooperation that is relatively flexible, or chooses to take the unilateral
solution if no international cooperation fits into its agenda.³⁰ China has also developed its
own strong interests and values. Supporting by its increasing economic power and
political influence (especially in the emerging market economy and developing countries),
China is less willing to compromise its interests and values; instead, it is more likely to
promote its own norms via interactions with international organizations. As Elizabeth
Economy argued, ‘Beijing has launched a “go out” strategy designed to remake global
norms and institutions’; and ‘China is transforming the world as it transforms itself...
China has become a revolutionary power’. (Economy 2010: 142) It is uncertain how
strong China is to change the rules in the international financial economy, yet it is
definite that China is not a passive rule taker. It strives to promote an international
financial economic system where its own expansion is not largely constrained.

³⁰ China’s bilateral, unilateral and regional financial cooperation will be discussed later in Chapter 7.
The socialization approach takes the international norms as granted, which overestimates the correctness, universality, and adaptability of the norms. The international norms are not static. They may be extended to a global level; and in this case it is difficult to tell if the later changes in the state are due to socialization by a specific international organization or the general environment. The international norms advocated by the international organization may also fall behind the development of the political environment and become unsuitable for guiding the state’s policy practices anymore; and in this case it is not appropriate to assume the international organization continues to socialize the state into accepting norms that are out of date. IMF policy guidance for its member countries is controversial. Its incorrect policy guidance for the Southeast Asian countries during the Asian financial crisis incurred massive criticism. Its advocacy about capital control and exchange rate regime has been proved wrong in several cases. (Moschella 2012) In addition, the IMF’s internal governance structure does not match the economic power structure among states in the real international economic society. While emerging market economies are playing an increasingly important role in the world economy, the IMF is still mainly controlled by the western developed countries whose shares in the world economy are shrinking. (Woods and Lombardi 2006) Hence the IMF’s promotion of neo-liberalism and its unbalanced governance structure have made its norms less suitable and attractive among many states. It makes the proposition on IMF socializing states into accepting and internalizing its norms less convincing.
5 Conclusion: China’s Objectives and A Different View of the China-IMF Relationship

Hence we need a different approach to analyzing the relationship between China and the IMF in the later stage where China has developed its own objectives and strategies in the governance of the international financial economy. We need an approach that is not restricted to ‘normative’ factors in the interactions between China and the IMF; that also takes into account of China’s participation in other international institutions, and impacts of China’s domestic political concerns and institutions; and that correctly addressed China’s strong intentions that lead it to further participate in IMF programs. The last point is extremely important, because the Chinese government’s objectives largely (if not solely) determine its strategic moves in the international political sphere. China’s objectives should be regarded as the primary driving force of its participation in IMF programs in the new approach.

In addition, some of the causes of unsuccessful IMF policy advice are related to the inadequacies in IMF functions such as lack of expertise resources to support the Article IV Consultation for China and the weak advisory (rather than mandatory) features of Fund surveillance programs. Hence the new approach should pay more attention to the IMF’s functions that directly lead to the result of its interactions with China and other members.
The results of IMF policy advice also disclose the strong influences of the Chinese authorities’ political preferences. Since the authorities insist on protecting the interests of powerful domestic industries and financial sectors that are likely state-owned, they are reluctant to compromise when they deal with the IMF advice that calls for market-determined resource distribution and reduction of government administrative controls. It does not only happen in IMF surveillance and policy advice. In general, when the IMF’s preferences deviate from those of the Chinese authorities, the results of interactions between the two are likely to be disappointing. The impacts of the Chinese authorities’ preferences further emphasize China’s initiative in participation in IMF programs. China, as an increasingly influential IMF state member, is not submissive to the Fund’s decisions and norms.

The limitations of socialization theory thus drove my attention to principal-agent theory. Principal-agent theory refers to relationships between states and international organizations based on delegation. States, based on their needs and objectives in a certain issue area, delegate authority to an international organization that performs the delegated tasks on the states’ behalf in order to benefit the states. International organizations have independent functions and institutional rules and political practices, and they decide the ways in which they want to accomplish the delegated tasks. International organizations can be highly influential that they can influence the states’ decisions on delegation, which is compatible with socialization theory’s focus on international organizations’ impacts on their state members.
As a theoretical framework, principal-agent theory is not restricted by the division between material and normative factors. It takes into account the states’ institutional features and their relative positions in the international organization. Most importantly, it emphasizes the states’ objectives and the international organizations’ functions as the reasons for delegation. Principal-agent theory also looks into the states’ preferences, compared to those of the international organizations’, in order to assess the results of the interactions between states and international organizations.

Principal-agent theory overcomes some limitations in socialization theory, yet it does not deny the probability of international organization socializing state members into accepting their norms and values. It recognizes the normative influences of international organizations, which are based on the organizations’ institutional rules and patterned behaviour and the staff’s working principles and values. Hence, it greatly supplements socialization theory in analyzing the relationship between China and the IMF in the later stage. The essential concepts and causal relations in principal-agent theory will be reviewed and discussed in the next theory chapter. Following the theory chapter, principal-agent theory will be used to analyze the relationship between China and the IMF in Chapters 5, 6 and 7.
Chapter 4 - Theoretical Approach (II): Principal-Agent Theory

1 Introduction

Principal-agent theory in international relations is used as a direct approach to defining the relationships between states and international organizations. It assumes states as principals, and international organizations as the states’ agents in the international political sphere. (Nielsen and Tierney 2003) Principals and agents are tied up together via ‘delegation’, which is also the most essential interaction in principal-agent theory. All the causal relations are based on delegation in the principal-agent theoretical framework. States delegate authority to international organizations because the latter have advanced functions that can help the former accomplish various tasks in order to achieve their goals. (Hawkins et al. 2006)

Principal-agent theory not only defines relationships between states and international organizations, but also examines the related factors of delegation, including its causes, processes, and consequences. The purpose of such examination is to pursue a more comprehensive and thorough understanding of the relationships between states and international organizations. Delegation indicates dynamic relationships between states
and international organizations, affected by various features of both sides of the actors as well as the external environments. For instance, states’ and international organizations’ interests and preferences can primarily affect the states’ decisions on delegation. States’ and international organizations’ governance structures also matter. An international organization’s institutional structure determines each state’s role of governance and thus its decision making power in the organization, which leads to specific delegation consequences. A state’s governance structure determines the form of delegation (with a certain degree of discretion) and the length of the ‘delegation chain’ in a principal-agent framework. States’ decisions on delegation to an international organization do not remain the same permanently, and they vary according to the consequences of delegation. If satisfactory delegation consequences are generated, states may choose to ‘re-delegate’; however, if the delegation consequences are undesired, states may ‘de-delegate’. In the dynamic process of delegation, states seek to use controlling mechanisms to ensure satisfactory delegation consequences; meanwhile, international organizations use agency strategies to influence the states’ decisions on delegation. (Ibid)

Principal-agent theory can be used to analyze the relationship between China and the IMF, because the Chinese government has explicit objectives in the international financial economy that can be achieved with the IMF’s assistance. In other words, the Chinese government delegates tasks to the IMF due to its advanced functions, so that the IMF can accomplish the tasks more effectively (than China undertaking the tasks on its own or delegating them to other institutions). This is consistent with the Chinese government’s pragmatic and cautious diplomatic approaches: driven by its distinct
objectives, the Chinese government gets engaged with international organizations for various benefits; meanwhile, it avoids getting involved in controversial events or those that threaten China’s sovereignty. Principal-agent theory also facilitates assessments of the consequences of China’s delegation (of tasks) to the IMF. Such assessments involve examinations of a number of key factors mentioned above, such as actors’ preferences and governance structures, principal controls, agency strategies, and so on, based on China’s and the IMF’s functional roles that are set as principal and agent respectively. Before the examinations are carried out, the key concepts and causal relations in principal-agent theory need to be reviewed and discussed.

Section 2 of this chapter includes a brief introduction of principal-agent theory in multiple disciplines, including microeconomics, American politics, comparative politics and international organization studies. Section 3 focuses on the concept of delegation, especially the reasons for states to delegate tasks to international organizations. When states make decisions on delegation, they are usually motivated by international organizations’ outstanding expertise, political skills, and resources; agenda setting power that enables them to generate equilibrium in controversial circumstances; capability to govern decision-making in situations where the contract is not explicit; capability to solve time-consistency problems; and capability to ‘lock-in’ political winners’ policy effects. In section 4, the key features of the main actors in the principal-agent framework—principals, agents and third party actors— are discussed based on the existing literature.
The reviewed essences of principal-agent theory effectively contribute to the proposal of a systemic approach to analyzing the relationship between states and international organizations in Section 5. The approach has four stages: identifying actors, analyzing agents’ functions and principals’ consequential delegation decisions, evaluating agents’ delegation actions, and assessing the consequences of delegation. These four stages are a connected sequence; and the results of one stage are linked to the later stages. In particular, the consequences of delegation depend on the features of the involved actors, their functions and delegation processes. The proposed research approach enables us to specify the relationship between China and the IMF in a more analytical and orderly way. However, the interactions between China and the IMF mark a unique principal-agent framework, where some specific features and causal relations are distinct from the principal-agent interactions in the previous research. They reflect the originality of applying principal-agent theory in the China-IMF interactions. These unique features and causal relations are examined in the 6th section of the chapter.

2 Principal-Agent Theory

Principal-agent theory derived from agency theory in the field of microeconomics. It was originally designed to solve the information asymmetries issues in the insurance sector. (Spence and Zeckerhauser 1971) Economists specified the key concepts and issues of principal-agent theory and developed a canonical model to test the theory. (Holmstrom 1979; Shavell 1979) The later development of the theory increasingly focused on information asymmetries and incentives; and it was applied in a broader range of areas
Principal-agent theory further developed in the studies of American (especially congressional) and comparative politics. (Shepsle 1979, 1986, 1989; Weingast and Moran 1983; Weingast 1984; McCubbins and Schwartz 1984) For example, Weingast and Moran argued that the congressional committees possess sufficient rewards and sanctions to create an incentive system for agencies. The bureaucrats are motivated by incentives to act in the Congress’ best interests. Therefore, members of the Congress shape bureaucratic behaviour without monitoring, by offering implicit contracts based on the observable effects of the behaviour. (Weingast and Moran 1983; Weingast 1984; Miller 2005) Political scientists also used principal-agent theory to explain the relationship between the chief executive (as the agent) and the general public (as the principal). (Downs and Rocke 1994)

This rational choice institutionalist logic was extended to studies of international organizations, where international organizations are regarded as bureaucracies at the international level. The basic framework of principal-agent theory applied in international organization studies is that member states (as the principal) hire an international organization (as the agent) to perform some functions that will benefit the members. (Nielson and Tierney 2003: 245) The member states usually have clear goals to achieve; and under the impact of conceived benefits of international organization functioning, they choose to delegate tasks to the international organization in order to pursue the goals. Member states use various forms of controlling mechanism to ensure their international organization agent would fulfill its duty to accomplish the delegated tasks. Yet it does not

31 For Classic works in agency theory in Economics, please see Alchain and Demsetz 1972, Williamson 1975, and Fama 1980.
mean the international organization agent loses all of its controlling power to the principal member states. While international organizations carry out tasks, they act independently, with little interference from the member states. They are sometimes even empowered to sanction member states in order to facilitate dispute resolution or bolster treaty commitments. Yet some other international organizations are more constrained to follow the orders of their member states. The degree to which the international organization enjoys autonomy depends on its institutional design and relationship with the member states.

Just like in domestic institutions, problems emerge when member states delegate to their international organization agent. Kiewiet and McCubbins pointed out three specific difficulties when delegating. Similarly, in international spheres, the agent can even more easily ‘hide information’ from the principal whose revelation would hurt the agent and help the principal. The agent can do things behind the principal’s back, ‘concealing actions’ that the principal would sanction if known. The principal faces ‘Madison’s dilemma’- in which the need to delegate authority may give powers to the agent that can be used against the principal. (Kiewiet and McCubbins 1991) Principal-agent theorists mostly assume the principal and agent have different preferences, or opposite ones in some extreme cases, which is the main reason for uncoordinated actions and unwanted results of agent behaviour, that is agency slack. Although the principal uses various controlling mechanisms to keep the agent on the desired track, it cannot prevent the problems completely. In this case, the principal can renegotiate (or threaten to renegotiate) the contracts with the agent, which may lead to re-delegation or de-
delegation. Such threats and institutional reforms may impose costs on principals, but they can employ these tactics strategically to modify agent behaviour.

In a well-designed principal-agent framework, member states ought to have clearly established goals; and after careful assessment of the cost and benefit of delegation, they make the decision to delegate certain tasks to an international organization. The member states ought to design a self-enforcing contract and carry out appropriate controlling mechanisms that induce the self-interested international organization to abide by the wishes of the members. Unfortunately, the ideal principal-agent model does not happen often; and agency slack is detected in most of the cases. In order to explore further principal-agent theory in the studies of international organizations, I need to firstly clarify the key concepts in the theory.

3 Delegation

Delegation refers to the most essential relationship between the principal and the agent. Without delegation, the principal-agent framework could not function. According to Hawkins et al, delegation is ‘a conditional grant of authority from a principal to an agent that empowers the latter to act on behalf of the former.’ (Hawkins et al 2006: 7) This grant of authority is not automatically valid permanently, which means the principal can revoke the authority from the agent because of results that differ from the expected ones when the delegation decision was originally made. Principal-agent theorists often emphasize the importance of principals’ and agents’ preferences. They consider that the
agent’s preferences differing from those of the principal’s leads to undesired practices and results, although they do not imply particular assumptions about the actual preferences of both sides. What puts specific theories under the name of ‘principal-agent theory’ is a focus on the substantive acts of principals in granting conditional authority and designing institutions to control possible opportunism by agents. (Hawkins et al 2006:7) Therefore, principal-agent theory is a relationship- and action- based theory, a theory that is based on ‘delegation’ in particular. It is the strategic interactions between principals and agents and the consequences that matter.

When the principal grants authority to the agent, it could set strict rules to restrict certain actions to be undertaken by the agent in order to accomplish the tasks. Nevertheless, in most of the cases in international relations, member states would not carry out this rule-based delegation to international organizations; instead, they would prefer discretion. Discretion refers to a grant of authority that specifies the principal’s goals but not the specific actions to be undertaken by the agent to achieve the principal’s goals. Discretion enables the agent to accomplish the delegated tasks in the way it prefers, under the guidance of its specified expertise and techniques. Therefore, discretion is more likely to lead to a professional and efficient accomplishment of the tasks, which is one of the essential reasons why the principal decided to delegate in the first place. Discretion enables the agent to enjoy a larger degree of autonomy, with which the agent is able to develop its own interests and policy practices.

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32 Hawkins et al regard autonomy as the range of potential independent actions available to an agent after the principal has established mechanisms of control. It is different from agency slack (which will be analyzed later in the chapter) as agency autonomy is intentional, whereas agency slack is undesired. (Hawkins et al 2006:8)
Before the principal makes the decision to delegate, it usually has already run a careful assessment of the costs and benefits of delegating certain tasks to the agent. The assessment could be based on the principal’s own knowledge of the agent. It could also be based on information provided by the agent, especially if the potential principal is not initially familiar with the specific functions of the agent. In the latter case, the agent could use strategies to convince the potential principal to delegate. After the authority is already granted, the agent could still use strategies to convince the principal to (re)-delegate more precisely designed tasks, or to authorize new pursuits for the agent later. For example, in the domestic political sphere, the executives could use favourable policies to convince the voters to, or to continue to, support the government. In the international sphere, international organizations could introduce specific programs to the member states and convince them to delegate tasks to the organizations. Thus with regard to the decisions about delegation, the agent is not necessarily subordinate to the principal, as its functions and strategies to a large extent influence the principal’s decisions to delegate, or not.

3.1 Reasons to Delegate

The principal’s decisions about delegation- including which agent to delegate to and what tasks to be delegated- are based on the agent’s functions. This logic is very close to the functionalist approach of rational choice theory. Pollack maintained that it explains choices of institutions in terms of the functions a given institution is expected to perform and the effects on policy outcomes it is expected to produce, subject to the uncertainty
inherent in any institutional design. (Pollack 1997:102-103\textsuperscript{33}) To be applied in the studies of international organizations, it explains why member states pick a specific international organization to govern certain subsequent interactions. In general, the principal-agent model of delegation has inherited the functionalist approach, by which it has identified a number of functions for which principals may choose to delegate authority for. However, the agent’s functions that seem conducive to the principal do not sufficiently lead to successful and productive delegations. In practice, successful and productive delegations also largely depend on the institutional design of the agent organization, an argument that differs from that of Pollack’s. In any case, I would like to discuss first the reasons for the principals to delegate, i.e. distinct functions of the agents, in the following pages.

First of all, the Principal delegates tasks to an agent, instead of taking an action by itself, because of the agent’s outstanding expertise, political skills, and resources to perform the tasks. The agent’s specialization is the most basic reason that leads the principal to delegate. Nevertheless, gains from one-time task accomplishment is unlikely to lead to delegation. When one-time tasks occur, the actor would probably perform the tasks by itself rather than bear the costs of designing, creating, finding and controlling an agent. On the other hand, if the tasks to be performed are repeated or increasingly challenging, specialization-driven delegations are likely to take place. Delegation to an international organization is largely because of the organization’s superior technical expertise,

\textsuperscript{33} Pollack quoted Robert Keohane’s argument on this point, ‘in using rational-choice analysis to study institutions… we are immediately led toward a functional argument… In general, functional explanations account for causes in terms of their effects… So, for example, investment is explained by profit, as in the statement ‘The increased profitability of oil drilling has increased investment in the oil industry.’ Of course, in the temporal sense investment is the cause of profit, since profits follow successful investment. But in this functional formulation the causal path is reversed: effect explains cause. In our example, this inverse link between effect and cause is provided by the rationality assumption; anticipated profits lead to investment.’ (Keohane 1984:80)
credibility, and legitimacy that states are lack of to make policy on their own. For example, the International Criminal Court has the superior legitimacy to prosecute international war crimes and crimes against humanity that are inappropriate to be processed by the courts at national levels. (ICC official website\textsuperscript{34}) The intervention of the UN Peacekeeping force is more legitimate than that of any single sovereign state. The IMF has centralized expertise to collect and analyze data from various nation states, which enables the Fund to provide policy advice to its member countries. States delegate routine loan decisions to the World Bank and IMF, whose professional risk assessment and lending conditionality ensure the safe return and good use of the money. However, powerful states sometimes acquire sufficient technical expertise to perform the tasks on their own or by cooperating with a small group of privileged states; yet such actions do not enjoy the same level of legitimacy as delegating to an international organization.

Secondly, states sometimes cannot reach an agreement on policy with regard to some controversial issues, in which case they can delegate to an agenda-setting agent to induce an ‘equilibrium when one might not otherwise exist’. (Hawkins et al 2006:16) International Organizations often provide member states with a forum to discuss the issues that affect multiple entities, which are not only impossible to be solved unilaterally, but where the states also find it extremely difficult to reach an policy agreement. This happens especially when the relevant states have diverging opinions on the issue, and the political power influences among these states are relatively balanced. Pollack used the example of the European Commission’s role within the European Union

\textsuperscript{34} Accessed at: \url{http://www.icc-cpi.int/en_menus/icc/about%20the%20court/Pages/about%20the%20court.aspx}
to prove the distinctive agenda-setting power of international organizations as agents. (Pollack 2003: 84-85) However, even if the issue is brought into an International Organization, collective-choice dilemmas may still happen, especially when the organization managing the coalition’s collective preferences is far from the preferences of the powerful member states. On the other hand, the more convergent the membership’s preferences and the politically weaker the preference outliers in social intransitive settings, the more likely states will be to delegate to an agenda-setting international organization. (Hawkins et al. 2006: 17)

Thirdly, the relationships among states and other non-state international actors are largely based on various contracts, such as Free Trade Agreements, Status of Forces Agreements, the CTBT, and so on. Some of them are bilateral and some are multilateral. These transnational contracts reflect mutual agreements among the actors on various issues in international affairs, yet they do not guarantee completely coordinated actions among actors. This is because the contracts are invariably incomplete. Although the related parties endeavour to consider all possible future situations and to negotiate ex ante the responsibilities and appropriate actions, it is impossible to settle a permanent contract to include all the possible contingencies. (Williamson 1985) Therefore, as Milgrom and Roberts argued, the contracting parties would rather ‘content themselves with an agreement that frames their relationship- that is, one that fixes general performance expectations, provides procedures to govern decision-making in situations where the contract is not explicit, and outlines how to adjudicate disputes where they arise.’ (Milgrom and Roberts 1990: 62)
Pollack pointed out that these procedures may, or may not involve the creation of a new agent and/or delegation to an existing agent. If the uncertainty is relatively less great, the parties may choose to lay down rules governing future decision-making and dispute arbitration. If the uncertainty is very great and future decision-making is expected to be complex, the parties are more likely to choose to delegate these activities to an agent that can fill in the details of an incomplete contract and adjudicate future disputes among the parties. (Pollack 1997: 104) In particular, if the parties have difficulties in reaching an agreement on the contract, they can create an agent or select an existing agent with high autonomy. With its strong autonomy, the agent can generate a more fair agreement that is more accepted by the principals in general. If the principals design the agent and sequent policy processes well, the agent’s decision will reflect the average purposes of the agreement.

Fourthly, policymakers suffer from time-inconsistency problems, because they attempt to implement policies that aim for long-term political goals, which may violate the short-term interests of the affected parties. In this case, the political actors lose credibility among the affected parties. Credibility problems can also occur when issues impose concentrated costs and diffuse benefits, as argued by Pollack. To prove the argument, he used the example of EU competition policies that hurt producers but benefit general EU citizens to explain credibility problems for states with major producers negatively affected by the policies. (Pollack 2006) When the political actors suffer from credibility problems, they could choose to delegate authority to an international organization or
revise an existing IO contract to enhance the credibility of their policy commitments. (Martin 1992a; Stone 2002) In some cases, the issues are simply too complex to be processed in a national-level institution, and thus the tasks are delegated to an international independent institution with higher political credibility. In any cases, Hawkins suggested that ‘principals can mitigate these problems by delegating policy to enforcing agents with high discretion and, typically more extreme preferences so that, left to their own devices, the agents will move policy in the desired direction.’ (Hawkins et al 2006: 19)

And finally, the political actor that seizes the power to implement policies may lose its power in the future; and in this case the actor could choose to delegate to an agent in order to preserve the validity of its advocated policies. This is called ‘lock-in’ effect in American politics. As Moe described it, ‘most political institutions arise out of a politics of structural choice in which the winners use their temporary hold on public authority to design new structures and impose them on the polity as a whole’. (Moe 1990: 213-222) It could also apply to international institutions. For example, the United Nations Security Council has a permanent membership that is composed of the winners of the Second World War, which aims to ‘lock-in’ the balance of power in the international political society in 1945 when the War just ended. When principals delegate to international organizations to ‘lock-in’ their preferred policies, they would design the mandate carefully so that it cannot be easily changed or removed. For example, they would design specific voting rules that will stick to the agent to reserve their political dominance in the agent. For instance, the IMF voting rules that ensure the veto power of the US and the EU
countries added together, respectively, have successfully ‘locked-in’ the utility and political dominance of the Fund’s western advanced economy members.

4 Actors in the Principal-Agent Framework

Assessments of the consequences of delegation to international organizations require accurate analysis of the involved actors’ identities, including their institutional rules, structures and preferences. They can be very complex sometimes. Wrong identification of the actors may lead to incorrect application of principal-agent theories. The key actors in a principal-agent model are principal, agent and third party actor, yet each category may include more than one entity, depending on the setting of the model.

First of all, since various member states delegate authority to an international organization, the organization needs to respond to multiple principals respectively. Sometimes they delegate authority to the international organization over a common contract, and in this case the member states are considered as a collective principal. Yet the way the decision-making power is distributed among the collective principal is crucial. In fact, in most of the cases, member states delegate authority to an international organization as a collective principal. However, we often focus on the relationship between a specific member state and the international organization in research. Nevertheless, we cannot ignore the impact of other member states, either as separate principals or as the remaining part of the collective principal. In addition, the impact of the preferences of the member state as a single principal differs from that of the member
state as a part of a collective principal. Moreover, although so far we have assumed ‘member states’ as principals, in many cases a specific sector(s) of the states acts as the direct principal. The preferences of the sector(s) may differ from those of other domestic sectors, and in this case the principal’s policy strategies toward the agent may become complicated, as it needs to convince the other domestic sectors at the same time. Other sub-national, national and supranational actors are also often considered as principals in IR studies.

Agents also have complex identities. We usually consider international organizations as agents in principal-agent models. Most international organizations have complex internal governance structures and various functioning sectors. In one international organization, not all the functioning sectors act like agents to the member states, yet they have overlapping responsibilities within the organization. In some cases, when the international organization has strong influence on the member states’ (especially developing country member states) domestic policy practices, they act like principals to these same states that are also part of the collective principal to the organization itself. In addition, the agent’s preferences are crucial when we assess the consequences of delegation. If the agent’s preferences largely differ from those of the principal’s, and the principal does not carry out effective controlling mechanisms, it is likely to generate undesired results of delegation.

Last but not least, principals and agents are not the only actors in the principal-agent framework, where third party actors may also play an important role. For example, driven
by their own interests, the third party actors may attempt to influence the principals, who consequently lead their agents to act in certain ways. The third party actors sometimes could even influence the agents directly and lead them to act independently from their principals.

Due to the complexity of the structures of the actors (both principal(s) and agent(s)), the principal of one agent could be the agent of another principal. In addition, the line between the third party actor and the principal can be blurred sometimes, depending on how significant the actor’s impacts on the agent are. In any case, the networks among principals, agents and the third party actors are important constituent parts of the principal-agent framework.

4.1 Principal

Principals are the political actors with clear intentions, goals, and preferences. They delegate part of, or all of their tasks to agents, the action of which makes them principals. Principals cannot keep their status without agents. In the simplest principal-agent model, a single principal delegates authority to a single agent. Nonetheless, in reality, usually more than one actor delegates to an agent. When a single agent has more than one contract with organizationally distinct principals, such delegation relationship is called ‘multiple principals’ (Calvert, McCubbins and Weingast 1989; Hammond and Knott 1996) A good example of ‘multiple principals’ delegation is the EU, where the European Commission is responsible to both the Council of Ministers and the European Parliament. Both the institutions, acting as principals, can re-contract with the European Commission
independently. (Nugent 2003) On the other hand, when an agent has more than one principal, and the principals delegate through one contract, such delegation regulation is called a ‘collective principal’. Most international organizations are responsible to collective principals. For example, the member states send representatives to the IMF, and some of them become executive directors who compose the executive board. The executive directors reach agreements among themselves and then delegate tasks to the IMF (staff and management). If the executive board cannot reach an agreement, whether via discussion or voting, then they have to keep the status quo.

While the members share one delegation contract with the agent, they often do not have the same influence on the agent. In some cases, a small group holds a disproportionately large amount of influence; and in the most extreme case, one strong member holds dominating influence. Therefore, the way the decision making power is distributed among the actors (for example, voting rules, or election rules) within the collective principal is crucial. Within a collective principal, if one actor or a group of actors has a veto power, then any decision to remove the agent or reform the agent’s incentives must be preferred to the status quo by the veto player. This makes the status quo difficult to change. Nielson and Tierney pointed out that an agent at the status quo might be insulated from interfering principals, especially if coordination within the collective principal is costly or if any member or group of members with the power to veto a change is willing to do so. (Nielson and Tierney 2003: 248)
Within the collective principal, each member’s preferences, especially those compared to other members’ preferences can affect the coordination between the (collective) principal and the agent. Since delegation requires member states to resolve their policy conflicts before they can mutually decide to grant authority to the agent, the more unified the member states are, the more likely it is that they will reach agreement and delegate to the international organization. The less similar the member states’ preferences, the less likely they will be to delegate to the agent. However, in an international organization, it is unlikely that all the member states share the same goals and preferences. In addition, the greater the heterogeneity of the member states, the less likely they will be to revise an existing delegation relationship, since some of the members would prefer the status quo to any proposed institutional and policy change. Preference heterogeneity gives more space for agent autonomy, because if the agent is aware of the disagreement among the collective principals, it could play the members against each other. It makes it difficult for the collective principal to revise, or threaten to revise, the delegation contract. Hence, the agent can more easily ignore threats and refuse to modify its behaviour. (Nielson and Tierney 2003: 249)

When we study the relationships between states and international organizations, we often simply assume the ‘state’ is a single actor. In the principal-agent framework, we often consider the ‘member state’ as the principal and the international organization as the ‘agent’. Such simplification of actors’ identities could sometimes lead to incorrect assessment of the causes and consequences of the actors’ interactions. When the state government appoints a specific team of officials and their functioning department to
collaborate with an international organization, these officials (together with their
department) only represent a certain set of all the state governmental mandates and
functions. These officials compose the proximate principal of the international
organization. These officials cannot independently make delegation decisions. They are
either controlled by some domestic governments of higher levels, or directly responsible
to the domestic voters and interest groups. Therefore, while they delegate to the
international organization as a principal, they also play the agent role vis-à-vis some other
political actors. This complex mechanism is described as ‘delegation chain’. (Nielson and
Tierney 2003; Broz and Haws 2006)

Take the US delegation to the IMF as an example: following the delegation chain, several
domestic actors can have direct and indirect influences on IMF behaviour. The delegation
chain includes four groups of actors: private actors (voters and interest groups), Congress
(legislators), Executive (President, Secretary of the Treasury), and the IMF (US
Executive Director). Broz and Haws used this delegation chain that links US private
actors to international decision-making to explain the ‘micro-incentive that underpin the
behaviour of complex international organizations’. They assume that private sectors
advance their international financial policy goals through one of three channels: directly
to the IMF, via the Executive Branch, or by way on Congress. Meanwhile, since the
Congress plays an active role in funding decisions, the Congress can indirectly influence
the Fund via the Executive Branch. Therefore, IMF behaviour is not only directly subject
to the control of the Executive Branch, but also that of the Congress and the private
actors, indirectly. Eventually they found out that, through the delegation chains described
above, American ‘money-centre’ banks comprise a key constituency for the IMF and lobby on its behalf. US policy-makers use their influence at the Fund to ensure that countries where American banks are highly exposed can secure IMF loans. (Broz and Haws 2006: 77-80)

Unlike the US, most other states are not so deeply embedded in international organization decision-making processes and the international political society in general. Nonetheless, they also often have complex delegation chains vis-à-vis international organizations, although the distant principals may not effectively influence international organization behaviour. However, since the proximate principal is often subject to the influences of other domestic political sectors, the delegation contract with the international organization could turn out to be complicated. Therefore, the longer the delegation chain is, and the more complex the principal state’s domestic political environment is, the less predictable is the delegation result.

4.2 Agent

The title of ‘agent’ makes a political actor sound subordinate, because agents receive tasks from, and accomplish them on behalf of, the principals. Agents do not initiate tasks by themselves. In international organization studies, we consider international organizations as agents. Most of the international organizations were established under the initiative of one or a group of states, in order to undertake the tasks delegated by the founding states. Nonetheless, when states delegate to international organizations, the contracts often include considerable degrees of discretion. Discretion enables
international organizations to enjoy agency autonomy, with which they are able to develop their own interests and policy practices. As international organizations develop over time, their interests and policy practices gradually grew into a unique ‘organizational culture’ that remains within them. The international organizations mostly composed of international civil servants are likely to have more autonomy than those with staff sent from national bureaucracies. (Cortell and Peterson 2006)

Agents can use their autonomy to influence the principals’ future policy decisions, especially when the agent pool is limited and/or agents possess significant expertise. Agents can demonstrate to states through past success to the states, or lobby state government officials, for more authority and resources. They negotiate with states the terms of their contracts, and even use their resources and knowledge to influence principals’ preferences. As Burley and Mattli concluded, agents use autonomy to expand their influence through function spillover, political spillover and upgrading common interests. (Burley and Mattli 1993)

Agents have various strategies through which they can gain autonomy. Agents interpret principal mandates and other rules prior to delegation, in a principal-friendly way in order to receive delegations. Agents reinterpret those rules once states have delegated, in a way that increases the costs of principal control mechanisms or that decreases the probability that principals will override such reinterpretations. Moreover, agents expand permeability to non-principal third party actors, especially when their preferences align, when third party actors have specific information demanded by agents, when agents are attempting
to gain the compliance of third party actors and it is costly to coerce compliance, and when they share basic understandings, norms, or professional commitments. Finally, agents create barriers to principal monitoring by using dualism and ceremonialism. Agents can compartmentalize monitoring by promoting ‘dualist’ features in their own organization, displaying the part of their organization that is most pleasing to outsiders while hiding the other part remains hidden. Agents can ceremonialize monitoring by making principals accept incomplete or even symbolic information or by making monitoring merely formal and superficial. (Hawkins and Jacoby 2006: 205-212)

Agent functions are the fundamental causes of delegation. Other than that, agent preferences also largely affect the actual result of delegations. Agents’ preferences are often distinguished from those of principals; sometimes they are assumed to be quite opposite. Principal-agent theory traditionally assumes that agents pursue their own interests, subject to the constraints imposed upon them by their principals. (Kiewiet and McCubbins 1991:5) According to Williamson (1985:30), agents are ‘self-interest seeking with guile’, and especially when the principals cannot perfectly control their agents, the agents’ subsequent actions are undesired by the principals. This consequence of principal-agent interaction is called ‘agency slack’. Principals could use certain controlling mechanisms to mitigate agency slack, but cannot prevent it completely.35 When states delegate to international organizations, they are more likely to succeed if the international organizations have similar preferences to their own.

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35 Agency slack is an important focus in principal-agent theory, and it will be further discussed in Chapter 7.
Like principals, agents also have complex institutional structures. Most international organizations have complex internal governance structures and various functioning sectors, as well as external official links with other institutions. Apart from formal governance via voting and other regular mechanisms, international organizations are also often subject to informal governing rules. A mixture of formal and informal governing rules makes the principal-agent relationships a more complex network. It may provide agents with more autonomy, because they can use their informal governing leverage to lead the policy products of delegation in the direction they prefer. On the other hand, it may also strengthen the influence of the organization’s most powerful members, because they are usually the most active ones in the informal governance.

In an international organization, not all the functioning sectors act like agents to member states, yet they have overlapping responsibilities within the organization. In some cases, when international organizations have strong influence on the member states’ (especially developing country member states) domestic policy practices, they act like principals to the same states that are also members of the collective principal to the organization itself. They sometimes even have the power to sanction member states for not following the rules and regulations of the institutions. For example, when multilateral development banks and funds lend to member countries, they usually attach various conditionalities to the loans, which are used to guide the required policy reforms in the borrower countries. If the borrower country fails to live up to the pre-agreed requirements for the loans, the multilateral development bank/fund could refuse to release the next installment.
4.3 Third Party Actors

Principals and agents are not the only actors in the principal-agent framework, where third party actors may also play an important role. Although the third party actors do not have shares in the formal voting rights of agents, they are indeed influential in both principal and agent behaviour. In international relations, a large number of domestic and international social groups are active in almost every issue area including security, economic, health, environmental, human right, and so on. They can offer the information needed by both states and international organizations. For example, social groups can help states monitor international organizations, as well as they can lobby them, help fund them, observe and participate in debates. Where international organization agents are appointed, interest groups can utilize persuasion, shame, information or symbols to influence decision-making. (Keck and Sikkink 1998) They have evidently influenced the behaviour of international organization agents, and through them even those of their state principals. On the other hand, driven by their own interests, they also attempt to influence the states that consequently lead their international organization agents to act in certain ways.

5 Principal-Agent Theory As an Analytical Tool

Principal-agent theory locates states and international organizations in specific interactive relationships, and identifies their roles in these relationships as principals and agents respectively. It provides a framework where the functions and structures of both states and international organizations are assessed based on the essential interaction between
the two: delegation. Since the principal-agent relationship is about states delegating authority to the international organizations with advanced authority, expertise and techniques (in certain issue areas) so that the latter can better accomplish tasks on behalf of the former, the eventual consequences of delegation are undoubtedly the focus in research. Moreover, principal-agent theory is a theoretical framework that focuses on the actors in international relations, yet it does not overlook the structural and social elements both inside institutions and in the general international political system. These structural and social elements play an important role in determining the specific relationship between a state and an international organization, and whether or not the international organization can successfully accomplish the tasks delegated from the state. Principal-agent theory thus could be used as a practical analytical tool to examine the relationship between a state and an international organization. Based upon the basic features of principal-agent theory and its actors introduced in the previous sections, I am going to propose a four-stage approach to analyzing the relationships between states (as principals) and international organizations (as agents).

First of all, identify the features of the actors. These features include the actors’ objectives, interests and structures. On top of that, it is important to locate the actors in the corresponding positions first, that is states as principals and international organizations as agents.\(^{36}\) To be a principal, the state needs to have clear intentions, goals, and preferences in a certain issue area. Hence, after the state measures its capability of achieving these objectives on its own and realizes it is not able to do so, it can choose to

\(^{36}\) However, international organizations can act like principals in some cases, when states need to fulfill their responsibilities toward international organizations to continue their memberships.
either create a new agent or delegate to an existing agent. The state can create an agent alone, yet in most cases it creates an agent together with other states with similar objectives in the specific issue area. The state’s objectives may change over time. The state’s objectives are the primary driving force of delegation, so when we use principal-agent theory to analyze state-international organization relations, we ought to ensure the state’s dynamic objectives are correctly applied.

The structures of the actors, especially those of the agent, determine the form of delegation. As discussed earlier in the chapter, a state is often a member of the ‘collective principal’ of the international organization it participates in. Different states have different weights in the collective principal. The state’s weight among all members of collective principal significantly determines its decision making power in the international organization. The state’s weight is determined by both formal and informal governance rules of the international organization, which will be discussed later.

Agents’ interests also matter in principal-agent theory, and need to be clarified in the research. Despite the influence of its strongest member state(s), the international organization acts as an independent institution with unique interests and rules for practices. Agents’ interests are decided by the objectives of each international organization that are developed from its unique founding principles. They are also greatly influenced by the staff’s working principles that are developed from their education background and working experience. Nevertheless, although international organizations’ interests are independent from those of their member states, they are under strong
influence of their strongest member(s)’ preferences, especially if the strongest member(s) are also the founding state(s) of the international organization. The international organization’s interests, and mostly the staff’s interests in some cases, greatly decide the agent’s capability to accomplish the tasks delegated from states.

Secondly, analyze the agent’s functions and the principal’s consequential delegation decisions. It has been stated earlier in the chapter that an international organization’s functions are the most fundamental reasons that lead the state to delegate certain tasks to the organization. Hence in order to assess a state’s delegation decisions toward an international organization, we need to initially look into the organization’s specified functions. The main functions of international organizations that distinguish them from any state and sub-state level institutions were discussed earlier in the chapter. They include outstanding expertise, political skills, and resources to perform the tasks; agenda-setting power to induce an ‘equilibrium’ among states on controversial issues; capability to govern decision-making in situations where the contract is not explicit; capability to solve time-inconsistency problem; and capability to ‘lock-in’ the validity of the political winner’s advocated policies.

These functions are enabled and supported by international organizations’ superior authority, competence, and legitimacy. However, not all the international organizations have an equal strength as the mentioned functions. Hence, in order to assess the state’s decisions on delegation, we need to look into each of the functions the international organization has. Based on the strength of each function, the state makes the decision on
delegation accordingly. A state often expects an international organization to solve multiple tasks due to its multiple functions; and the relationship between a specific function of the international organization and delegation decision on a single task made by the state needs to be assessed on a case-by-case basis.

Thirdly, evaluate the conceivable factors of the state’s delegation actions. The consequences of delegation largely depend on the state’s delegation actions, including the degree to which authority is granted and the extent to which staff autonomy is tolerated. A state’s delegation actions are crucial especially when the international organization has more than one principal. Before we assess the consequences of delegation, we should evaluate the conceivable factors of states’ delegation actions. One important influential factor of states’ delegation actions is the state’s preferences. The state’s preferences compared to those of the international organization determine whether the interactions between the two will be smooth and productive. In the case of a collective principal, a state’s relative preferences compared to those of other members can significantly influence the state’s delegation actions. For example, Martin explained the influence of actors’ preferences on agency autonomy in the context of evolution of IMF conditionality. She made four hypotheses to test how actors’ preferences shape states’ delegation actions in the IMF. She concluded that the closer a state’s preferences are to those of the Fund’s, the more likely the state will tolerate staff autonomy. (Martin 2006)

The other important factor of states’ delegation actions is the organization’s governance rules. Governance rules decide a state’s decision-making power in the international
organization. Governance rules vary among international organizations. Some international organizations have their policy decisions made mostly based on formal governance rules (for example, voting rules and election rules), some based on informal governance rules (for example, an informal forum outside the international organization’s formal governing mechanism), and some are mixed. The state’s aggregate decision-making power - derived from the mixture of formal and informal governance rules - determines the extent to which the international organization’s final policy practice converges with the state’s decision. The state’s influence among international organization staff, especially when the staff are granted a large degree of autonomy, also contributes to the state’s decision-making power in the organization. These two factors of state delegation actions – consistency of preferences and international organizations’ governance rules - greatly contribute to the assessment of delegation consequences.

Finally, assess the consequences of delegation. The purpose of delegation - that is letting the international organization accomplish the tasks that could not be done effectively by the state on its own - has already been emphasized as the fundamental driving force of the whole principal-agent interactions. Hence, it naturally leads the principal-agent approach to its final analytical stage, also an important goal of the approach - assessing whether or not the consequences of delegation have fulfilled the state’s objectives. If the international organization accomplishes the tasks as the state expected, we say the agent has generated satisfactory delegation consequences, which may lead to re-delegation. If the international organization failed the tasks or did not fulfil them as the state expected,
we say the agent has generated undesired delegation consequences, which may lead to de-delegation.

International organization staff’s actions that lead to undesired delegation consequences are defined as agency slack. Agency slack happens quite often, as it could be caused by multiple reasons, for instance, the staffing rules of the international organization do not reflect the state’s interests; the international organization’s governance rules reduce the state’s decision making power among all collective principals; the state’s preferences deviate from those of the international organization; the international organization’s resources are inadequate to solve the tasks delegated from the state; and so on.

However, agency slack could be avoided, or at least reduced to some extent. One key to avoid or reduce agency slack is to use effective principal control mechanisms, such as screening and appointment processes, control of the budget, clear rules, and sanctions through rewriting the delegation contract. (Alter 2006) Yet controlling mechanisms can be costly, plus the principal could be too reliant on the agent’s expertise, and thus the principal may decide to continue delegation while knowing agency slack is happening. Assessment of delegation consequences is a crucial step in principal-agent theory used as an analytical tool, because it explains the state’s decisions toward the international organization: to re-delegate or to de-delegate. Such delegation decisions reveal the essence of the relationship between a state and an international organization, and show the prospects of the actors’ roles in the related issue area.
When principal-agent theory is applied to analyze the relationship between states and international organizations, the actual approaches vary due to the specific features of actors and their interactions, yet they ought to mostly follow the four stages suggested above. I will use this approach to analyze the relationship between China (as principal) and the IMF (as agent) in the next three chapters. It provides an suitable framework where China’s objectives that led it to the IMF, together with the unique interactions between China and the IMF that are affected by their preferences, functions and structures will be discussed. Eventually, I intend to assess the extent to which the IMF performs as a diligent agent that assists China to achieve its objectives. Before that, in the next section, I will briefly explain why principal-agent theory is suitable for analyzing the relationship between China and the IMF, and how I will do it.

6 Use Principal-Agent Theory to Analyze the Relationship between China and the IMF

Scholars of International Relations have used principal-agent theory to analyze the interactions between states and international organizations, and especially the effectiveness of international organization functioning. A wide range of regional and international organizations has been scrutinized by the approach. They include the regional institutions such as European Union and its institutions the European Commission and the European Parliament, European Convention of Human Rights (ECHR) and its two main institutions the Commission and the Court, and European Court of Justice (ECJ). (Pollack 1997, 2006; Kassim and Menon 2003; Vaubel 2006; Milner
More studies were done on international organizations including the international economic organizations such as the GATT/WTO (Cortell and Peterson 2006; Xu and Weller 2007; Elsig 2010), the IMF, World Bank and multilateral development banks (MDBs) (Nielson and Tierney 2003, 2006; Gutner 2005; Vaubel 2006; Lyne, Nielson and Tierney 2006, 2009; Broz and Hawes 2006; Milner 2006; Martin 2006; Nielson, Tierney and Weaver, 2006; Gould 2006; Clegg 2010), and other international organizations such as the UN Security Council (Thompson 2006), International Court of Justice (ICJ) (Alter 2006), the International Labour Organization (ILO) (Vaubel 2006), and World Health Organization (WHO) (Cortell and Peterson 2006).

Some of these studies explain general interactions between international organizations and states by using principal-agent theory. Others focus on specific delegation, or emphasize the characteristics of specific actor(s) (principal, agent or the third party actor). Several scholars have done research on the IMF, yet with different focuses.

For example, Broz and Hawes analyzed the ‘chain of delegation’ and explored the influence of US domestic politics and private actors on IMF lending decisions. Via the assessment of complex power actors in US politics and their respective ties with the IMF, the scholars demonstrated that only the correct identification of principals lead to accurate assessment of delegation consequences. (Broz and Hawes 2006)
Martin closely scrutinized the connections between principal and agents, she specifically analyzed the reasons for agency autonomy in the context of evolution of IMF conditionality. She pointed out two sources of variation in the autonomy of IMF staff: divergence of preferences among the executive directors and private information held by the staff. She argued that IMF staff get a larger degree of autonomy when state preference diverge; and staff get more flexibility in dealing with information when the demand for high-quality information is intense and when their preferences are believed to converge with those of the major member states. (Martin 2006)

Gould explored factors that lead to agency slack in the context of IMF conditionality programs. He argued that the divergence of interests between the principal and agent, high costs of monitoring and the informational asymmetry between the principal and agent lead to agency slack. He also pointed out that the principal-agent framework needed to better detect and measure the agent’s interests and take into account the influences of their party actors in order to work better. (Gould 2006)

Clegg used the case study of the IMF Poverty Reduction Strategy Paper (PRSP) initiative to demonstrate the significance of integration of the agential influence of state preferences with the structural influence of social environments in explaining the changes within international organizations. (Clegg 2010) In a more recent work, he combined principal-agent theory with the constructivist theory to explain US influence in IMF concessional lending. (Clegg 2012)
Some analyses made by the above scholars could be applied to the case study of China-IMF interactions, yet some others are less suitable. Similar to the previous research on state-international organization interactions with the principal-agent theoretical framework, I will also explore the key terms such as delegation, agent autonomy, agency slack, agency strategies, principal control mechanisms, and so on. More importantly, I intend to find out the relations among these terms in the context of China-IMF interactions in various policy issues and activities, which contribute to a comprehensive analysis of the China-IMF. However, when principal-agent theory is applied to analyze the relationship between China and the IMF, a number of concepts and causal relations are distinct from those in the previous research that need to be emphasized.

First of all, *China is a non-traditional principal*. Most of the existing research that examines the relations between states and international organizations with principal-agent theory assume the US and/or other advanced developed states as principals. (Lyne, Nielson and Tierney 2006; Martin 2006) In some cases, even though the scholars recognized that member states work together as a ‘collective principal’, such as the Executive Board in the IMF, they assume it is led by the strongest principal(s) in the Fund. (Milner 2006; Broz and Hawes 2006; Gould 2006) It is true that many international organization policy decisions are highly influenced or even dominated by the strongest member states such as the US and other developed states. ‘Western dominance’ and ‘unbalanced power distribution’ are two crucial factors of IMF governance and decision-making processes, which will be considered in the later analysis. However, it does not mean other members of the collective principals do not have an impact on organization
decisions. Lyne, Nielson and Tierney argued that highly institutionalized international organizations require a complete model of possible member-state coalitions encompassing the preferences of all member states, not just major powers. They used the case of World Bank to show that if the formal rules suggest that the preferences of any member state are represented in the ultimate policy choice, then the preferences of all member states should be included when predicting agent behaviour. (Lyne, Nielson and Tierney 2009)

Among all the IMF member states other than the US and the Fund’s other traditional western controlling power states, China is one of those with growing voices in IMF governance and increasing objectives vis-à-vis IMF programs. Moreover, due to its rapid economic expansion and increasing international influences, China has gradually accumulated a considerable amount of authority in the international political system. In addition, China has also developed an explicit goal of larger flexibility in the international monetary system and greater decision-making power in the governance of the international financial economy. These conditions make China an eligible principal of the IMF.

However, compared to the IMF’s other member states, China is a non-traditional principal. It is non-traditional because Chinese officials and economists have relatively thinner knowledge about IMF operation and weaker diplomatic techniques in international economic affairs compared to the Fund’s dominant western state members, especially in the early stage of engagement. As a principal, China does not have the sort
of complex ‘delegation chain’ that the US does (Broz and Hawes 2006), yet the domestic actors do matter with regard to the Chinese government’s decisions on delegation. It is non-traditional also because the tasks China delegates to the IMF include less explicit instructions and rules. In other words, although the Chinese government has clear objectives that it wants the IMF to achieve via implementing the delegated tasks, it does not specify how IMF staff should do it. Hence the tasks China delegates to the IMF are generic, yet it does not weaken China’s eligibility of being a principal as long as it has clear objectives. Despite its relative weakness, China’s principal role also explains its stance facing other regional and international financial economic institutions and its further goals with regard to the international financial economy.

Secondly, the IMF is an influential agent. In the previous chapters, I used socialization theory to explain the IMF’s influence on China’s domestic institutional building and policy changes via technical assistance and policy advice mechanisms. Although the sequence of socialization- mimicking, social influence and persuasion- has not been completed, the IMF has had some significant influences on China’s domestic economy. For example, IMF technical training programs have provided Chinese officials with information in formatting and processing financial data and policies with internationally formalized methods; IMF policy advice has had some moderate influences on China’s exchange rate policy. The IMF’s strong influences on China that have already been proved do not contrast with the Fund’s role as an agent. Being an agent does not mean it fulfills tasks delegated from states with no controlling power. In fact IMF functions of technical assistance and policy advice not only prove why China delegated tasks to the
Fund in the first place, but also help us understand the IMF’s role as an influential agent that enjoys a large degree of autonomy. This feature of the IMF is compatible with the existing research that focuses on the distinct role of agents in international organization studies, and the Fund’s agent influences are even stronger facing the non-traditional principal China. Hence my earlier analysis of the IMF’s influence on Chinese officials will help us understand the Fund’s great agent autonomy and agent strategies in the later chapters.

However, I argued in the previous chapter that the IMF did not convince the Chinese government to fully change its mind, values and attitudes to further liberalize its economy, and the reasons for China’s resistance to IMF policy advice is both political and institutional. The reasons include lacking accuracy and depth in the Article IV Consultations; the advisory, rather than mandatory nature of IMF policy advice makes it pale and unconvincing facing China’s strong stance; protection of domestic industrial and financial groups prevents IMF neo-liberal economic norms from intervening into China’s domestic policymaking; the IMF’s corresponding institution in China - the PBC- lacks political influence in China’s domestic political system. Most of these factors could be incorporated into the reasons for unsuccessful China-IMF interaction, and they contribute to the undesired delegation consequences, agency slack, which will be examined in Chapter 7.

Thirdly, *China’s share of decision-making power among all ‘collective principals’ needs to be verified*. China is a member of the Fund’s collective principal. Its share of decision-

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37 For example, Hawkins and Jacoby 2006 and Thompson 2006.
making power among all ‘collective principals’ directly affects China’s decisions on
delegation and the consequences of delegation. If it has a large decision-making power,
the consequences of delegation are more likely to be consistent with China’s expectation,
and vice versa. Since China is a restrained principal compared to the US and other western advanced develop states, its decision making power in relative terms is crucial.
Since IMF governance is divided into formal and informal governance, China’s role in each category needs to be examined respectively.

Principal-agent theory focuses on a state’s governance role in the international organization as a factor in the effectiveness of delegation. When applied in the China-IMF case, it reveals China’s dynamic role in IMF governance. It thus appropriately illustrates the significance of China’s quota and voting share increase in the IMF, which explains the Chinese government’s efforts in pushing forward IMF governance reforms in the past years. On the other hand, a state’s formal governance role in the international organization could be ignored in socialization theory.

Fourthly, social constructivist factors are not ruled out. Principal-agent theory also emphasizes the agent’s preferences, which are mostly reflected in the staff’s interests. In the case of the IMF, the staff mostly read economics in the US and other western developed countries, and therefore their education background and working experience decided their assumptions and working principals are dominated by the neo-liberal economic norms. The staff’s interests, together with the IMF’s institutional rules
contribute to building a unique ‘organizational culture’ of the Fund. According to socialization theory, the IMF attempts to socialize China into its organizational culture and internalize the norms attached with such culture. On the other hand, principal-agent theory further argues that the difference between the state’s preferences (for example, protection of domestic economy in China’s case) and the agent’s preferences (neo-liberal economic norms in the IMF’s case) can explain the undesired consequences of delegation. Hence in this case, principal-agent theory does not rule out social constructivist factors in the framework, and it uses such factors to explain the interactions between states and international organizations. It thus helps provide a comprehensive analysis of the relationship between China and the IMF.

Fifthly, apart from the actors themselves, the external context matters. The context of the interactions between China as a principal and the IMF as an agent is crucial. The contextual influences include international economic trends, financial crises (both the Asian financial crisis and the recent global financial crisis), governance of regional financial economic cooperation (as a complementary or substitute to IMF programs), and so on. These external contextual factors can largely influence both China’s and the IMF’s interests and strategic roles in the international political economy.

Finally, ‘outside options’ could be real options rather than strategies of leverage. Scholars of international organizations argue that a strong member state with large ‘outside options’ can use these options as a lever to make the agent achieve principal

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38 The concept of organization culture was developed by Barnett and Finnemore (1999, 2004), and it will be further discussed in the later chapters.
objectives. However, in China’s case, its ‘outside options’ are likely to be real practical options instead of tools to increase its bargaining power.\textsuperscript{39} For example, while it delegates certain tasks to the IMF, it may also delegate similar tasks to another regional or international organization that could fulfill the same type of tasks. It thus reveals China’s ‘multiple agent’ pluralist approach to the governance of international financial economy.

\section{Conclusion}

This chapter has reviewed the key concepts and causal relations in the principal-agent theoretical framework, among which delegation is the most important one. In the studies of international organizations, principal-agent theory indicates a pragmatic rational choice-based connection between states and international organizations: states delegate conditional authority to international organizations in order to achieve their objectives in a more effective way.

Unlike socialization theory, principal-agent theory locates states in a proactive position. The states are thus not simple norm takers as socialization theory suggests; instead, they take the initiative to make decisions on whether to delegate authority to international organizations and the extent to which they get involved with the organization designed programs.

\textsuperscript{39} Outside option will be discussed in Chapter 7.
Like socialization theory, principal-agent theory also recognizes international organizations’ strong influences on states’ decisions on delegation and other policy decisions. Principal-agent theory argues international organizations have their unique organization cultures that are based upon staff interests and institutional rules and norms. It takes into account the principles and preferences of actors. Yet principal-agent theory does not only focus on the normative impacts of international organizations. It discusses the impacts of states’ controlling mechanisms and international organizations’ strategies on delegation consequences. It also points out that an international organization’s specific governance structure can influence the states’ delegation decisions and effects.

Most importantly, principal-agent theory focuses on the examination of delegation consequences, which are regarded as an important measure of the dynamic relationships between states and international organizations. In the socialization theoretical framework, it is difficult to measure if participating in an international organization can actually convince the state government to redefine its interests and values. On the other hand, principal-agent theory performs better in assessing the consequences of interactions between states and their international organization agent. This is because measures of delegation consequences (especially measures of agency slack) are well specified by principal-agent theory, of which more details in the case of China-IMF interactions will be provided in the later chapters.
In addition, principal-agent theory also takes into account the influences of third party actors and external environments, and it increases the accuracy and comprehensiveness of the research.

Hence, propositions from principal-agent theory supplement socialization theory and present a more suitable theoretical framework to examine the relationship between the pragmatic Chinese government, as a principal, and its influential international institution agent the IMF. The four-stage approach proposed in this chapter will be used as a specified analytical tool to analyze the China-IMF relationship. It is the first time principal-agent theory is used to assess the interactions between an emerging power and an international organization, more specifically a western dominated Bretton Woods institution. Undoubtedly the related case studies contain some distinct features that are unexplained in the previous principal-agent theory research in international organization studies; these features are briefly discussed in this chapter, and they will be taken into account when the China-IMF relationship is examined in the next three chapters.
Chapter 5 - China participates in the IMF: A Principal-Agent Framework

1 Introduction

This chapter analyzes China’s features as a principal, and the IMF’s features as an agent. More importantly, it discusses the IMF’s outstanding functions that attract the Chinese government to delegate multiple tasks to the Fund. It also discusses each task China delegates to the IMF, according to the Fund’s functions. This chapter thus responds to the first two stages of the four-stage approach to analyzing the relationship between China and the IMF within a principal-agent theoretical framework.

The Chinese government had some clear goals regarding economic advancement and economic links with abroad in the early period of ‘reform and opening up’\textsuperscript{40} that started in the late 1970s. China’s participation in the IMF reflected some of its goals, for example the Chinese government sought to learn from the IMF the methods and techniques of running a modern financial system, to get information about other countries’ financial economy from the IMF, and to get reconnected with foreign economic institutions and become an eligible member of the international political society via participating in IMF programs. These goals initially legitimated China’s

\textsuperscript{40} It refers to China’s domestic reform program (mainly in the economic sector) that started in 1978.
principal role in the interactions with the IMF, although it was a relatively weak member of the IMF’s ‘collective principal’. The 24 Executive Directors that represent all 188 member countries compose the Fund’s Executive Board. The Executive Board is the ‘collective principal’, and IMF staff who represent the Fund are the agent in the framework. When assessing China’s principal role, its preferences and relative position in the Fund’s structure of governance require to be clarified. When assessing the IMF’s agent role, its functions, staff autonomy, and strategies are the most essential factors that affect its interaction with states, and thus need to be explained initially.

After clarifying the features of China as a principal and those of the IMF as an agent, the chapter focuses on China’s delegation to the IMF. China delegates various tasks to the IMF for a number of reasons. First of all, the IMF has prominent expertise and information advance. Hence the Chinese government delegated the technical training task to the IMF in order to learn internationally standardized methods and techniques in financial governance. The case study of the IMF Statistics Department’s technical training programs for Chinese officials was included in Chapter 3, yet it was explained from the perspective of China being socialized into accepting IMF norms by learning. However, the case study probably fits better into the principal-agent theoretical framework, because the Chinese government took the initiative to decide the contents and forms of the technical training and then request IMF assistance. Hence it is more reasonable to regard China as a principal who delegates the task of technical training to related IMF departments (in a pro-active way), instead of being socialized into accepting
the IMF’s norms (in a re-active way). Yet it does not change any facts in China’s participation in IMF technical assistance programs.

Meanwhile, China also delegates authority to the IMF’s surveillance and policy advice programs (such as the Article IV Consultations analyzed in Chapter 3), the results of these programs are published in various staff reports and working papers. From the reports and working papers of the results of surveillance for other countries, China can get a further picture of the international financial economy. At the same time, China shows its commitment to the Fund’s supervision on orderly economic growth and reasonable stability of price and exchange rates.

In addition, China also delegates tasks of multilateral lending to the IMF, because the IMF has decades of experience in dealing with loan arrangements for member countries. Lending via the IMF not only avoids more risks but also demonstrates China’s international responsibility via an internationally recognized channel (compared to aiding via bilateral lending to the countries with controversial political states).

Secondly, the IMF has outstanding agenda-setting power that enables the member states to achieve equilibrium on the controversial issues. The IMF provides the states with a forum to discuss and solve some issues on which agreements are not easy to achieve otherwise. The example analyzed in the chapter is the IMF Multilateral Consultation on Global Imbalances, which brought together China, the US, Euro Area, Japan and Saudi Arabia to discuss the issue and seek to find a multilateral solution.
Finally, the IMF is expected to help China solve some complex issues that cannot be solved by China on its own. The chapter discusses this standpoint with the example of China’s attempt to delegate to the IMF the task of reforming the US dollar-dominated international monetary system and creating a favourable monetary environment for China’s RMB and financial stability.

2 China as a Principal

Recalling the historical background, China experienced a series of drastic domestic political reforms in the 1970s, which also led to the economic reforms later in the decade. The gradual opening that started in the early 1970s, including diplomatic, intellectual and trade opening, made the Chinese leadership realize that China was far behind many other states in terms of economic welfare, technology and expertise. When the reformist leadership that was led by Deng Xiaoping seized the political power after Mao’s death, it decided to embrace the idea of economic interdependence by reconnecting China to the world economy. Meanwhile, the leadership also initiated domestic political and economic reforms in a liberalization fashion. Nevertheless, decades of domestic wars and isolation left China with little knowledge about how to build up a modern economic regime and social system. By the late 1970s, China was still running a centrally planned communist economic regime. Therefore, China was in need of a large amount of expertise to enable it to establish a market-based domestic economic system, as well as to communicate and
cooperate with foreign economic institutions. This need eventually drove China to join the international economic organizations such as the IMF and World Bank in 1980.

It took the Chinese leadership a whole decade to finally make this decision. As already discussed in Chapter 3, the decision was made upon several factors including numerous rounds of communication with both institutions, several careful assessments run by the UNSG of costs and benefits of joining the institutions, and the concerns about Taiwan’s political status at the time. Therefore by the time the Chinese government decided to join the IMF, it had a clear idea about what costs and benefits IMF membership would bring to China. More importantly, the Chinese government had a clear goal of what it wanted the IMF to help China achieve:

- China wanted to learn from the IMF the methods and techniques in running a modern financial system that meet international requirements.

- China wanted to get information about other countries’ financial economy from the IMF.

- China wanted to get (re)-connected with foreign economic institutions via participating in IMF programs.

- China wanted to accelerate the expulsion of Taiwan from the international political society by demonstrating its legal membership in the IMF.
• China wanted to show to the world that it could be a friendly member of the international political society, which would significantly enable smooth economic cooperation with foreign states.

China’s goals were not static, and they would develop over time. In fact, China’s goals in international financial affairs via IMF have advanced in the past three decades, as China has become more influential and ambitious in the international financial economy. We will certainly return to this point later. Above all, it is important to know that China had obvious incentives to join the IMF and, more importantly, explicit objectives that it wanted the IMF to help it achieve. It made China an eligible principal of the IMF.

To recall the definition of principal, it is ‘an actor who grants conditional authority to an agent’ (Hawkins et al 2006). Therefore, China is the principal that grants conditional authority to the IMF, which is the agent. However, China is not a single principal of the IMF, yet it is one of the IMF’s ‘collective principals’. Like most of the international organizations, the IMF responds to many member countries that delegate through one contract. (Nielson and Tierney 2003:247) Each member state appoints one governor and one alternate governor (usually the minister of finance or the governor of the central bank), who together compose the IMF’s Board of Governors. The Board of Governors is the highest decision-making body of the IMF, yet it has delegated most of its powers to the IMF Executive Board for daily business.
The 24 Executive Directors at the EB represent all 188 member countries. Essential economies like the US, Japan, Germany, France, UK, China, Saudi Arabia, and Russia have their own seat at the table but most countries are grouped in constituencies representing four or more countries. The EDs are sent directly by the member states, often from the Central Banks, to reside in the IMF and represent the states’ interests. Therefore, in this context, the EB is set as the collective principal, which collectively delegates the tasks to IMF staff. The most common tasks delegated by the member states are designing conditional loan agreements, providing loans to the member states with balance of payments difficulties and helping them solve the problems, providing technical assistance to member states, and surveillance on the member states’ financial stability. According to the collective principal concept, decision rules that aggregate preferences within the collective principal are primary. IMF EDs have different voting weights. Each member state’s voting weight is pegged to its quota in the IMF. This decision-making system was designed to reflect the relative positions of its member countries in the global economy.

When the delegation relationship between China and the IMF is discussed later in the thesis, China is regarded as an independent principal of the IMF. It specifically means that the decisions to delegate tasks to the IMF (instead of taking the unilateral move or choosing other forms of international cooperative) are decided solely by the Chinese government rather than jointly with any other entities. However, many other issues in the IMF, such as lending decisions, governance reforms, and expansion of IMF financial resources, have impacts on multiple members and thus require collective approval from
the EB. Therefore, collective decisions can affect the IMF’s capacity in solving international issues, and thus influence the Chinese government’s decisions to delegate, re-delegate, or de-delegate. In this case, China is also regarded as a part of the collective principals.

The collective principal of the IMF has some distinct features. First of all, members in the EB have different preferences. As we discussed in Chapter 3, the IMF has socialized China into accepting some neoliberal economic norms to a certain level; yet China’s preferences fully converge with neither those of the Fund’s advanced economies nor those of the Fund itself. In some cases—such as debates on China’s currency rate—China’s preferences are opposite to those of the latter two. (Xinhua 2010; Renmingwang 2009)

Secondly, the decision-making powers are unequally distributed among the members. The formal decision-making powers are distributed in terms of ‘voting shares’, which are proportionately related to the members’ financial contribution to the Fund. The US has the single highest voting share, which has earned it a crucial veto power since the IMF was initially founded. Adding EU countries’ voting shares together also generates a veto power. The veto power enables the holder(s) to stop any change from the status quo. On the other hand, the IMF’s emerging market economy and developing country members, including China, have disproportionately low voting shares. (Woods and Lombardi 2006) Hence, they cannot influence IMF policy decisions as effectively as the Fund’s advanced economy state members that hold more voting shares do. It makes China and other under-
represented members feel their opinions not being sufficiently respected, and thus discourages them to delegate more tasks to the IMF. (IMFC 2008a)

Facing the IMF, China is not a principal with a strong stance. Although China was one of the original funding members of the IMF, the Guomindang government and the later Taiwanese leadership were not much involved in Fund activities. When the Communist Chinese government gained its legal IMF membership in 1980, it had very little knowledge about the Fund’s day-to-day business. Although China’s economic strength, political status, and capacity in performing international economic activities have improved greatly in the following decades, it does not act like an ‘owner’ of the Fund. China has indeed learned a great amount of methods and techniques of financial practices via interactions with the IMF and other international economic institutions, yet its financial system is still rather backwards in terms of variety of financial products and inflexible in terms of financing channels and controls. It is mainly due to the priority of state ownership in China’s main industrial and financial sectors; and the fact that the government set the goal of ‘stability’ instead of ‘profit’ for China’s banking sector.41 China’s interests are thus different from those of the IMF, which increases the possibility of undesired delegation results, that is ‘agency slack’. The domestic concerns are fundamentally embedded in China’s political interests, which thus greatly affect China’s decisions on delegating tasks to the IMF. When China delegates tasks to the IMF, it does not want too much policy intervention from the Fund staff. One may argue that China is not very specific about the exact tasks that the IMF should achieve; it is however

41 Details about China’s domestic concerns with regard to state ownership were explained in Chapter 3. More of China’s domestic financial and economic features will be discussed later.
definitely clear about what it does not want the IMF to achieve from delegation. For the same reasons, China acts like a distant, instead of a close, principal when it delegates and/or participates in other activities of the IMF.

In addition, China’s relatively weak principal role is not merely reflected in the inadequate voting share to match its shares in the actual world economy. Voting share is the official, yet not the only sign of decision-making power in IMF governance. Some IMF decisions are made mostly under the impact of informal governance. (Stone 2011) Some IMF decisions are made by IMF staff, who would only submit the proposals that are mostly likely to be approved by the Board. According to their experience and expertise, the staff know the exact criteria for a qualified proposal, and they would not submit a proposal that does not meet the requirements. IMF staff thus have a large degree of ‘agency autonomy’ in running the Fund. Like in the EB, China is also relatively less influential in both informal governance and among the management staff team compared to some other advanced western economy state members. Contrasting to China’s relatively weak principal stance, the IMF is an influential agent.

3 The IMF as an Agent

The IMF was established under the initiative of the US and the UK in order to bring the international financial economy back to order in the post-war era. The IMF’s original goals therefore reflected the founders’ interests and values: to promote institutionalized international monetary cooperation, to facilitate growth of fair international trade, to
maintain exchange stability, to assist in the establishment of free multilateral payment system with no foreign exchange restrictions, and to assist the member states with balance of payments difficulties. Since the Fund started to function, the membership has grown, especially among the developing countries. In the 1960s and 1970s, the IMF switched its policy focus from the developed to developing country members, especially in lending and policy advice. However, IMF goals and basic principles have not changed greatly. The US is still the most influential member of the IMF; and the western European advanced economy members share the governance power with the US.

Despite the mighty US influence, the IMF is an independent international economic organization with unique interests and rules for practices. These interests and rules gradually compose a unique ‘organizational culture’ that is embedded in all IMF programs. Principal-agent theory scholars often assume agent interests as opposite to those of the principals’, for example the bureaucracy intends to ‘maximize their budget, their staff and their independence’. (Niskanen 1971, Vaubel 1996: 195) This assumption simplifies the character of the IMF. We could assess IMF interests via the structure of its staff members. The staff members that work in the IMF (both headquarters and residential representative offices all over the world) consist of two major parts: the officials sent by member state governments; and the international civil servants who are directly hired by the Fund, also those who serve the interests of the Fund instead of any member state. We do not usually count the former as a part of ‘IMF staff’. The latter comprised the majority of IMF staff, which is also assumed as the ‘agent’ that represents the Fund’s interests. Cortell and Peterson argued that the international organizations
mostly composed of international civil servants are likely to have more autonomy than those with staff sent from national bureaucracies. (Cortell and Peterson 2006)

The IMF is comprised of an international staff of economists mostly trained in a few universities in the US and west Europe. They share very similar academic backgrounds that conferred them similar assumptions and principles. Gould argued that IMF staff are trained as economists and want to be successful economists, influencing the direction of the international economy at large and the economies of individual borrowers by applying theoretical principles. (Gould 2006: 288) They would like to be part of a successful IMF that helps improve the world economy. IMF staff are thus unlikely to focus only on maximization of budget and independence at the expense of IMF reputation. Therefore it is incorrect to put the agent preferences in opposition to those of the states. On the other hand, some scholars argue that the IMF is manipulated by the US, and thus it adopts the preferences of the US as its own. This is yet another overly simplified assumption. Nevertheless, due to their education background and working environment, IMF staff have preferences that are closer to those of the US than those of emerging market economy and developing country members.

The IMF is a rather influential agent vis-à-vis China. The IMF obtains a large degree of autonomy from China’s delegation. This is specifically because China does not explicitly specify the tasks to be delegated to the IMF, as it is less familiar with the techniques and methods used in financial operations compared to other strong principals. In fact, China has learned many techniques and methods from the IMF via participating in interactive
programs. The large IMF autonomy is also because China does not run strict monitoring programs over IMF programs, which provides the IMF with an even larger degree of autonomy. In some cases, the IMF could use its autonomy to influence China’s delegation decisions. As Burley and Mattli argued, agents use autonomy to expand their influence through function spillover, political spillover and upgrading common interests. (Burley and Mattli 1993) Agents could also demonstrate to states their past success, or lobby state government officials for more authority and resources, which is how the IMF convinced the Chinese authorities to join the IMF in 1980. Since then, the IMF has continued to use its technical assistance and policy advice facilities to influence China’s preferences. The IMF uses these strategies to encourage China to delegate more tasks and confer more resources to the Fund. For example, the IMF encouraged China to comply with Article VIII of the IMF Articles of Agreement to make its currency freely convertible on the current account in 1996; to join the GDDS in 2002; and to commit to the FSAP in 2008.

The FSAP mainly focuses on the factors that affect China’s financial stability. China’s first FSAP evaluation started in August 2009. The evaluation team included a rather large group of IMF and World Bank staff. They met with senior officials and staff from the PBC, China Banking Regulatory Commission (CBRC), China Securities Regulatory Commission (CSRC), China Insurance Regulatory Commission (CIRC), etc.; as well as

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42 China does get worried that the IMF may overly intervene in its domestic economic policy-making and other activities; however, since it does not submit much information to the IMF anyway, it does not need to frequently monitor IMF programs.

43 They were described as ‘socialization tools’ in the previous chapter, but ‘agent strategies’ here. Since they both explain the same action, the two approaches are complementary rather than substitutes for each other.

44 Details of GDDS were explained in the previous chapter.
representatives from financial institutions, industry organizations, and private sector representatives in Beijing, Chongqing, Nanchang, Ningbo, Shanghai, and Shenzhen. Compared to the Article IV Consultations, the FSAP evaluation shows a larger degree of thoroughness and depth.

The first FSAP report for China recognized China’s banks and financial sector were healthy, but pointed to vulnerabilities that should be addressed by the authorities. It pointed out the near-term risks in China’s financial sector: deterioration in loan quality due to rapid credit expansion; growing disintermediation by shadow banks and off-balance sheet exposures; a downturn in real estate prices; and the uncertainties of the global economic scenario. It encouraged China to push forward financial reforms to prevent medium-term vulnerability from harming the whole economy. The reforms include broadening financial markets and services and developing diversified modalities of financial intermediation in order to foster healthy competition; reorienting the role of government away from using the banking system to carry out broad government policy goals and allowing lending decisions to be based on commercial goals; expanding the use of market-based monetary policy instruments and using interest rates as the main instrument to govern credit expansion; and upgrading the financial infrastructure and legal frameworks, including strengthening the payments and settlement systems, as well as consumer protection and expansion of financial literacy. China’s commitment to the FSAP shows China’s further willingness to delegate to IMF surveillance. (IMF 2011e)

As stated by PBC governor Zhou Xiaochuan at an IMF-PBC joint symposium in 2011, ‘China will further strengthen its financial stability, regulatory and supervisory
framework and promote financial reform and development by incorporating the findings of the China FSAP as appropriate.’ (IMF 2011f)

In addition, the IMF is aware of the Chinese authorities’ usual reserved and sensitive attitude toward international advice, and thus it uses specific tactics to deal with China. In the Article IV Consultation program, the IMF has been making moderate yet persistent suggestions on China’s undervalued exchange rate problem, instead of harsh criticism like some Western governments would do. The IMF understands that the Chinese government takes domestic concerns as the absolute priority. Harsh criticism and international pressure would not convince China to sacrifice its domestic benefits; in contrast, it may offend the authorities and drive them away from the Fund. On the other hand, the Chinese authorities do get intimidated by negative international feedback, especially those from an influential intergovernmental organization like the Fund. In this case- despite the argument that the IMF is not able to impose policy implementation on its members because of the advisory rather than mandatory nature of the institution itself- moderate and persistent suggestions ought to work better than harsh criticism and enforcement for China.

4 China Delegates to the IMF

China delegates to the IMF because of the Fund’s specific functions that enable China to achieve goals in a more efficient way than it would have done by taking unilateral or other cooperative approaches. The motivation of state delegation is usually based on the
international organizations’ outstanding functions; yet the contents of tasks and the extent to which they are delegated to the agent vary. China’s tasks for the IMF consist of generic rather than explicit objectives.

4.1 Expertise and Information Advance

The Principal delegates tasks to an agent, instead of taking an action by itself, because of the agent’s outstanding expertise, skills, and resources to perform the tasks. The agent’s specialization is the most basic reason that attracts the principal to delegate. China delegated to IMF technical assistance, as it hoped to learn from the IMF the methods and techniques in running a modern financial system that meets the international requirements. Therefore the Chinese authorities would decide what kind of methods and techniques are in short supply among Chinese officials, and they would make requests for IMF technical assistance on the demanded methods and techniques; the IMF then responds with appropriate technical assistance programs after discussing with the authorities. The contents of IMF technical assistance programs were discussed in the earlier chapter, and they proved a rather effective delegation result as China has implemented some techniques and methods in financial practices that were learned from the IMF.

China also delegated to the IMF in order to get information about other countries’ economic trends and the general international financial economy. Thompson argued that it is the neutrality of international organizations that allows them to serve as informative agents of the international community, supplying information that an individual state
could not credibly supply. (Thompson 2006: 232) Apart from the neutrality, the IMF also has centralized expertise to collect and analyze data from various nation states, which keeps China updated with the world economic developing trends. The information and data is delivered via staff reports for various monitoring and assessment programs (for example, Article IV Consultations and Financial Sector Assessments), working papers done by IMF economists, and other assessment reports grouped by regions, periods and issue areas.

China delegates to IMF surveillance and policy advice programs to fulfill the agreement of subjecting its economic and financial policies to the scrutiny of the international community. Via participating in these programs, China shows its commitment to orderly economic growth and reasonable price stability, to avoid manipulating exchange rates for unfair competitive advantage, and to provide the IMF with data about its economy. In order to get the information and keep IMF monitoring and assessment programs credible, the Chinese authorities must sacrifice some of its (economic) sovereignty and submit data and information to the Fund. The extent to which China is involved in IMF surveillance and policy advice programs reflects its willingness to sacrifice its sovereignty in order to pursue better cooperation with foreign financial economic institutions. For example, China has increasingly delegated authority to programs such as the GDDS and FSAP. Participation in both programs reflects China’s increasing interests in delegating authority to the IMF.
Moreover, like many other members, China also delegates the tasks of multilateral lending to the IMF. The IMF staff have rich experience in dealing with loan arrangements for member countries, including negotiations, risk assessment, designing lending contracts, making proposals for the EB to approve, and monitoring whether borrower countries live up to the conditionalities. According to Rodrik, multilateral agencies are supposedly better at providing information, especially that necessary to monitor the recipient; and the interaction of multilateral organizations with recipient countries can be less politicized than that between donor countries and recipient. (Rodrik 1996)

Unlike the US, China has a much smaller degree of involvement in the borrower countries’ domestic politics and economy. Broz and Hawes did a study to prove that US ‘money-centre’ banks comprise a key constituency for the IMF and lobby on its behalf’. And US policy-makers use their influence at the Fund to ensure that countries where US banks are highly exposed fall under the IMF’s insurance umbrella. They found that the size of and IMF loan to a country is positively related to the degree of US money-centre bank exposure in that country. (Broz and Hawes 2006: 77- 106) Thacker developed a macroeconomic model to prove that political friends of the US are more likely to receive loans than its enemies; and moving political interests toward those of the US’ increases a country’s possibility of receiving loans from the IMF. (Thacker 1999) Compared to the US, China has much less political intention when it delegates to IMF lending mechanisms. It thus does not usually have particular maneuvers over IMF lending programs.
China delegates to IMF lending mechanisms by contributing to IMF financial resources, and the funds would be lent out to the countries with temporary balance of payments difficulties according to IMF arrangements. One example was during the Asian financial crisis, China participated in the IMF rescue package for stricken Asian financial economies by lending Indonesia $200 million, Thailand US 1 billion, and funds to South Korea supporting its exports. (Kent 2007:132) Another example was that when Europe was hit by the Euro-zone crisis, China chose to lend to Europe via IMF -and European Financial Stability Facility (EFSF)- programs rather than directly to the crisis-hit countries. China has contributed significantly to IMF lending power to protect the world economy from Europe’s debt turmoil. It agreed to contribute $43 billion to the IMF at a G20 meeting in Los Cabos, Mexico in June 2012. (IMF 2012d) Chinese scholars consider lending via the IMF as the most secure way of lending. (Sun 2012) The IMF thus acts like a guarantor for the borrower countries. IMF lending programs could also be the ‘signpost’ for China’s outward foreign investment decisions. Since the countries that receive IMF loans are likely to be subjected to IMF conditionalities, their financial stability is under IMF supervision. Hence for Chinese companies, it is safer to invest in these countries than other countries that do not receive IMF financial assistance.

In addition, China also delegates multilateral lending tasks to the IMF as a means to fulfill its role of a ‘responsible great power’. Profit is not the main purpose of China’s decision on delegating to IMF lending mechanism. Yet it is the reputation of a responsible member of the international political society that China would rather obtain
via IMF multilateral lending. As the world’s most influential financial intergovernmental organization, the IMF confers on China the reputation it wants via active participation and interaction. It gives other states a feeling that China does not only pursue profit in the international business, but it also contributes to the maintenance of international financial stability. It also shows China’s willingness to participate in international political society, and solve problems in a collective and cooperative fashion. As a leading Chinese scholar at the CASS said in an interview:

‘Europe needs help now, and other countries may need help in the future. Should we help them? Yes, because we need to take the responsibility at some point. So to help is better than not to help. How do we help them then? Multilateral (means) is better than unilateral (means). So we prefer to help them via the IMF.’  

4.2 Agenda-setting Power and Multilateral Decision-Making

China, as well as other states, delegates to the IMF when it cannot reach an agreement on policy with regard to some controversial issues, because the IMF’s agenda-setting power helps the states find a negotiated equilibrium. The IMF provides states with a forum to discuss the issues that affect multiple entities, which not only cannot to be solved unilaterally, but where the states also find it extremely difficult to reach a policy agreement. This happens especially when the relevant states have diverging opinions on the issue, and when political power influences among these states are relatively balanced.

45 The interview was conducted in Beijing. The interviewee (interviewee 2) is a leading scholar in China’s political economy.
In some cases, the affected states can reach mutual agreement via some contracts among themselves, yet the contracts do not guarantee completely coordinated actions. This is because the contracts are invariably incomplete. Although the related parties endeavour to consider all possible future situations and to negotiate ex ante the responsibilities and appropriate actions, it is important to settle a permanent contract to include all the possible contingencies. (Williamson 1985) In this case, the states may choose to create a new agent and/or delegate to an existing agent that can fill in the details of an incomplete contract and adjudicate future disputes among the states. (Pollack 1997:104) This could happen especially when the states face an emergent situation when an institutionalized mutual agreement- possibly together with the institution - is urgently needed; and when the uncertainty is very great and future decision-making is expected to be complex.

Hence, China delegated the tasks of solving global issues that involve multiple actors to the IMF. China does not possess the same level of sophisticated financial diplomatic skills that the US and other advanced economy countries do; neither does it lead the consensus of opinions and policies in international political society. Hence, when China encounters global issues that involve multiple actors, it may not be able to handle them on its own. In addition, the Chinese authorities are rather sensitive to criticisms from western governments and other foreign governmental bodies. They often regard the criticism from the west as hostile and provocative. In such cases, they would prefer to leave the issues to be solved by the multilateral institutions whose standpoints are usually milder than those of the western state governments’.
Global imbalances are an example of an issue that could only be solved by multilateral approaches. Both industrial developed and emerging market developing countries were deeply trapped into this problem before the global financial crisis started. Natural rebalancing alone was not sufficient to resolve the problem; instead, additional structural adjustments were required in the countries that were at the centre of the global imbalances. In order to solve the global imbalances, the US could cut their budget deficits and save and export more; while surplus economies, notably China but also countries like Germany and Japan could rely more on domestic demand. The international community imposed large pressure on these affected countries and urged them to reform their macroeconomic and trade policies to rebalance the world economy. However, national governments were unwilling to let other countries’ agendas lead the pace and scope of change, and individual countries’ economic sovereignty and self-interest continued to take precedence over international cooperation. (Guerrieri 2010: 687) At this point, the IMF was expected to be the right platform on which to build effective policy coordination to resolve the global imbalances.

China’s exchange rate regime incurred much criticism from the west for ‘artificially keeping the RMB undervalued’. However, the Chinese government and scholars denied the accusation and refused to revalue the RMB as a direct response to international pressures. The Chinese government has restated in the past years that the exchange rate regime is a domestic issue and should be exempted from intervention by any other external forces. However, it does not mean that China is unwilling to cooperate with the international community to resolve the problem of global imbalances. Yet the Chinese
government prefers to resolve the global imbalances issues via a multilateral institution instead of facing the pressure from the west by itself.

Therefore, China decided to delegate the task of resolving the global imbalances issues to the IMF Multilateral Consultation on Global Imbalances, along with the Euro area, Japan, Saudi Arabia, and the US, in 2006. The IMF maintained that among the above countries/regions, they could mitigate vulnerabilities inherent in the present pattern of imbalances and help sustain world growth as demand and savings patterns adjusted. (IMF 2007a) The Multilateral Consultation included bilateral visits and multilateral meetings in 2006 and 2007. At these meetings, the states and the IMF agreed that the problem of global imbalances is a medium-term problem that requires gradualist and multilateral approaches. They agreed that the objective of any measurements vis-à-vis the global imbalances were not just to reduce imbalances, but also to sustain robust global growth. Thus it was suggested that measures to boost US national savings should be accompanied by measures to strengthen domestic demand and growth elsewhere; and these measures would be bolstered by increased exchange rate flexibility in some cases. And finally, the policy coordination across countries needed to be further strengthened. (IMF 2007b: 8-9)

The participants submitted to the IMFC a report on the discussion and the details of their policy plans in April 2007, and agreed to further measures on resolving the imbalances that are consistent with the IMFC strategy in the future. A later IMF staff report on the Multilateral Consultation program revealed some positive progress. For example, the

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46 The above countries either contribute directly to the imbalances through current account deficits or surpluses, or represent large shares of global output.
RMB had appreciated in nominal terms, and the currency band for daily exchange rate fluctuations against the dollar had been widened. In the US, a congressional budget resolution had adopted the administration’s balanced-budget objective over the medium term. (IMF 2007b: 10)

In summary, although the multilateral consultation did not lead to more direct and notable results, it did bring China to the negotiation table to discuss an issue where China resisted discussing it directly with those who had adverse contentions. China expects the IMF to play a role of mediator when it is facing multilateral challenges. China also expects the IMF to facilitate fair discussion and multilateral implementation among the key players of the global imbalances, while minimising potential conflicts. China also expects the IMF to use its agenda-setting power to solve multilateral problems in the long term.

4.3 China Lacks the Power to Deal With Controversial Issues Alone

In September 2008, China replaced Japan and became the largest foreign holder of US debt. China officially declared $1.95 trillion in hard currency reserves at the end of 2008, not including holdings beyond the People’s Bank of China. In total, Chinese state investors were estimated to possess $2.3 trillion in US assets in September 2008, with approximately $1.5 trillion invested in US dollar-denominated debt. This represented about 30 per cent of global currency reserves, more than twice the reserve level of Japan, and four times the holdings of Russia or Saudi Arabia. In 2008, China purchased 46 per cent of official US debt. (Lakshmanan 2009) As the world’s biggest US dollar and US dollar-denominated assets holder, China has expressed increasing anxiety toward the
potential depreciation of the US dollars and the US dollar-denominated assets in the past 6-7 years. The president of the China Investment Corporation, Gao Xiqing, made a harsh comment on US financial products in 2008, ‘if you look at every one of these [derivative] products, they make sense. But in the aggregate, they are bullshit. They are crap. They serve to cheat people.’ (Follows 2008)

As the crisis deepened, the Chinese officials urged the US to protect the value of China’s US dollar-denominated assets and guarantee Chinese capital’s access to US product markets. Especially when China switched to assets with higher risks and return, for example to the bonds issued by government-sponsored enterprises (GSE) such as Fannie Mae and Freddie Mac, the protection of the value of China’s dollar-denominated assets was extremely desired. However, Chinese pressure yielded unsatisfactory results. The most significant accomplishment was to push the Treasury Department to place Fannie Mae and Freddie Mac into receivership; yet China’s persistent efforts to use financial statecraft failed to move US policies on asset protection. China repeatedly urged, insisted, and threatened the US government to provide asset protection, but the US officials declined China’s requests for explicit guarantee of the GSE debt.

Some policy analysts warned the US government of the dangers of excessive dependence on foreign financial creditors while ignoring their requests. Stephen Roach stated, ‘given America’s reliance on China’s funding of its external deficit- a reliance that will only grow in an era of open-ended trillion dollar budget deficits- the US is in no position to risk reduced Chinese buying of dollar-denominated assets.’ (Roach 2009: 7)
warned, ‘A Chinese or Russian decision to reduce holdings of dollars would probably inflict more pain on the United States than vice versa. Alternative sources of external financing would probably not be willing to lend to the United States on a comparable scale at the same terms.’ (Sester 2008: 3-4) Some US analysts and policymakers specifically worried China would transfer its creditor advance into financial leverage over the US. However, Drezner did not agree. He argued that for financial leverage to yield tangible concessions, the target state (the US in this case) must be unable to find alternative creditors, lack the capability to inflict costs on the sanctioning country in response to coercive pressure, anticipate few conflicts with the coercing state over time, and try to maintain a fixed exchange rate. These conditions did not apply to the US. Because the US still has many other sources of credit, it was still perceived as a safe heaven compared with the alternative market even after the financial crisis hit the US. Moreover, if China reduced its purchase of US assets, the dollar would inevitably depreciate against the RMB, which would lead to capital loss in China’s external investment portfolio. In addition, the US possesses great monopsony power in the issuance of liquid assets, and creditor countries cannot easily diversify away from holding the dollar. (Schwartz 2009) The interdependence between China and the US further makes it difficult for China to use financial leverage over the US. Furthermore, the expectation of future conflict will reduce US willingness to accede to China’s pressure. And finally, the US does not maintain a fixed exchange rate regime, and it issues debt denominated in its own currency. (Drezner 2009: 7-45)
The facts showed that China became a net seller of US debt for the first time in more than two years in November 2008, yet it did not significantly affect US financial policy. China also failed to receive any enhanced guarantee of access to US markets. Although China’s policymakers and economists kept calling for changes in US fiscal and monetary policy in several international conferences and forums, they failed to create either political or market pressure on the US.

*Xinhua* commented on the financial crisis and the volatile US financial system, ‘the financial crisis, as many have known, is a result of ill-advised macroeconomic policies by some advanced economies and their failure to enforce vigorous regulation over the ever growing financial industry.’ (Ming 2009: 18) In order to avoid more effects from the deepening financial crisis and to prevent itself from falling into another financial crisis caused by the under-regulated US financial market, China became more and more eager to free itself from the US containment that is backed by the US dollar’s dominant status in the international monetary system. As argued by Paola Subacchi, ‘…in today’s larger and more integrated world economy the dependence on the dollar as the basis of both trade flows and financial reserves has clearly become excessive, creating a system that is fundamentally unbalanced.’ Thus the existing international monetary system needs to evolve into a multicurrency system that would respond more flexibly to the demand for liquidity and would provide a way to diversify the accumulation of reserve assets. (Subacchi 2010: 667) In order to divert and reduce the risks caused by the single-reserve currency characteristic of the system, the Chinese government realized that diversification would be the ultimate long-term solution. Especially since the global
financial crisis provided the chance for a new layout of the international monetary policies and redistribution of governance power among the institutions, China has sought to play a more proactive role in the reforms of the international monetary system. Some of China’s highest government leaders including President Hu Jintao and Vice Premier Wang Qishan have expressed China’s determination in pushing forward the reconstruction of a ‘diversified’, ‘scientific’ and ‘organized’ international monetary system. (The 21st Century Economic Report 2011)

Chinese authorities and economists think the IMF should play an important role in correcting the single-reserve currency problem in the current system. China hoped IMF rules would include symmetrical external discipline on domestic policies for all countries including the US, which has dramatically abused its status as the main reserve currency country. (Eichengreen 2009) They urged the Fund to strengthen surveillance on macroeconomic policies, especially the currency issuance policies of the major reserve issuer countries. It is consistent with Drezner’s argument that financial statecraft is more likely to work with multilateral support. (Drezner 2009: 22) Deputy People’s Bank Governor Hu Xiaolian said in March 2009, ‘under the current situation, we feel that the IMF particularly needs to strengthen its surveillance of the economic policies and financial policies of the major reserve-currency-issuing nations.’ (Baston 2009: A10) The Chinese delegation at the IMF called on the Fund to promote diversification of the international monetary system and disconnect it from the US economic conditions and sovereign interests. Lacking the capability to face the US alone, some Chinese policymakers and economists regarded China’s participation in IMF reforms as an
effective approach to larger decision-making power in the governance of the reformed international monetary system.

In particular, Xiang argued that the main purpose of China’s efforts toward IMF reforms was to protect itself from the damage caused by the ‘Dollar Standard’. (Xiang 2010) The Governor of the People’s Bank of China Zhou Xiaochuan called on the IMF to increase the use of the SDR as a super-sovereign reserve currency. Zhou suggested the IMF should set up a settlement system between the SDR and other currencies; actively promote the use of the SDR in international trade, commodities pricing, investment and corporate book-keeping; create financial assets denominated in SDRs to increase its appeal; and further improve the valuation and allocation of SDRs to include the currencies of all major economies in the basket. (Zhou 2009) However, these simple suggestions were not developed into a constructive proposal. They lacked a technically practical focus. Some Chinese economists agreed with Zhou’s suggestion on the expansion of the SDR, and further emphasized the IMF’s crucial role in the international financial regulation. For example, they argued for more purchase of SDR denominated assets to increase China’s influence in IMF financing (Zhang 2009); to let the RMB join the SDR basket (Wang 2009a; 2009b); and to rebuild the IMF as the world’s central bank that effectively oversees and coordinates monetary policies in all the countries (Qiao and Xu 2011: 5).

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The above cases indicated when, for what reasons, and in what ways China delegated to the IMF. China delegates to IMF technical assistance programs to learn from the IMF the methods and techniques in running a modern financial system that meet the international requirements. China participates in IMF monitoring and policy advice programs, submitting its information and data to the IMF, as well as obtaining information and data of economic trends of other member states and general international financial economy. China also delegates the tasks of making lending risks assessment and designing lending contracts to the IMF. China delegated to IMF Multilateral Consultation on Global Imbalances, as the IMF was able to provide a forum on which China (along with four other major players whose economic policies are highly related with the global imbalances issue) could discuss the controversial exchange rate regime issues in an open international environment instead of facing harsh western criticism alone. Finally, China increasingly faces the potential damage caused by depreciation of US dollars and US dollar-denominated assets. It is also threatened by the growing instability in the international monetary system cause by the single-reserve currency problem. Yet it is simply too weak to challenge the might of the US economy and enforce reforms in the international monetary system. In this case, China expected the IMF to strengthen monitoring of US domestic economic policy; and assist China to diversify the international monetary system by promoting the SDR.
5 Conclusion

The chapter has discussed the key features of China as a principal, more precisely a member of the ‘collective principal’; and those of the IMF as China’s international institution agent. The People’s Republic of China is not a founding principal of the IMF, hence it does not ‘own’ Fund policies like the US and its western developed country allies do. On the other hand, the IMF performs as an influential agent that assists China in achieving its objectives in the international financial economy.

The Chinese government delegates various tasks to the IMF due to the Fund’s distinguished functions. The chapter discussed the Chinese government’s delegation to the Fund, including delegating to IMF technical training, surveillance and policy advice and multilateral lending programs because of the Fund’s prominent expertise and information advance; delegating to the IMF Multilateral Consultation on Global Imbalances because of the Fund’s outstanding agenda setting power; and its attempt to delegate to the IMF the task of reforming the US dollar-based international monetary system and creating a favourable environment for China’s RMB and financial stability because China cannot balance against the US power in the international financial market on its own.

The tasks delegated by the Chinese government mostly aim for the IMF’s advanced functions. Via delegation, China seeks to learn more methods and techniques of financial governance; get information about the international financial economy; solve global imbalances in a transparent and open forum; show its commitment to international
cooperation and orderly growth of the world economy; and achieve an international monetary system that is less subjected to the restrictions of the US and more friendly to China’s financial advancement.

However, the consequences of China’s delegation to the IMF are yet to be assessed. Benign wishes and efforts do not guarantee satisfactory consequences. The actual delegation decisions and actions of the Chinese government are greatly influenced by China’s preferences compared to those of the IMF and its other member states, China’s relative decision-making power in the IMF’s governance mechanism, and China’s influence among IMF staff. These listed factors will be assessed in the next chapter.
Chapter 6 - China participates in the IMF: Preferences, Governance, and Staff Autonomy

1 Introduction

This chapter examines China’s preferences regarding IMF policy decisions and policy processes; China’s relative decision-making power in the IMF’s formal and informal governance mechanisms, respectively; and China’s influence among IMF staff. These three factors largely affect China’s delegation decisions and actions, which also lead to different consequences of delegation. The examination conducted in this chapter responds to the third stage of the four-stage approach to analyzing the relationship between China and the IMF within a principal-agent theoretical framework.

China’s preferences regarding IMF policy decisions and policy processes directly influence China’s decisions on delegation and the processes of delegation. Hence, in order to assess China’s delegation decisions and the consequences of delegation, its preferences need to be clarified first. It is difficult to detect a state’s real preferences, because sometimes states say one thing but do a different one. In this research, China’s preferences are reflected in the Chinese representatives’ statements at the semiannual International Monetary and Financial Committee meetings. These statements may not
include all the opinions held by the Chinese authorities regarding IMF operation, yet they reflect a considerable amount of Chinese authorities’ true preferences, although interpreted in a rather diplomatic way. The research looks into the Chinese representatives’ statements in the period from 2001 to 2011, and they include increasingly explicit propositions that reflect the Chinese authorities’ increasing involvement in IMF programs. China’s propositions refer to various IMF issue areas; and they are divided into six categories: to understand member countries’ domestic environment; to respect member countries’ sovereignty; to follow IMF mandate and not go beyond it; to meet member countries’ needs; to treat the IMF’s developed and developing country members fairly; and to increase developing country members’ representation and participation in the IMF. (IMFC 2000; 2001; 2002a; 2002b; 2003a; 2003b; 2004; 2005a; 2005b; 2006; 2007a; 2007b; 2008a; 2008b; 2009; 2010a; 2010b; 2011)

China’s delegation process and especially its effectiveness are determined by China’s relative position in the IMF’s structure of governance, in both formal and informal spheres. A state’s quota and voting share in the IMF represent its formal governance power: the more quota and voting share it holds, the higher formal governance power it has, and thus the more likely it delegates tasks to the Fund with larger tolerance for staff autonomy. China’s IMF quota and voting share has become a popular topic among both scholars and policymakers in the past decade. The Chinese government conceived its quota and voting share were severely lower than China’s actual proportion in the world economy, and started to request for more representation in the IMF since the late 1990s.
The Fund’s other emerging market and developing country members have been in the similar situation, some are more severely underrepresented, and some are less. The IMF thus has suffered legitimacy problem due to the unequal governance structure. In order to solve the legitimacy problem, the IMF has initiated three major rounds of quota and voting share reforms in 2006, 2008 and 2010. The results of these reforms indicate the dynamic changes in China’s share in the Fund’s formal governance.

However, a state’s formal governance power does not reflect its full decision-making power in the Fund; the informal governance of the IMF reveals its hidden structure. A state exercises its informal governance power in the informal forums and groups outside the EB, such as the G7, the group of EU representatives to the IMF (EURIMF), the G24 and so on. The informal governance power reflects a state’s capability to network and to influence IMF staff in the Fund.

Finally, the chapter looks into the IMF’s staff, attempts to find out how much influence China has among IMF staff. IMF staff’s expertise in various fields of economics and their status of ‘international civil servants’ enable them to enjoy a large degree of autonomy. IMF staff, but not officials from any state government or other political organizations, are technically running the Fund including its daily administration and practices of all crucial policy decisions. Hence, IMF staff’s knowledge and judgments are crucial to the final decisions of the IMF. In other words, the degree to which IMF staff acquire an accurate and comprehensive understanding of a member country’s domestic political social environment and economy determines the effectiveness of the Fund policy toward that
member country. I assume IMF staff have a naturally better understanding of the country/region they come from; hence the more staff are recruited from one country/region, the better IMF policies reflect that country/region’s real problems and meet its real needs. In this way, I evaluate the effectiveness of IMF policies for China by examining the proportion of the IMF staff with Chinese nationality. The more IMF staff with Chinese nationality are employed, the better IMF policies serve the Chinese people’s real interests; and vice versa.

2 China’s Preferences

Actors’ preferences are crucial in principal-agent theory. In the case of China-IMF relationship, what matters is not only China’s preferences compared to those of the IMF’s, but also to those of other, especially the strong western advanced economy state members’. Conflicts of preferences among member states, which are described as ‘distributional conflicts’ by Lisa Martin, could largely affect the delegation consequences. (Martin 2006: 142) The international organization, that is the IMF in this case, also has its specific preferences on specific issues. Martin put the states’ preferences on a spectrum, where the IMF’s ideal point could also be located. She found out that when states preferences diverge and thus there are disagreements among states about the desired policy, the IMF staff have large room of maneuver and thus greater autonomy. In contrast, when states’ preferences converge, the IMF staff have less flexibility. Moreover, when the states believe that staff preferences are in line with them, they are more likely to grant authority to the IMF and allow them more flexibility. If the states perceive that the
IMF staff has divergent preferences, they would act more reserved toward the Fund. Those states whose preferences are closest to those of the staff will be the strongest proponents of staff autonomy. (Ibid: 142-145)

In the case of IMF, since the Fund’s preferences are closer to those of the US and other western advanced economy member states, the consequences of ‘staff autonomy’ are often consistent to what these countries would prefer. At least they are closer to these countries’ preferences than those of China’s. Therefore, if China’s preferences diverge from those of the US and the Fund’s other western advanced economy member states, and if the states’ preferences are widely distributed along the preference spectrum, the consequential agency autonomy may lead to undesired delegation results for China. If China’s preferences differ from those of the IMF’s, it may decide not to delegate; or reclaim authority, setting more explicit guidelines for policy or exercising more direct oversight if the authority has already been delegated to the Fund.

It is not easy to identify a state’s explicit preferences in all issue areas. Yet we can find what a state prefers in general through its speeches and activities in the IMF. In China’s case, I shall identify its preferences with regard to Fund policy decisions and activities via the Chinese representatives’ statements at IMFC meetings. The Committee discusses matters of concern affecting the global economy and also advises the IMF on the direction of its work. The IMFC has 24 members who are usually central bank governors, ministers, or others of comparable rank and who are drawn from the governors of the Fund’s 188 member countries. The membership reflects the composition of the IMF's
Executive Board. The IMFC meets twice a year, at the Bank-Fund Annual Meetings and at the Spring Meetings. The members’ statements at IMFC meetings include their opinions about IMF policies and programs, and their requests and advice for IMF policies and programs. Therefore, these statements directly reveal the members’ preferences vis-à-vis the Fund, as well as those compared to other member states. (IMFC 2002b, 2003b, 2005a, 2005b, 2006a, 2006b, 2007a, 2007b, 2008a, 2009, 2010a, 2010b, 2011a)

Chinese representatives at the IMFC have increasingly made explicit statements with regard to the IMF’s various issues areas. They include the IMF’s lending facility and conditionality, standards and codes, surveillance mechanism, HIPC Initiative and Poverty Reduction and Growth Facility Program, anti-money laundering regulations and regulations against other criminal financial activities, SDR locations, sovereign debt restructuring, reforms in the quota and voting share system, and the IMF’s own institutional and financing mechanism reforms. The Chinese representatives’ statements (or requests) reflect China’s preferences with regard to IMF policies and programs. They are summarized in the following subsections. (Ibid)

2.1 To Understand Member Countries’ Domestic Environment

First of all, China argues that in the IMF’s programs, genuine concern about member countries’ actual domestic political and economic environment and their different development stages would help avoid any ineffective ‘standard’ or ‘fit-for-all’ models. An updated study of the world economic environment would help the IMF facilitate the macroeconomic stability of its members in a dynamic international monetary system. In
particular, Chinese officials believe that the implementation of the IMF standards and
codes should adequately reflect differences in member countries’ economic and
institutional development stages and, especially the reality in most developing countries.
(IMFC 2001: 2; 2003a: 3) Moreover, the recipient countries’ domestic weakness in
infrastructure and capacity building should be fully considered while the IMF provides
financial and technical assistance and policy guidance, so as to avoid imposing unrealistic
requirements and expectation on them which would hinder progress of poverty reduction
and increase the burden on them. (IMFC 2002a: 4) In 2005, China supported the use of a
joint IMF-World Bank low-income countries debt sustainability analysis framework,
emphasizing the need to consider each country’s actual conditions when analyzing its
ability to sustain debt. (IMFC 2005a: 5)

Chinese officials also particularly emphasized the importance of correct understanding of
each member country’s unique domestic complexion in IMF surveillance, for example
when the Fund promotes new transparency policies (IMFC 2004: 4). Chinese officials
strongly appreciated the IMF managing director’s report on the Spring Meeting in 2005
which advocated the adoption of different forms of communication for different countries
and effectiveness of surveillance based on different countries’ unique characteristics.
Chinese officials pushed forward the implementation of this proposal, and advocated that
Fund staff policy recommendation should be even more specific and that each country’s
conditions could be reflected in a more objective, accurate, and focused manner in the
Article IV Consultation report. (IMFC 2005b: 4) Chinese officials also pointed out that
the focus of Fund surveillance should be on reviewing whether a member country’s
macroeconomic policies are consistent with the objective of maintaining domestic and international economic stability. Therefore, surveillance over exchange rates should focus on whether the adopted exchange rate regime is consistent with a country’s macroeconomic policies rather than on the exchange rate level. Evaluating the exchange rate level alone would hardly be objective and certainly miss more fundamental issues. (IMFC 2006: 4, 2006b: 4) Due to the problems in the global financial sector that were disclosed during the 2007/08 financial crisis, Chinese officials urged the IMF to update its understanding of the dynamic world economic environment, study the inherent deficiencies in the current international monetary system and propose fundamental improvements according to current global economic and financial circumstances. (IMFC 2008b: 3-4)

2.2 To Respect Member Countries’ Sovereignty

The second point Chinese officials have brought up in several meetings and negotiations with the IMF is that the Fund should follow the founding principles to respect member countries’ sovereignty and trust their governments. Some of the Fund policies should be implemented by member countries on a voluntary basis. Chinese officials specifically emphasized that IMF technical assistance and policy guidance should not comprise any sort of direct audit, and Fund assessments should comply with local laws and policies. (IMFC 2000: 5) China also thinks that the IMF should be cautious in publishing data referring to its member countries, and data provision should continue to be on a voluntary and consultative basis. (IMFC 2004: 4) Moreover, while dealing with loans, the IMF should faithfully respect the intentions and policies of its borrowing members, and
develop mutual understanding and trust with its members, so as to ensure the success of Fund assisted programs and strengthen members’ ownership of Fund programs. (IMFC 2001: 3) Chinese officials also pointed out that in IMF anti-money laundering programs and other programs for preventing criminal financial activities, the sovereignty and situations of individual countries should be respected, and the ownership and initiatives of national governments should be brought into full play. (IMFC 2002a: 5) Furthermore, Chinese officials commended the IMF’s efforts in assisting low-income countries’ poverty-reduction and long-term development programs, but they also demonstrated that the Fund should let the poor countries autonomously draft their own poverty-reduction strategy documents.

2.3 To Follow IMF Mandate

Chinese officials maintain that the IMF should strictly follow its mandate and not operate in issue areas beyond its mandate. In addition, the IMF should avoid overlapped functions with other international economic institutions such as the World Bank and the Bank for International Settlements. (IMFC 2000: 2) Chinese officials brought out this point when they commented on the IMF anti-laundering and other criminal financial activities. They argued that since the IMF has neither mandate nor expertise in anti-money laundering and terrorism financing activities, it should not get directly involved in them; instead, the Fund should direct its efforts to areas where it has mandates, as prescribed in its Articles of Agreement. The relevant assessments and technical assistance should follow a unified, voluntary and cooperative approach but not include
aspects of law enforcement; neither should they compromise the Fund’s core. (IMFC 2002b: 6, 2003a: 6)

2.4 To Meet Member Countries’ Needs

Chinese officials maintain that the IMF should make and implement their policies based on demands from its member countries, especially those who receive most of the Fund assistance and guidance. In its HIPC Initiative and Poverty reduction and Growth Facility programs, the Fund should listen more carefully to suggestions and comments from the developing countries to better understand and resolve problems emerging from the procedures of these programs, for example the PRSP preparation process. (IMFC 2000: 6-7) The IMF should understand that the formulation and implementation of any standards and codes and policies must achieve the objective of promoting the ‘rule-taker’ countries’ economic development; and thus it is important to listen to these ‘rule-taker’ countries and understand their demands. Based on this point, Chinese officials maintain that the IMF should learn about the imperfections in the developing countries’ financial sectors and provide sufficient expertise and technical assistance to meet their institution- and capacity-building needs. (IMFC 2005b: 4) Moreover, during IMF surveillance, while the Fund emphasizes data provision by member countries, it should also pay close attention to fostering and improving their capacity building, particularly in helping the developing countries strengthen their fundamental statistical work. (IMFC 2004: 4) In the management of IMF lending facilities, for example conducting the review of access limits, the rate of charge and maturities of lending instruments, consideration should be
given as to how attractive these instruments are in satisfying the potential needs of member countries. (IMFC 2008b: 4)

2.5 To Treat the IMF’s Developed and Developing Country Members Fairly

Furthermore, the Chinese officials argue that IMF policies and programs should fairly reflect the distributions of economic resources among developed and developing country members and their different economic influences. First of all, since the developed countries have crucial influences in the global financial economy, the IMF should implement stricter policies over the economic activities of these countries. Chinese officials suggested several times that the IMF needs to tighten its surveillance of macroeconomic and financial policies of the major industrial countries and important financial centres, in order to prevent large fluctuations among the major currencies, ensure the sound and efficient operation of international financial markets, and promote healthy development of the world economy. (IMFC 2002a, 2002b, 2003a, and 2006a) Deputy Governor of People’s Bank of China Hu Xiaolian said in March 2009, ‘Under the current situation, we feel that the IMF particularly needs to strengthen its surveillance of the economic policies and financial policies of the major reserve-currency-issuing nations.’ (Baston 2009: A10)

After the 2007/08 global financial crisis happened, the Chinese officials further emphasized the need for the IMF to enhance surveillance over the macroeconomic policies of the advanced economies. (IMFC 2008b: 3) They proposed that the Fund surveillance should focus on the evolution of developed countries’ sovereign risks and
their impact on international market interest rates, exchange rates, and international capital flows; on public and private sector financing in developing countries; and on global inflation and the real economy. (IMFC 2008b: 3; 2010a: 4)

Secondly, the Chinese officials maintain that the IMF should always fulfil its responsibility toward poor developing countries and facilitate proper global allocation of major production factors. To achieve this end, the IMF should implement vigorously the initiatives in the Monterrey Consensus, and urge developed countries to reach the target for ODA of 0.7 per cent. (IMFC 2002b: 5) China continues to support the Fund’s HIPC initiative and Poverty Reduction and Growth Facility program; and encourages the IMF to increase flexibility with non-concessional financing to low-income countries. They also further called on the Fund to work with other international financial institutions to explore new financing mechanisms for more effective reallocation of productive resources to low-income countries in the wake of the 2007/08 global financial crisis. (IMFC 2009: 4) In addition, the Chinese officials pointed out that the IMF should be cautious about charging for technical assistance, because a high charge would reduce the demand of the service from the poor developing countries by which the IMF technical assistance is most needed. (IMFC 2007a: 4)

Finally, the Chinese officials have emphasized a few times in meetings with IMF staff that the developed countries should take the leading responsibility to help developing countries strengthen their economic development. Chinese officials argued that combining debt relief and poverty reduction should not result in stricter conditionality for
HIPC debt relief; and therefore, in addition to debt relief initiatives, the developed countries should provide extra official assistance funds for poverty reduction program to the HIPC countries. (IMFC 2000: 7) Chinese officials have also called on the industrial countries to renounce trade protection and continue to open up their markets to developing countries to create a favourable international environment; meanwhile they urged the IMF to conscientiously oversee the progress of the developed countries in the reduction of trade protection. (IMFC 2003a: 5) The IMF’s developed country members have also been encouraged to facilitate the smooth implementation of the Fund reforms that are intended to improve the developing country members’ representation and benefits. (IMFC 2007b: 5)

2.6 To Increase Developing Country Members’ Representation and Participation in the IMF

Chinese officials call on the IMF to include more emerging market and developing countries in the Fund’s decision-making and policy-formation processes in all issue areas, so that the Fund could serve the interests of all the member countries on a fair and justifiable basis. Chinese officials proposed two major approaches to a larger involvement of the emerging market and developing country members in the IMF’s key policy-making procedures. Firstly, the IMF should employ more staff from emerging market developing countries. For instance, Chinese officials suggested that the IMF and low-income countries could benefit from engaging more technical assistant experts from the emerging markets who are aware of the specific needs of the recipient members. (IMFC 2008b: 3) More importantly, Chinese officials have been endeavouring to push
forward the quota and voting-share reforms in the IMF since the late 1990s. Since then, Chinese officials have encouraged the IMF to speed up the reforms in quota and quota formula at almost every IMF-World Bank joint annual meeting and IMFC meeting. Chinese officials argue that quota shares and formulas should reflect the changes in member countries’ relative positions in the world economy and the rapid growth of developing countries, and the under-representation of emerging market and developing economies should be corrected.

The above statements made by the Chinese officials reveal China’s preferences with regard to IMF policy decisions and policy practices. The Chinese representatives do not usually use rigorous terms to criticize IMF in these statements, yet their ‘requests’ and ‘advocates’ reflect the Chinese government’s dissatisfaction with IMF policies. China thinks the IMF should be guided by a better understanding of its developing country members’ domestic political and economic environment and the difficulties they face during economic development. IMF assistances and policy advice should be provided based upon the recipient countries’ needs. China remains skeptical about the IMF’s bias toward its western advanced economy members and calls for fair treatments for all members. China thinks the IMF should carry out stricter surveillance on the developed countries to avoid fluctuations and disruptions in the global financial economy. China also urges the IMF to improve representation for the Fund’s emerging market economy and developing countries in order to maintain its legitimacy and effectiveness in the governance of global financial economy. China also thinks the IMF and its developed country members should take the major responsibility in helping developing countries
prompt economic growth and maintain financial stability. These points of view show that China’s preferences are in line with those of the IMF’s emerging market economy and developing countries; yet they are not completely clashing with those of the developed countries.

China also thinks the IMF should operate within the mandate of its Articles of Agreements. It should respect the member countries’ sovereignty, their freedom to accept or not accept IMF advice, and their ownership of the projects. Hence, China maintains the usual conservative and cautious attitude toward IMF intervention. This proposition is compatible with China’s rejection of IMF advice on the essential policy issues that may affect the interests of China’s powerful domestic industries and financial institutions. China’s preferences thus differ from those of the Fund’s advanced economies, together with its skeptical attitude toward IMF on some specific issues, such as the IMF’s unequal governance structure, can explain why China is distant from the IMF’s core decision-making mechanisms. It may also drive China away from delegating to the IMF.

3 China’s Decision-making Power in IMF governance

Another crucial factor of China’s delegation decisions and effectiveness is China’s decision-making power in the IMF’s structure of governance. IMF structure of governance is divided into formal and informal governance. In IMF formal governance, a state’s decision making power is represented by its quota and voting share; and in IMF
informal governance, a state’s decision making power is exercised through informal negotiation and networking. This section explores China’s decision making power in the IMF’s both formal and informal governance.

3.1 China’s IMF Quota and Voting Share and Formal Governance Power

China’s decision-making power in the IMF’s formal governance is determined by its quota and voting share in the Fund. Quota subscriptions are a central component of the IMF’s financial resources. Each member state of the IMF is assigned a quota, based broadly on its relative position in the world economy. A member state’s quota determines its maximum financial commitment to the IMF, its voting share, and its access to IMF financing. The IMF uses a quota formula to guide the assessment of a member state’s relative position in the Fund. Therefore, the changes in China’s IMF quota and voting share indicate its evolving position and decision-making power in the Fund. China’s relative position and decision-making power among IMF state members reflect the strength of China as a principal.

China initially faced the dilemma between a desire to keep its quota, and thus its potential liability low, and a desire to attain a quota larger than that of India’s and one that would enable it to elect an executive director with a single country constituency. Eventually Chinese opted to become a major contributor. In July, 1980, the IMF board of governors made the first decision of China’s quota as SDR 1.2 billion, which was increased to SDR 1.8 billion in November in the same year. In 1983, as a consequence of the Eighth General Quota Review, China’s quota was further increased to SDR 2.39 billion which
was just above that of India’s, making it the ninth largest in the IMF.\(^{48}\) (Jacobson and Oksenberg 1990: 76) China’s quota was upgraded moderately in the 1990s, but not greatly enough to satisfy China’s requirements. The Chinese officials believed that given their quotas at the time, developing countries lacked sufficient votes to affect Fund policies. In particular, China wanted more active participation and bigger voices in the IMF, with a quota increase to better reflect its position in the world economy following the resumption of Chinese sovereignty over Hong Kong. (Kent 2007: 132) The IMF responded to China’s request with a positive answer. On January 4, 2001, Horst Hohler, the Managing Director of the IMF, announced that the Executive Board had proposed to the Board of Governors an increase in China’s quota to SDR 6.4 billion from SDR 4.7 billion. The new quota represented about 3.0 per cent of total quotas, made China the eighth largest quota holder in the Fund. (IMF 2001a; 2001b)

After entering the new century, as China’s economy continued to grow rapidly, China realized that its representation in the IMF was lagged far behind its proportion in the global economy, which hindered it from exerting influences on IMF policymaking. Therefore, China enhanced its requests for quota and voting shares reform in the Fund, calling for a shift of quota proportion and voting shares from developed countries to emerging market economies and poor developing countries. The Chinese delegations have emphasized IMF quota and voting share issue at IMFC meetings in almost every year since 2002. In IMFC April meeting in 2002, the Chinese delegation called on the IMF to complete its review of quota formulas as soon as possible to introduce new

\(^{48}\) The member states having quotas larger than China were, in order of the size of their quotas: the US, the UK, the Federal Republic of Germany, France, Japan, Saudi Arabia, Canada, and Italy.
formulas to reflect objectivity and fairly the status and needs of developing countries in the world economy, and especially to increase the representation of African countries in the Fund. (IMFC 2002a: 5-6) In the September meeting, the Chinese delegation pointed out that the relative size of the Fund’s quotas had decreased to its lowest level in nearly 30 years and it may cause a liquidity shortage. Therefore the delegation urged, again, the IMF to make a decision on quota increase during the 12th General Review of Quotas, in order to fulfil the Fund’s core role in safeguarding the stability of the international monetary system. (IMFC 2002b: 7)

China continued to call for reforms in IMF quota formulas and voting shares to reflect the rapid economic growth of developing countries. In IMFC April meeting in 2006, the Chinese delegation also emphasized that the Fund’s governance structure should be enhanced through an appropriate increase in basic voting rights to boost the voice and representation of small and medium-size developing countries, particularly African countries. (IMFC 2006: 5) IMF staff accordingly proposed an ad hoc quota increase package that was passed by the members at the IMF Annual Meetings in Singapore in September 2006. Members agreed to a package of reforms to be completed over a two-year time frame on the meeting, which comprised the following elements:

1. An initial ad hoc increase in quota for the most underrepresented members: China, Korea, Mexico, and Turkey;
2. A new quota formula to guide the assessment of the adequacy of members’ quotas in the IMF;
3. A second round of ad hoc quota increases based on the new formula;

4. An increase in the basic votes that each member possesses to ensure adequate voice for low-income countries, as well as protection of the share of the basic votes in total voting power going forward; and

5. Allocating additional resources for the two Executive Directors representing African members, as they stand for a fairly large number of countries. (IMF 2007c)

The first element was implemented in 2006, due to which the quota shares of China, Korea, Mexico and Turkey increased by 1.8 per cent in total. All the other components of the package were endorsed by the Executive Board on March 28, 2008. During 2006-2008, China continued to call on all parties to strengthen consultations to complete the second-stage of the reform within the agreed timeframe. The Chinese officials pointed out that the first round ad hoc increase only moderately alleviated the underrepresentation of China, Korea, Mexico, and Turkey, which still remained the most severely underrepresented. Therefore, they contended that the second round ad hoc increase should be based on the post-Singapore level and an overall increase of at least 12.5 per cent was appropriate. The Chinese officials also argued that the new quota formula should be simple, transparent, and easy to implement; and it should include four variables- GDP, openness, variability, and reserves. They called for giving GDP the greatest weight, using a blended GDP variable with at least 25 per cent Purchasing Power Parity (PPP) weight. They also supported a slightly lower weight for openness and a higher weight for variability, which would better reflect members’ potential need for financial resources from the IMF. They also added that there should be a built-in
mechanism for periodically reviewing and adjusting members’ quotas to reflect timely changes in the global economic landscape. Finally, the Chinese officials called for stronger political will from the authorities of the advanced economies to facilitate smooth implementation of the quota and voting-share reform. (IMFC 2007b: 4-5)

In April, 2008, the IMF Board of Governors approved the proposal of a package of further quota and voting shares reforms that responded partly to China’s specific requests. The package included a single quota formula- substituting the old five formulas-based on four updated variables: a blend of GDP (30 per cent weight) and PPP (20 per cent weight), openness (30 per cent weight), variability (15 per cent weight) and reserves (5 per cent weight). The measurement of GDP in PPP terms would consequentially increase the weight of developing countries whose GDP measured at PPP is much higher than their GDP measure at the market rates. The modified variables of openness and reserves would also be favourable to the emerging market economies that are increasingly open to the global market and accumulating a large amount of foreign reserves. The reform package also intended to strengthen the representation of the poor countries via the changes in the administration of the constituencies chaired by two African executive directors, the tripled basic votes measure, and a realignment of quota and voting shares every five years in order to result in a further increase in the share of under-represented countries. (IMF 2008a) Finally, some emerging market economies such as Korea, Singapore, Turkey, China, India, Mexico, and Brazil would have their quota shares increased, although not by much. It took a rather long period of time for the reform to come effective, eventually on March 3, 2011. (IMF 2011g) Due to the
implementation, China’s quota increased from 3.718 to 3.996 per cent of the total quotas, and its voting shares increased from 3.651 to 3.806 per cent of the total voting shares, which did not substantially change China’s decision-making power in the IMF. (IMF 2010b) The Chinese delegation complained that the 2008 ad hoc quota increase fell far short of the objective of the Singapore resolution, and thereby continued to call for a pragmatic approach to promote further progress on the reform, including further adjusting the quotas of under-represented members in the next general quota review and a regular mechanism for quota adjustment establishment. (IMFC 2008a: 3)

Amidst the recovery from the global financial crisis, the increasing role played by the emerging market economies vis-à-vis the rebalance of the global financial economic system stimulated the urgency of a further IMF governance reform. On December 15, 2010, the IMF Board of Governors approved a proposal of further governance reforms that was described by the Fund Managing Director Dominique Strauss-Kahn as ‘the most fundamental governance overhaul in the Fund’s 65-year history and the biggest ever shift of influence in favour of emerging market and developing countries to recognise their growing role in the global economy.’ (IMF 2010c) When this proposal is implemented, the IMF promises a significant shift of more than 6 per cent of quota shares to dynamic emerging market and developing countries while protecting the quota shares and voting power of the poorest countries. With this shift, China, Brazil, Russia and India will be included in the Fund’s 10 largest shareholders. In particular, China will have 6.394 per cent of the total quotas and 6.071 per cent of the total voting power and become the Fund’s third largest member. On the other hand, the advanced European countries will
reduce their combined Board representation by two chairs at the latest by the time of the first election after the reform comes effect. A comprehensive review of the current quota formula was scheduled to be completed by January 2013, and the 15th General Review of Quotas will be brought forward to January 2014. (IMF 2010d)

The IMF undoubtedly made a remarkable step toward the rebalance of the member countries’ representation in the Fund through the 2010 Reform. However, the official agreement on the reform reached by the Board does not necessarily guarantee an effective and efficient implementation. A recently published report on the outcome of the quota formula reviews concluded the Executive Board decided that achieving broad consensus on a new quota formula will be integrated and moving in parallel with the discussion on the 15th Review. The report showed there were divided opinions among IMF staff toward the four variables of the current formula and a potential new variable of ‘financial contribution’. Despite the disagreements, it did not sound like a very different quota formula that favours the emerging market economy and developing countries will be generated later. (IMF 2013c) Moreover, the Fund’s as well as the member countries’ institutional features further hampered efficient implementation of the 2010 Reform. Implementation of the 2010 Reform Package requires a pass of the member countries’ domestic legal approval processes before being implemented, which is usually time consuming.

The Fund has been pushing forward the implementation; especially the IMF Managing Director Christine Lagarde has urged the member countries to complete the necessary
legislative procedures to implement this agreement within the agreed timeframe for several times throughout 2012. On the World Bank-IMF annual meeting in October 2012, both Lagarde and the G-24 Chairman Palaniappan Chidambaram indicated that they were confident with the implementation of the 2010 reforms by January 2013. Lagarde specifically pointed out that it would take only one or two countries to press the yes button for the governance reform to be implemented. (IMF 2012e) However, The IMF website updates on the matter on February 5, 2013 indicated that at least 14.61 per cent of the voting power was still to be needed in order to reach the 85 per cent of the Fund’s total voting power for the reform to enter into force.\(^{49}\) It is worth pointing out that the US, as the IMF’s biggest member with 16.7 per cent of the total voting power, had yet not accepted the 2010 reforms. (IMF 2013d) In other words, just like in many other cases, the IMF needs the US to press the yes button so that it could proceed and eventually implement the 2010 reforms. The complex US domestic policy process makes the implementation of any IMF decisions even more difficult. In fact, the 2010 reform has not been implemented until the thesis is submitted.

Overall, IMF quota and voting shares reforms include long and complex processes. Every procedure of each round requires the Fund’s advanced economy members\(^{50}\) to agree on and implement the decisions that would potentially reduce their own decision power in the Fund. Some of the Fund’s advanced economy members were reluctant to forego their

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\(^{49}\) In order for the proposed amendment on reform of the Executive Board to enter into force, acceptance by three-fifths of the Fund’s 188 members (or 113 members) having 85 per cent of the Fund’s total voting power is required. As of February 5, 2013, 132 members having 70.39 per cent of total voting power had accepted the amendment. For the list of the countries that have accepted the amendment, please check [http://www.imf.org/external/np/sec/misc/consents.htm](http://www.imf.org/external/np/sec/misc/consents.htm)

\(^{50}\) Such as the US, Japan, Germany, France and the UK
decision power, which together with their complex domestic legal approval system made the implementation of IMF reforms even more difficult. Despite the bureaucracies, the actual impact of IMF governance reforms on China’s and other emerging market economy and developing country members’ representation and voicing power in the Fund remains debatable. When the 2010 reform comes effective, the US quota share will be reduced to 17.407 per cent from 17.670 per cent that was agreed under the 2008 reform, but return to the pre-2006 reform level. Meanwhile, with a slight reduction, the US will keep 16.479 per cent of the total voting power that ensures the ‘veto’ right is retained. The EU countries will forego around 2.7 per cent and 3.1 per cent of total quotas and voting power respectively compared to the pre-2006 reform level, which are insignificant compared to the proportion retained: 30.2 per cent and 29.4 per cent respectively. The G7 will secure 43.4 per cent of the total quota shares, which still surpasses the 42.3 per cent held by all the emerging market and developing countries added together. The G7’s voting shares will fall behind those of the emerging market and developing countries’, although not by far.51 Therefore, the increase of China’s quota and voting shares, although contributes significantly to its own decision-making power growth in the IMF, does not put China in any position to challenge the dominating power of the Fund’s advanced economy members. China’s increasing yet relatively weak decision making power indicates that it remains a relatively weak principal compared to the US and the fund’s other advanced economy member states in the Fund’s formal governance.

3.2 China’s Informal Governance Power

The quota and voting share is the most essential index of a member state’s formal governance power in the IMF; however, the informal governance of the IMF reveals the hidden structure of the Fund. As argued by Stone, ‘the formal rules specify voting rights and legitimate procedures that embody a broad consensus of the membership, while the informal rules allow exceptional access for powerful states to set the agenda and control particular outcomes.’ (Stone 2011: 13) Therefore, to understand China’s decision-making power in IMF governance, we need to find out China’s role in Fund informal governance.

The US has kept the biggest voting share in the Executive Board, yet its share has declined since the Bretton Woods conference as new members joined the IMF. The US has always controlled a minority of shares, stopping it from directly controlling Fund policies, although the veto power enables it to block adoption of any new policies. However, the US has relatively direct control in the Fund’s informal governance, especially on the non-general structural and policy decisions, such as lending decisions. For the IMF’s general structural and policy issues, the EB delegates a large degree of authority to IMF management, which in turn delegates detailed decision making to staff. On the other hand, when the issues are important to major shareholders, the informal governance starts to operate. The decision-making of such issues are moved outside the EB to forums that better reflect the international distribution of resources, and management’s formal proposal power is exercised informally by individual shareholders, which shape proposals before management brings them to the board. (Stone 2011: 55) The G7 is the most obvious example of such informal governance forums/groups.
As mentioned earlier, the IMF management and staff to a large degree (if not by all means) control the proposals. They negotiate with the affected countries and initiate the proposal accordingly. They would only submit the proposals to the EB knowing it would likely to be passed. However, informal participation allows influential shareholders, mostly the G7 members and especially the US, to shape the agenda and craft proposals before they are brought to the Board. It is mostly because the US has large organizational advantage over other countries as they have extensive diplomatic corps, especially influential private financial institutions, advantages in gathering information, and of course the advantage of having the IMF located in Washington, DC. The rest of the G7 members usually keep their voices consistent with that of the US’. For example, the US ED always requested a special briefing before a country item regarding a Latin American country came to the Board. In some important cases, including Argentina, Brazil and Mexico for example, the US ED requested meetings to debrief the chief of mission before and after each trip abroad. Via such briefings, the US ED was able to effectively monitor the progress of negotiations. In addition, the G7 EDs are sometimes briefed before the other countries. (ibid: 51-79)

Moreover, Woods and Lombardi did a research on the importance of informal arrangements in IMF governance, in terms of the lobbying and agenda-setting roles played by the informal coalition groups outside the EB, such as the G7, the group of EU representatives to the IMF (EURIMF), the G11, the G24, the Asia-Pacific Group, and so on. Each chair of the EB is a member of one or more informal groups. The purpose of the
informal arrangements is to leverage preferential access to IMF senior management and staff in order to affect the institutional agenda at an early stage, before it is formalized in specific policy proposals. The coalition groups serve as a forum for discussing issues and deriving a better sense of the institutions, its agenda and the implications of items on the agenda. They also serve to assist in finding collective solutions and to leverage access and input into knowledge and research. (Woods and Lombardi 2006; Lombardi 2011: 169) These informal groups are formed by the chairs from the same region, or with common interests, gathered to discuss related policy issues. For example, the Chinese representatives are in the Asia-Pacific Group with the representatives from Japan, Korea, Thailand, and India. Woods and Lombardi’s research pointed out that the leverage of the Asia-Pacific group had a limited effect on Board dynamics compared to that of the G7 or the EU, because of its relative diversity and limited total voting shares. (Woods and Lombardi 2006) Therefore, China, together with other emerging market and developing countries, are lagged behind in informal IMF governance.

According to an senior IMF official in an interview⁵², he said 20 years ago, not many officials at Fund meetings would come to the Chinese representatives; yet now more and more officials, especially those from emerging market and developing countries do actually come to the Chinese representatives and hoping to get approval and support from China on various policy issues. The Chinese representatives are increasingly developing networks within the IMF; however, till it becomes a strong player in the informal

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⁵² Interview conducted in the IMF Headquarter in Washington, D.C. The interviewee (Interviewee 3) is a senior IMF official of the IMF.
governance, it will continue to request for a larger say in the formal IMF governance, that is via the quota and voting share increase.

4 IMF Staff Autonomy and Chinese Nationality

Studies of International Organizations often focus only on the role of states or international organizations as whole units. Those analyze the role of international organizations often focus on the international organizations’ functions, structures and governance. Staff of international organizations are sometimes ignored, or simply counted into the structures of the organizations. However, international organization staff should be examined as an organism whose characteristics, including their structure, competence, legitimacy and culture, can significantly affect the operation of international organizations. People who work in international organizations to a large extent determine the organizations’ capability to accomplish their tasks and to fulfil their promised duties. As Xu and Weller argued, ‘…their [international civil servants] power is derived from shared values of multilateral cooperation, their expertise, competence and continuity and their capacity to shape the institutions and behaviour of the states involved.’ (Xu and Weller 2007:37) International organization staff become more influential if they have a larger degree of autonomy. Xu and Weller introduced five sources of autonomy: control of information, longevity, technical expertise, leadership, and legitimacy. Examination of staff characteristics and their autonomy is crucial in the case of IMF, especially if we want to investigate to what extent Fund staff determine IMF policies.

53 ‘International Civil Servants’ represent the same concept of what I call staff of international organization staff here.
IMF staff have gained a rather large degree of autonomy from its principals over time. Several scholars have explored the development of IMF staff autonomy. Susan Strange particularly remarked on one event as the sign of ‘important shift of responsibility from the US to the Fund’, that was when members stopped discussing their prospective requests for drawings directly with the US ED prior to submitting a formal request in 1956. She added that IMF consultations and the need to make decisions in a timely manner further contributed to greater staff autonomy. (Strange 1973: 267-279) Miles Kahler argued that the US supported expansions of staff autonomy, in part as it did not have a choice, because the programs required a degree of expertise and information that EDs and their staffs could not provide. (Kahler 1990: 96) Margaret Garritsen de Vries argued that frequent staff-ED communication meant that staff could convey information informally to EDs, so that explicit oversight was unnecessary; and that over time EDs came to be more confident with the staff. The staff also gained autonomy as they accumulated expertise. Keith Horsefield argued that moving the venue of negotiations from Washington to members’ capitals significantly enhanced staff autonomy. Although some EDs originally objected this policy change, the informational demands of drafting effective programs eventually convinced the EB to delegate this authority to IMF staff. (Horsefield 1969: 270) The consequence of these reforms in the IMF is ‘a strong management/staff and an Executive Board that acted largely on Management recommendations’. (Southard 1979: 9)
IMF staff work is crucial to keep the whole system running. It is particularly important to the work of the EB, because the EB’s work is largely based on the memos and papers produced by the staff. For example, it is the IMF staff that are taking charge of releasing IMF resources to member states and the primary conduit for conditionality. The country wishing to access to IMF resources usually negotiates a stand-by arrangement with IMF management and staff. The staff then pass the arrangement to the EB to be approved. Once the arrangement is approved, it allows the country to draw on Fund resources on a specified schedule, under certain conditions that are included in the Letters of Intent attached. This procedure reflects the relative influences of the EB and the staff and management. The EB cannot approve a program without a proposal from the staff, which confers on the staff a large degree of agenda-setting power. The EB holds the power to make the final decision to either accept or reject staff proposals. In other words, IMF staff take the control of the initial plans and arrangement s of all lending programs.

As an IMF report showed real debates over policy and issues are rarely conducted in the Board, controversial cases and stand-off issues are even more rare. The ‘peaceful’ atmosphere of the EB is also due to ED’s protectiveness towards the countries they represent, and their consequent expectation of similar deference from their colleagues. Hence, in the words of the IMF External Evaluation, what is supposed to be ‘peer pressure’ in fact becomes ‘peer protection’. (Woods 2001: 87-88; IMF 1999) If the staff anticipate that the EB would disapprove its proposal of a potential program, it could refuse to present it to the EB in the first place, which confers IMF staff the ‘gatekeeping’ power. Once the program is in place, the staff continue to use the agenda-setting power to
assess whether the borrower country has met the conditions of the loan and make recommendations about whether to release the next stage of the drawing. (Martin 2006: 147-149)

IMF staff have strong knowledge about macroeconomics and significant experience in dealing with the financial difficulties of member states. The staff’s ability to use expertise and knowledge is the Fund’s crucial source of autonomy. The staff’s technical knowledge, solid credentials in monetary policymaking, and experience in the field have made the Fund ‘an authority’ and a credible source of policy advice. (Barnett and Finnemore 2004: 50) IMF staff’s expertise enabled it to access to the member states’ domestic economic governance. For example, the IMF staff drew from their economic training to develop models that created new intellectual connections between domestic economic stability and balance-of-payment position. The Fund created a unique model to tackle the member states’ balance-of-payment problems, which identified a unique relationship between domestic credit and international reserves.\(^5^4\) Unsurprisingly, the model had normative implication. By its structure and assumptions, the model framed the problem as one in which both the case of and the solution to balance-of-payments problems lay in the deficit state. This shows how IMF programs shape the economic norms in the member states and the international economy. Meanwhile, the Fund’s staff also offer technical assistance, together with the conditionality, enable the Fund to move from a limited focus on balance-of-payments lending to even deeper structural

interventions in members’ economies and societies. This standpoint is also consistent to
the socialization proposition that the IMF seeks to socialize member states into accepting
the Fund’s advocated norms via various interactive mechanisms.

Knowing the IMF staff autonomy enables the Fund to expand its authority over its
member states, we now go back to the origin of the staff autonomy. Barnett and
Finnemore described it as ‘expertise authority’, and they pointed out:

‘What makes the prescriptions of the Fund so authoritative is that they are undergirded
by a body of economic analysis that is accepted by a large number of economists in many
countries. The Fund’s expertise creates some amount of agreement that certain basic
features of the Fund’s model and stabilization programs are right and true in some
objective way. Widely shared agreement among economists across borders on certain
modes of analysis and perceived truths is one component of the deference paid to the
Fund’s recommendation.’ (Barnett and Finnemore 2004: 68)

The solutions provided by IMF economists are not purely technical and value-neutral;
they aim to reconstitute the member states’ economies to conform to the market-
dominated models that are at the core of the international neo-liberal economic norms.
IMF economists and other staff together are a crucial component of the Fund’s
‘organizational culture’; and the ‘organizational culture’ sustains staff autonomy facing
the Fund’s member states. Constructivist scholars use ‘organization culture’ to explain
the origin of staff autonomy. It comprises ‘shared ideologies, norms, and routines that
shape staff members’ expectations about how agendas are set, mandates are operationalized, projects are implemented and evaluated and what staff behaviour will be rewarded or punished in promotions and demotions.’ (Nielson, Tierney and Weaver 2006: 109) The IMF’s organizational culture is characterized by neoliberal economic theory and a technocratic approach to problems. Such cultural provides the IMF staff with guidance for its operations of policies and programs. It strengthens the IMF staff’s autonomy, and consolidates the staff’s judgments and decisions in any Fund program.

Hence, it’s the IMF staff running this big institution. They operate research on economic development of the member countries and the global market in order to provide them with advice. They also meet the policymakers and private sectors of the member countries in order to produce Article IV consultations. They prepare all sorts of proposals and documents for the Executive Board and Board of Governors to make a decision on. They organize various formal meetings and informal forums for the international policymakers to gather to exchange views and discuss issues of common interest. Other than those, they also attend the meetings of other related institutions such as the UN, World Bank, and G20 in order to promote policy coordination and cooperation in the global sphere. In a sense, the IMF final policy decisions and advice on world economic development are transformed from the staff’s expertise, knowledge and opinions.

Therefore, the degree to which IMF staff acquire an accurate and comprehensive understanding of the member countries’ domestic economy determines the effectiveness of the Fund program. In particular, in order to operate accurate analysis and offer
appropriate advice to the emerging market and developing countries, the IMF ought to employ the staff with accurate and comprehensive understanding of the involved countries and regions. The staff members originally from the emerging markets and developing countries presumably have better knowledge of their own countries and regions; therefore increasing the recruitment from these regions will bring more concerns about the specific countries and regions to Fund policy-making and decisions.\(^\text{55}\) In addition, the staff originally from emerging market and developing countries would bring some new concepts and ideas, encouraging the Fund’s organizational cultural to gradually include the economic ideologies and norms from these areas.

For both intellectual and legitimate reasons, the IMF has increased the recruitment from emerging market and developing countries in the recent years under its ‘Diversity’ principle; however, the share of these regions in all the staff, especially the senior B-level staff (senior staff positions with managerial responsibilities) remain considerably low. In China’s case, the data shows an obvious increase in the number of IMF staff with Chinese nationality in the recent years, yet among which the share in the B-level staff is surprisingly low. According to IMF annual diversity reports, the number of staff with Chinese nationality jumped from 51 in 2007 to 72 in 2009, followed by a continuous increase to 109 in 2012. (IMF 2008b, 2010e, 2012f) However, the IMF 2007 Diversity Report pointed out that the share of Chinese staff in the Fund (1.9 per cent) remained far below the country’s quota (3.7 per cent), and thus made the world’s largest and fastest growing emerging market economy underrepresented in the Fund. (IMF 2008b: 33) What

\(^{55}\) No matter which countries the Fund staff members are from, they do not represent the interests of their state governments or any domestic interest groups.
made it worse was China’s severe underrepresentation at the Fund’s senior staff level. The number of Chinese B-level staff has not gone beyond 4 since 2004; and the 2011 Diversity report indicated that 3 Chinese nationals made 0.94 per cent of all Fund B-level staff by April 30, 2012. (IMF 2012f: 37) Moreover, the data also showed that the Chinese staff had relatively low rates of promotion and poor career advancement in the Fund. Only 2 Chinese staff member was promoted to the B-level in the seven years from 2000-2007 (IMF 2008b: 26); and none was promoted in 2011-2012 as the latest data shows. (IMF 2012f: 15) The 2011 report indicated that ‘diversity’- although essential in the general recruitment policy- does not drive promotion; (IMF 2012f: 14) in other words, Chinese staff would not get promoted because their country is underrepresented in Fund governance.

Since the strategy to achieve greater diversity was formalized in 1996 under the Managing Director’s statement on ‘Measures to Promote Staff Diversity and Address Discrimination’, the Fund has increasingly institutionalized its ‘diversity’ principle in recruitment and management.\(^{56}\) The Fund considers ‘diversity’ in staff nationals as a sign of strong organizational environment that generates diversity in thoughts. Nevertheless, it is challenging to transfer the principle into practice by adapting the Fund’s organizational culture to accommodate the new thoughts that may clash with orthodox IMF norms. Despite the efforts made toward diversity, the IMF remains highly western-dominated.

The 2011 Diversity Report showed more than half of Fund staff members were from the

\(^{56}\) These measures include initiating various diversity workshops and seminars, introducing related Code of Conduct, introducing diversity-sensitive interview methods and training, carrying out staff surveys, adopting enhanced Diversity Action Plan with quantitative benchmarks, creating a Diversity Council and several Diversity Reference Groups, implementing diversity scorecard, recently implementing new policy measures to strengthen senior-level diversity, and so on.
Fund’s 24 industrial country\textsuperscript{57} members out of 188 in total. In particular, among all the B-level staff, those from the industrial country group amounted to 70 per cent. (IMF 2012f: 34) In particular, in the Asia-Pacific area department, 42.1 per cent of all B-level staff members are from Europe, Canada and the US. It is thus questionable whether the Asian national staff in the Asia-Pacific department could sufficiently use their language, knowledge and experience advantages in their research, and whether the result of their research could accurately reflect the economic and social development in the region.

Moreover, the result of the investigation of Fund staff’s education background further proved the western-domination characteristic of IMF staff. In 2011, among all the Fund staff, around 63 per cent of PhDs, half of the Master’s degrees and 40 per cent of Bachelor’s degrees were obtained in the US; and the UK, France, Canada, Germany and Italy were other important education sources of Fund staff. Although China was also among the top ten countries of education of Fund staff, its data is almost negligible compared to that of the US- only 0.6 per cent of PhDs, 1.1 per cent of Master’s degree, and 2.6 per cent of Bachelor’s degree were obtained from China. (IMF2011h: 27-28) It means most of the staff with Chinese nationality left China before their Master’s degrees. In this case, the Fund staff with Chinese nationality may not acquire thorough understanding of China’s domestic economy and therefore unable to contribute to the more country-sensitive advice that better serves China’s specific policy insufficiencies.

\textsuperscript{57} The Industrial Country Groups includes Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Taiwan, Province of China, United Kingdom, and United States of America.
In summary, IMF staff have a large degree of autonomy, based on which they could affect Fund programs and domestic economies of the member states. However, China is excluded from this mighty staff authority. IMF staff includes a rather small proportion of members with Chinese nationality. Among the IMF staff members with Chinese nationality, the majority were educated in the western institutes, which prepared them for working in the IMF that is guided by the neo-liberal economic norms. Employing more staff with Chinese nationalities – or more precisely, with better understanding of the Chinese economy- does not mean these staff members will serve the interests of the Chinese state, yet it at least brings in better knowledge of China’s domestic economic structure and social-political regime. During an interview, an IMF staff who originally came from China and finished her bachelor and masters degrees in China was asked if ‘the Chinese voice has increased within the Fund’, and she said ‘I want to clarify that there is no Chinese voice in the IMF, because we all work as international civil servants and we do not represent the voice of any state.’\textsuperscript{58} It is certainly a good thing that IMF staff work on a neutral and non-political basis; and this Chinese IMF staff’s answer should certainly be regarded as a positive statement. However, based upon the neutral and non-political assumption of IMF working environment and the assumption that the staff originally from China have a better understanding of China’s domestic economic development, lacking staff members with Chinese nationality does not help the IMF develop an accurate understanding of Chinese economy. Neither does it help China gain a larger decision making power in the Fund. Lacking staff members with Chinese nationality in the IMF proves China’s weakness in the staff authority. It makes China a

\textsuperscript{58} The interview was conducted in IMF Headquarter, Washington, D.C. The Interviewee (Interviewee 4) is a staff member in one of IMF research departments.
less influential principal with regard to the issues that are subjected to the maneuver of Fund management and staff. On the other hand, is the IMF really neutral and non-political? With its prevailing neo-liberal economic norms, it is quite likely not so.

In addition, the selection process of IMF managing director has incurred criticism from its emerging market economic and developing country members, especially the BRICS (Brazil, Russia, India, China and South Africa) country members. There is a ‘latent’ rule in the IMF and World Bank that, the managing director of the Fund is usually from a Western European country and the president of the Bank from the US. Protesting against this rule, several international agreements called for a truly transparent, merit-based and competitive process for the selection of IMF managing director and other senior positions in the Bretton Woods institutions, to replace the obsolete unwritten convention that requires that the head of the IMF be necessarily from Europe. Even some European policymakers announced that IMF managing director does not need to be European. For example, in 2007, during the selection of Dominique Strauss-Khan as the new IMF managing director, Jean-Claude Junker, president of Euro group declared that ‘the next managing director will certainly not be a European’ and ‘in the Euro group and among EU finance ministers, everyone is aware that Strauss-Kahn will probably be the last European to become director of the IMF in the foreseeable future’.

However, in early 2011, some high-level European officials reversed the tune and made some public statements to the effect that the position of IMF managing director should continue to be European that triggered the BRICS statement. The IMF EDs representing
BRICS countries made a statement on May 24, 2011, complaining about the IMF managing director appointment system. They stated that ‘... if the Fund is to have credibility and legitimacy, its managing director should be selected after broad consultation with the membership. It should result in the most competent person being appointed as managing director, regardless of his or her nationality. …that adequate representation of emerging market and developing members in the Fund’s management is critical to its legitimacy and effectiveness.’ They further called for that the next managing director should not only be a strongly qualified person, with solid technical background and political acumen, but also a person that is committed to continuing the process of change and reform of the institution so as to adapt it to the new realities of the world economy. (IMF 2011i) However, about half a month after the BRICS’ statement, on July 5, 2011, Christine Lagarde from France became the new appointed managing director of the IMF.

5 Conclusion

In this chapter, I examined the Chinese representatives’ statements at IMFC meetings in the period from 2001 to 2011, in order to generate an analysis of the Chinese government’s preferences regarding IMF policy decisions and policy processes. The Chinese representatives often call on the IMF to correct its western-dominated governance structure and policy propositions and make more policy decisions to compensate the economically disadvantaged developing countries. Hence China tends to be in line with the interests of the Fund’s emerging market economy and developing
countries, which makes China a non-traditional principal of the Fund. It may discourage China to delegate tasks to an IMF whose preferences are closer to those of its western advanced state members, at least until China perceives less preference contradictions. It could also potentially create difficulties for China to obtain more voicing power in an IMF that has been dominated by the western advanced states for a long history.

However, a state’s preferences do not fully explain its delegation decisions and actions. China’s IMF-related delegation decisions and effectiveness are largely determined by China’s decision making power in the IMF’s formal and informal governance. China’s quota and voting share— that represent its decision making power in the IMF’s formal governance— have increased for several times since 1980, especially in the past decade. Yet, China’s current quota and voting share still implies China’s state of ‘under-representation’ in the IMF. On the other hand, the US maintains an absolute dominant position in the Fund’s formal governance sphere by keeping the only veto power that is held by one single state. Adding EU countries’ voting shares together also generates a veto power. This situation makes China a relatively weaker principal among the Fund’s state members. Similarly, China does not have a prominent influence in the IMF’s informal governance either. Compared to the US and other western advanced states, China lacks skills and experience in negotiating with other states in the forums outside the EB or influencing IMF staff before they submit policy proposals. Therefore, China’s weak decision making power in IMF governance may prohibit its intention to delegate tasks to the Fund, or discourage it to grant IMF staff more autonomy if the delegation has already undertaken.
Finally, the proportion of IMF staff with Chinese nationality indicates the extent to which IMF policies reflect China’s real interests. The logic behind this causal relationship was explained in this chapter: IMF staff with Chinese nationality are more likely to have a better understanding of China’s domestic social political and economic environments and hence more likely to take into account of China’s real needs in Fund policy designs. The staff’s influences in IMF policy products are made possible by the Fund’s strong organizational culture and the staff’s acquisition of distinguished economic expertise and analytical techniques. However, the result of the examination conducted in this chapter showed that the IMF has a small proportion of staff with Chinese nationality, especially in the senior managerial tier. It does not sufficiently prove that IMF policy products are ignorant of China’s real needs, yet it does make IMF policy products regarding China’s problems less convincing. In addition, hiring more staff with Chinese nationality in the IMF could also help build up a strong link between the IMF and China, which may attracts more attentions to Fund programs from the Chinese government. Hence the ‘China influence’ is limited among IMF staff and in staff-driven IMF programs, which may also discourage the Chinese government to grant IMF staff more autonomy and prohibit the effectiveness of delegation.
Chapter 7 - China’s Role in the International Financial Economy: A Principal- Agent Framework

1 Introduction

This chapter examines the consequences of China’s delegation of multiple tasks to the IMF, which is also the last stage of the four-stage approach to analyzing the relationship between China and the IMF within a principal-agent theoretical framework. The results of the examination explain China’s relative position and strategic moves in the international financial economy.

China has gradually specified its goals in the international financial economy, which are to strengthen its decision making power and create an environment that is more flexible for China’s economic advancement and financial stability. It was already explained in the previous chapters that China decided to delegate authority to the IMF so that the IMF could assist China to achieve its objectives more effectively. Hence delegating tasks to the IMF is China’s approach to a higher role in the international financial economy. It is also one of the most legitimate and supposedly effective approaches due to the IMF’s authoritative role in the governance of the international financial economy. The consequences of China’s delegation of tasks to the IMF tell us if the ‘IMF approach’ functions as a good option.
If China’s delegation generates satisfactory consequences, the state government may consider continuing to delegate or delegate more authority to the IMF, which proves a successful IMF option toward its objectives in the international financial economy. On the other hand, if China’s delegation leads to undesired consequences, which is referred as ‘agency slack’ in principal-agent theory, the state government may call off delegation. In this case, China could either deal with agency slack and mitigate the negative impact to the minimum, or seek alternative solutions other than participating in IMF programs, or both.

So is the IMF a diligent agent or a slacker? The examination builds upon the analysis conducted in the previous chapters, and extends the factors of China’s delegation decisions and process to the eventual consequences of delegation. Some of the evidences were explained with details in the previous chapters, for example the impact of IMF technical assistance and Article IV Consultation, yet they are re-interpreted in this chapter from the perspective of principal-agent theory. It focuses on five causes\(^{59}\) of agency slack: IMF staffing rules, IMF structure of governance, preference deviation between China and the IMF, China’s reliance on IMF expertise and costly controlling mechanisms, and inadequate IMF resources.

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\(^{59}\) Sometimes the causes of agency slack could be interpreted as the impacts of it. For example, the IMF does not have enough financial resources, hence it cannot sufficiently play the role of ‘lend of last resort’ and fulfill the task of multilateral lending when crises happen; on the other hand, it is because the IMF fails the role of ‘lender of last resort’, member states loose faith in the IMF and stop contributing to the IMF financial resources.
The analysis shows neither China acts like a capable principal with powerful controlling
mechanism, nor the IMF performs like a diligent agent with consistent interests and
values. Agency slack explains why China is dissatisfied with IMF policy decisions and
policy processes, and why China often attempts to gain more shares in the governance of
the international financial economy in alternative ways. While China increases
participation in IMF programs, it also develops bilateral links with other states and
regions especially other emerging market economies, and gets more engaged with Asian
regional financial cooperation mechanisms such as the Chiang Mai Initiative (CMI),
ADB, ASEAN10+3, and the Asia-Pacific Economic Cooperation (APEC). China’s
alternative approaches could be regarded as China delegating authority to other
regional/international organizations in order to achieve its objectives in the international
financial economy. They significantly justify China’s principal role facing international
institutions. China’s alternative cooperative moves (other than through the IMF) are not
the focuses of this research, hence they will only be briefly described in the last part of
this chapter (in Section 4); however, they shed light on China’s multilateral view of the
governance of the international financial economy.

2 China’s ‘IMF Option’

China initially decided to rejoin the IMF in 1980; and since then it has been increasingly
participating in IMF programs. China showed clear intentions and goals while making the
decision on what particular IMF programs, and to what degree it would participate in.
The Chinese authorities intended to learn from the IMF the methods and techniques in
running a modern financial system that meets the international requirements; to get information about other countries’ financial economy from the IMF; to get (re)-connected with foreign economic institutions via participating in IMF programs; to accelerate expulsion of Taiwan from the international political society by demonstrating its legal membership in the IMF; and to show to the world that it could be an eligible member of the international political society, which would significantly enable smooth economic cooperation with foreign states. Driven by these goals, China decided to delegate authorities to the IMF. Recalling the definition of delegation - ‘a conditional grant of authority from a principal to an agent that empowers the latter to act on behalf of the former’ (Hawkins et al 2006: 7) - China delegated to the IMF because of the Fund’s specific functions that would enable China to achieve the goals in a more efficient way than it would have by taking the unilateral or other cooperative approaches.

When China re-joined the IMF, the Chinese government was still considerably resistant to the western-dominated international political economic system. Nevertheless, China did become more open toward the IMF in the later years, via which it also established connections with other states. It made China develop more confidence in the Fund, which could be reflected from the Chinese government’s increasing delegations of various tasks to the IMF. Unlike other developing countries, China did not aim for utilizing the IMF as an emergent financial source, therefore delegating to IMF financial assistance mechanism was not an initial part of the plan. China did not delegate to IMF lending mechanism as a debtor in the later years either. Yet due to the IMF’s specific expertise and information advance, its agenda setting power and multilateral decision-making mechanisms, and its
capability to solve the controversial issues that cannot be solved by China on its own, the Chinese government made decisions to delegate authority to the IMF in several other programs.

China delegated to the IMF the tasks of training its officials in various economic departments with internationally standardized methods and techniques in running a modern financial system. It increasingly delegated authority to IMF surveillance programs such as the Article IV Consultation, by submitting data and information to the Fund and expecting it to generate accurate technical analysis of the economies of IMF member countries. It delegated the tasks of multilateral lending to the IMF. Moreover, China also delegated the tasks of solving global imbalances to IMF Multilateral Consultation on Global Imbalances, by which China could discuss the solutions to the problem along with other essential economies. Furthermore, when China was facing the threats from the volatile dollar-dominated international monetary system, it sought to delegate to the IMF the tasks of strengthening surveillance on reserve currency issuer countries and diversifying the risky single currency based international monetary system.

As an international organization agent, the IMF carries out multiple tasks that are delegated from its member states. China does not simply delegate a task to the IMF for once and then let the IMF to perform as it wishes. It could later choose to re-delegate more precisely designated tasks and/or authorize new pursuits for the IMF (for example, it has increasingly delegated authorities to IMF surveillance and policy advice programs). It could otherwise choose to de-delegate authorities from the IMF because of undesired
delegation consequences (for example, banning the IMF from publishing the staff reports for the Article IV Consultation). Via such a dynamic delegation relationship between China (the principal) and the IMF (the agent), the IMF operates various programs with China’s participation in order to fulfill China’s goals.

The tasks China delegated to the IMF are so far generic and (relatively) simple. They usually do not involve complicated political concerns of other states, for example in the delegations to IMF lending mechanism. The Chinese government does not usually add extra difficult conditions - apart from the general principle to ensure China’s (economic) sovereignty is not largely intervened - on the tasks delegated to the IMF. Neither does it have specific technical requirements on these tasks. In addition, Chinese EDs and related officials do not use complicated manoeuvre on IMF operations. The generic and simple delegation is mainly because China does not really ‘own’ the IMF in the same way as the US does. China is less familiar with IMF procedures and roles, although such understanding has gradually increased.

These generic and simple tasks may not seem highly connected in terms of required IMF functions, yet they all serve one essential goal of China’s economic leadership: a larger role in the governance of international financial economy in the long term. The IMF performs the functions of a training centre for financial methods and techniques, an international policy advisory body, a lending agent with advanced risk assessment skills, a multilateral forum to solve controversial global issues, and a superior international institution to reform and govern the international monetary system. Via each of these
functions, the IMF provides China with the opportunity of collaborating with foreign and international economic institutions, which gives credit to China’s increasing role of a ‘responsible’ international player. To China, as a principal, the IMF is an international organization agent that brings China to the front of international financial and economic policies. To become a successful agent, the IMF needs to assist China – by performing the functions mentioned above to fulfill the tasks delegated from the Chinese government- gain a larger influence and decision-making power in the governance of international financial economy.

3 A Good Agent, Or A Slacker?

Is the IMF a diligent and effective agent that enables China to access to a larger role in the governance of international financial economy? To judge if the IMF is a diligent and effective agent, we need to start from the assessment of delegation consequences. If IMF staff accomplishes the tasks as China expected, we say the agent has generated satisfactory delegation consequences, which may lead to re-delegation. If IMF staff could not accomplish the tasks as China expected, either they failed the tasks or did not fulfil them as China expected, we say the agent has generated undesired delegation consequences, which may lead to de-delegation. The staff’s actions that lead to undesired delegation consequences are defined as agency slack. Agency slack takes place often in state-international organizations interactions, because of institutional, preference, and other reasons. Hence, the more causes and factors of agency slack exist in the China-IMF interactions, the more likely the delegation will generate undesired consequences; and
vice versa. This section will assess the consequences of China’s delegation to the IMF, by looking into the reasons and impacts of agency slack. It represents a ‘first cut’ analysis that has been partly generated by drawing on insights into broadly similar cases in existing literature, and on observations from the case study.

3.1 Staffing Rules

The procedure affecting the type of personnel hired for the international organization’s administrative elements, determine whether and to what extent the international organizations develop preferences distinct from those of the member states. (Cortell and Peterson 2006: 259) The distinct preferences may lead the staff to perform the tasks in a way that is not expected and wanted by the principals. Such impact of staffing rules could be applied in the IMF case. The IMF staff members are mostly composed of international civil servants. Compared to the staff members sent by state governments, the international civil servants are more likely to form distinct preferences. Especially in the IMF case, a large amount of staff members are experts specialising in different economic fields. They share a common professional identity. They usually handle the IMF’s missions on the bases of their shared knowledge and techniques. March and Olsen suggested that they developed a similar ‘logic of appropriateness’ (March and Olsen 1998), which significantly contributed to the IMF’s organization culture, including its concepts, ideologies and unique procedures and institutional rules.

Cortell and Peterson argued the ‘logic of appropriateness’ associated with serving a particular international social purpose or normative value leads the international
organization to understand its job in ways that may run counter to states’ preferences. (Cortell and Peterson 2006: 260) In the IMF case, the ‘logic of appropriateness’ is associated with the promotion of universal international neo-liberal economic norms, which do clash with some developing countries’ preferences. The Chinese authorities’ reaction to the Fund Article IV Consultation’s comments on China’s exchange rate issue proved this kind of clash. With respect to the Consultation’s persistent suggestions on China to revalue its currency RMB, the Chinese authorities denied the RMB was as under-valued as the Fund thought. They claimed the IMF had inaccurate assessments of China’s exchange rate regime because it *incorrectly* based its assessment of the degree of undervaluation upon uncertain forecast of the future current account, and thus *failed* to take a broader view on the path of the real exchange rate. (IMF 2011b:19) China has also continuously called on the IMF for developing a deeper understanding of the member states’ domestic environment, so that Fund programs especially its policy advices could be more country-sensitive. These appeals reveal China’s dissatisfied feeling toward the IMF’s ‘standard’ and ‘fit-for-all’ policy packages for its member states.

In addition, international civil servants have bureaucratic incentives to advance the international organization’s mission. IMF employees peg their job prospects with the reputation and development of the Fund, but not any member state. Such inward focus may lead the staff members to ignore the member states’ interests while designing interactive programs for the Fund. However, it is difficult to judge if Fund staff’s inward career focus has caused sacrifices of the member states’ benefits. This kind of causal

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60 The details about China calling the IMF for a better understanding of member states’ domestic environments at IMFC meetings were analyzed in Chapter 6.
relations is usually rather covert rather than explicit. Cortell and Peterson argued that although the international staff weighs the reputation and development of the international organization more important than those of the member states’, they are clearly aware that they are ‘dependent on states for the agency’s [international organization] existence and resources’. (Cortell and Peterson 2006: 260) It is thus unlikely that IMF staff would ignore the principals’ preferences and insist on following its own convictions.

3.2 IMF Governance Structure

The governance structure of the International Organization determines the relationship between the principals and the agent. IMF governance could be divided to formal and informal governance. For the formal governance, the member state’s relative quota and voting share among all EB members, which compose the Fund’s collective principal, is the most direct sign of its decision-making power. The more IMF quota and voting share a state has, the more decision-making power it obtains in Fund formal governance. IMF informal governance takes place outside of the EB in various forums/groups that better reflect the international distribution of resources. A state that is involved in more informal forums/groups, with better links with other states (or political aligns) and better knowledge about operation of the IMF (and the whole international monetary system) usually has a larger decision-making power in IMF informal governance. The larger decision-making power a state has, in both formal and informal governance, the more likely the IMF would carry out the delegated tasks in the way that is consistent with the
state’s expectation. In other words, the state with larger decision-making power encounters less agency slack.

China is an increasingly influential player in IMF Executive Board, which makes it a significant part of the Fund’s ‘collective principal’. Nevertheless, China’s quota and voting share stay relatively low, especially compared to those of the US’. The long and eventful quota and voting share reforms analyzed in the previous chapter indicated the difficulties for a non-traditional controlling principal to gain decision-making power in the IMF. On the other hand, China’s influence in the IMF’s informal governance is also relatively small. China does not have the sort of organizational advantage that the US has. Neither does it have the same level of diplomatic links that other G7 states do. Unlike the US and other G7 members, China does not act like an experienced player, using its expertise and networks to shape IMF proposals before they are passed to the EB. The former IMF Managing Director Dominic Strauss-Kahn said when he was interviewed by China’s Caijing (Finance) Magazine, ‘…when you are talking at the Executive Board of the IMF, the strength of your voice is more dependent on your involvement in the institution that the quota itself.’ (Li 2008) Lacking decision-making power and real influences in the Fund formal and informal governance prevents the state from taking a strong control of IMF programs.

IMF EB members make decisions on all the IMF structural and general issues via the formal governance. For example, all the Fund quota and voting share reforms are processed via the formal governance. This explains why it is extremely difficult to push
forward the real changes in IMF governance structure, representing by moving quota and voting shares from the Fund’s developed to emerging market economy and developing country members. Because it means in order to let the Fund’s privileged advanced economies forgo their decision power in IMF formal governance, the IMF needs to let such reform proposals pass the same system that is dominated by these advanced economies. In other words, the IMF needs to convince the advanced economies to vote for taking away their power. For example, to implement the 2010 quota and voting share reform, it has to get the official approval from the US domestic political system; since the implementation of IMF governance reforms requires for 85 per cent of total member state voting power, and the US itself currently holds 16.7 per cent. It explains why China’s intention to push forward IMF quota and voting share reforms are so time-consuming and difficult.

The western-dominated and unbalanced governance power in the IMF has created some problems in the Fund itself, as well as the international financial system. While the emerging market economies gradually accumulate stronger financial power, they became increasingly unsatisfied with the underrepresentation of their governance power in the IMF. Plus due to a series of wrong IMF decisions and movements during the emerging market crises of the 1990s, the Fund has been suffering a crisis of confidence among its emerging market economy state members. Since the Asian financial crisis, several scholars thought that the IMF prescription seemed ‘unhelpful, excessively intrusive and overly influenced by the goals of American policy-makers. (Chin 2010: 697; Higgot 1998; Bowls 2002; Stiglitz 2002) Developing country officials thought the IMF had too often
placed the onus of adjustment on developing countries without having any changed from themselves or the financier countries. (Chin 2010: 697). The crisis of confidence in the IMF has caused the emerging market economies’ reluctance to use Fund facilities. Instead, the emerging market economies tend to pursue a policy of ‘self-insurance’ through large accumulation of foreign reserves. For example, China has several strong reasons to pursue ‘self-insurance’ instead of IMF assistance. China’s motivation to hold a large currency reserves including: 1, to sterilize incoming capital flows in order to manage the exchange rate; 2, to meet the enormous needs of economic security and national defence; 3, to ensure that the Chinese government’s sovereignty is not delegated to any other country or institutions, considering China’s great power position; and 4, to deter against potential attacks by private speculators or foreign officials on the RMB. (Chin 2010) Therefore, until the IMF enhances its legitimacy in terms of shifting more decision making power to emerging market economy and developing country members, it is very unlikely the Chinese government would consider the IMF as an alternative to the self-insuring accumulation.

The rapid increase of sovereign wealth funds (SWFs) among the non-industrial economies- prominently China, Kuwait, Norway, Saudi Arabia, Singapore and the United Arab Emirates (UAE)- in the period 2007-2008 was seen as a sign of redistribution of the economic power and wealth away from the industrial economies toward rapidly growing emerging market economies, and of a loss of confidence in and diminished authority of the IMF. Anthony Elson argued that, ‘…the rise of SWFs must be seen as a reflection of an inadequate coordinating mechanism at the centre of the international economic system
and growing distrust on the part of many emerging market countries in the existing system centred in the IMF.’ (Elson 2008: 78-79) Xu argued that the rise of China Investment Corporation (CIC)\(^61\) was about ‘a shifting power relationship in the global economy’. (Xu 2009:2) Yet the IMF does not seem to be ready to adopt a change of economic power distribution like this in its own governance structure. In addition, the crisis of confidence in the IMF has also stimulated the proliferation of regional financial integration, for example the CMI in the Asian region.

### 3.3 Preference Deviation

The earlier analysis of IMF staff autonomy and organizational culture proved IMF staff have unique preferences that are beyond the simple assumption of maximization of staff budget and independence. IMF staff’s preferences are established upon the members’ common knowledge and ideologies on economic issues, accommodated in Fund institutional environment with specific procedures and rules and shaped by the Fund’s neo-liberal normative values. If the state principal’s preferences are converged with those of the IMF staff’s, its delegations to the Fund are likely to generate satisfactory consequences. In contrast, if the state principal’s preferences deviate from those of the Fund staff’s, agency slack is more likely to happen. (Gould 2006; Martin 2006)

The Chinese government’s preferences for a stable international financial system are consistent with those of the IMF’s. The Chinese government also supports multilateral approaches to the regulations of the crucial issues in the international financial system.

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\(^61\) China Investment Corporation is China’s biggest sovereign wealth funds company.
China supports the IMF to lead the post-crisis reforms in the international monetary system. However, apart from the convergence on the general interests about international financial stability and its governance, the Chinese government has distinct preferences on some specific details of Fund operation. China’s distinct preferences are reflected through its appeals and advice on IMF policies and activities, included in the Chinese officials’ statements for IMFC meetings. In those statements, the Chinese officials demonstrated several standpoints that are divided into three main themes. First of all, they pointed out that the Fund lacked comprehensive understanding of the unique state of the member states’- especially the developing states’- domestic economic policies, environment and weakness. The Chinese officials also pointed out that IMF staff should base its programs upon the real needs of the member states instead of the inherent knowledge and expertise they have with the institution. These two points showed the Chinese government did not have full confidence in the Fund’s west-centric policy-making and practices. The Chinese government considered the IMF programs should be more country-sensitive and demand-based. Since it is usually the developing countries on the Fund’s demand side, those two standpoints were actually calling the IMF to design its programs by taking into more account of its developing countries’ real interests.

Secondly, the Chinese officials emphasized that the IMF and its developed economy members should fulfill their responsibility toward the Fund’s poor developing country members. The IMF policies should be stricter for the economic activities of the developed economies; and meanwhile they should be more favourable toward the developing countries. In addition, China continuously criticized the IMF for its
unbalanced governance structure in which the emerging market economy and developing countries are severely under-represented. China has persistently pushed forward IMF quota and voting shares being transferred from its developed to developing country members; and it has also insisted that the IMF should employ more experts with emerging market economy and developing country origins. These strong standpoints evidenced China’s dissatisfaction toward the IMF’s policy inclination toward its western advanced economy members; and its eagerness for increases in, not only its own, but also other IMF emerging market economy and developing country members’ representations and decision making power in the Fund.

And thirdly, the Chinese officials strongly stated- in a semi criticism and semi pre-warning style- that the IMF should stick to its mandate and respect the member countries’ sovereignty and their domestic political, social and legal regulations. IMF policies should be implemented by the member countries on a voluntary basis. These standpoints demonstrated China does not want an IMF that aggressively impinges on China’s domestic policies.

When the preference divergence is exacerbated, China’s delegation to the IMF is likely to encounter agency slack. It is proved in the Chinese authorities’ cold reaction to IMF Article IV Consultation’s suggestion on accelerating the pace of China’s financial liberalization. The Chinese government willingly delegated authorities to IMF surveillance and policy advice programs. Yet it holds a rather cautious and evasive attitude toward IMF advocacies on further domestic financial liberalization that affects
the interests of crucial domestic government sectors and interest groups. IMF suggestions include the use of more price-based tools of monetary policy, to further raise controls on the capital account, to broaden the range of alternative investment vehicles for savers, to remove the government’s restrictions on bank lending and allow lending decisions to be based on commercial goals, to improve the financial infrastructure and relevant legal frameworks, and so on.

The Chinese authorities’ decisions on domestic financial reforms are mostly based on the relative benefits and influences of China’s domestic industries and financial institutions. The Chinese government is aware that a large revaluation of RMB, as the IMF and its western advanced economy members suggested, would harm China’s essential export industries. The liberalization of interest rates, again, as the IMF suggested, would reduce the profits of China’s powerful state-owned banks. The IMF’s policy advice that is largely based on its neo-liberal economic norms thus clashed with China’s preferences to protect its major state-owned sectors and domestic industries. In this case, the Chinese government firmly rejected the Fund’s advice to further liberalize its financial system, especially the advice on revaluing the RMB.

In addition, the Chinese authorities did not want to give the IMF (and most of other international economic organizations) the impression that it could easily intervene in China’s domestic policymaking. Hence even if China was deeply engaged in financial liberalization, it refused to admit the processes were directly affected by any specific IMF policy advice. If the Fund insists on China accepting the advice, China may choose to
withdraw authority from IMF programs. For example, China banned the IMF from publishing its Article IV Consultation reports on China in the years from 2007 to 2009. The exact reason for the ban was unrevealed, yet one could guess it was partly because of the Fund’s overly rigorous criticism on China’s domestic economic policies.

Nielson, Tierney and Weaver argued that when a state attempts to bring some reforms to the international organization, it would succeed if ‘the proposed reforms are adjacent to existing norms.’ In other words, the reformers need to articulate new ideas and goals (and incentives) to existing norms in ways that do not require the staff to largely forgo their pre-existing viewpoints and behavioural habits. (Nielson, Tierney and Weaver 2006; Kapur 2000; Hass and Hass 1995) It explains how the differences between China’s reference and the IMF’s western-dominated neo-liberalism based technocratic organizational culture prohibited China from pushing further forward the governance reforms in the IMF. China also urged the IMF to strengthen surveillance on its developed economy members, while making more favourable policies changes for the emerging market and developing country members. Such reforms require the IMF staff members who mostly read neoclassic economics and regard the western economic regimes as models to adjust its assessment criteria and change its inherent process methods. With no doubt, it would be extremely difficult to achieve.

In spite of the rigid inertia, Hass argued that the organizational culture could be altered through adaptation and learning (Haas 1990). Cultural change occurs where members contest and debate the pre-existing norms including its language theories and methods in
an incremental process. (Bebbington et al. 2004; Leiteritz 2005) Nielson, Tierney and Weaver suggested that the organizational culture could be changed via changes of ‘the personnel and organizational structures’ and designs of ‘measurable career incentives’ in order to enable and encourage the organization’s staff members to learn and internalize new norms and values. They further explained that it could be done by hiring personnel who share the ‘new’ values; (the principal) hiring instructors and investing in training and education with an eye toward inculcating certain norms; and changing the personnel within an organization and forcing work-related contact between new and old staff members. (Nielson, Tierney and Weaver 2006: 114) However, in the IMF, according to the Annual Diversity Reports, the proportion of the staff with the apparent ‘new’ values - that are more sympathetic toward the emerging market economy and developing countries- is still rather low. Especially reflected in the IMF’s senior level staff, the personnel and organizational structure remain mostly western-dominated. It further explains why China was defeated in pushing forward policies and activities that are more attractive emerging market economy and developing country members in the IMF.

3.4 Reliance on IMF Expertise and Costly Controlling Mechanisms

IMF staff expertise is one of the most important reasons that lead the Chinese government to delegate authorities to the IMF. The staff’s expertise has enabled the IMF to fulfil a number of tasks delegated from the Chinese government. For example, IMF technical assistance programs provided the Chinese officials with advanced methods and techniques in financial operations. IMF surveillance and policy advice programs also provided the Chinese economic leadership with some valid advice on its domestic
economic reforms. On the other hand, IMF expertise—especially its ‘expertise authority’—conferred on the Fund staff much autonomy that may lead to agency slack. A large degree of agency autonomy enables the IMF staff to control the contents of the proposals to be passed on to the EB as well as actual operation of Fund activities. For a relatively less strong and involved principal like China, the staff may drive Fund activities in a different direction from what China expected.

In addition, China and other states rely on IMF expertise because control and monitoring are costly. Hawkins et al. identified five major mechanisms for controlling their agents in order to prevent and mitigate agency slack. First of all, the principal uses contracts to specify the scope of the authority delegated to the agent, the instruments by which the agent is permitted to carry out its task, and the procedures that the agent should follow in employing those instruments. (McCubbins and Page 1987: 412) Secondly, principals use ex post monitoring and reporting requirements, typically specified in the delegation contract, to reveal information about the agent’s actions. Thirdly, via the screening and selection procedures, principals seek to reduce slack by selecting agents with preferences similar to their own. Fourthly, principals can structure agency relationships so that they contain institutional checks and balances that limit opportunistic behaviour by agents. And finally, principals can punish agents for undesired actions and reward agents for desired actions. (Hawkins et al. 2006: 26-31) Principals employ these mechanisms in

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62 Despite the advice on China’s sensitive domestic economic issues that was rejected by the Chinese authorities, the IMF did successfully provide the Chinese government with some policy advice, which was discussed in Chapter 3 (Section 3.4: Policy Advice).
varying combinations to minimize agency slack. However, mechanisms are usually costly and imperfect; and principals rarely engage in controlling agents completely. (ibid: 31)

Apart from the costs, it is sometimes difficult for principals to apply effective controlling mechanisms. Hawkins and Jacoby argued three reasons why principal controlling may not work. Firstly, principals can be ‘fooled’ into believing that they are monitoring something real and important about the agent that is actually not. Secondly, principals may not be able to agree among themselves on whether and how to change agent behaviour. And finally, the principals may still be relatively better off than without the agent- even that they are aware that they are relatively worse off than they would be with more effective monitoring instruments- and thus continue the delegation contract. (Hawkins and Jacoby 2006: 212)

In China’s case, it does not employ rigorous controlling mechanism over IMF activities. It is because China is not greatly familiar with the inside details of IMF operations. In particular, since the Chinese government tends to determine to what extent it would like to engage in IMF activities from the beginning- and the decision is usually not to be too much involved in Fund activities- it does not feel the need to employ ex post rigorous controlling mechanisms. With regard to the last type of controlling mechanism, Broz and Hawes showed that the IMF appears responsive to the need for expanded budgets from the most important member of its collective principal. (Broz and Hawes 2006) In China’s case, it has increasingly contributed to IMF financial resources, which does earn it increasing negotiation and controlling power in the Fund. As an official of a Chinese
financial institution said in an interview, ‘now the IMF needs China more than the other way around, because it needs Chinese capital to fill into its financial resources.’ Yet compared to the Fund’s other advanced economy members, especially the US, China does not yet obtain a strong creditor lever in the IMF.

Gould argued principal-agent model predicts that if control and monitoring are more costly, then agent activity should conform less to principal preferences. (Gould 2006) The IMF is a particularly costly agent for the state principals to control. For example, the technical nature of IMF activities, the quick expansion in the amount of IMF activity, and related extension of the IMF’s hierarchy make diligent monitoring increasingly costly; and the secrecy surrounding IMF activity prevents intervention of their-party enforcers. (Ibid; Barnett and Finnemore 2004; Martin 2002; Nielson and Tierney 2003; Lyne, Nielson, and Tierney 2006; McCubbins and Schwartz 1984) In particular, in the activities that are less observable, less measurable and more reliant on IMF expertise, then the costs of monitoring and enforcement would be even higher, and thus the possibility of agency slack would increase. Most of the IMF activities that China participates in do not refer to explicit ways of observation, measurements and evaluation; and they are mostly reliant on IMF staff expertise. It has further increased the possibility of IMF staff getting involved in agency slack in the programs with China’s participation.

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63 The interview was conducted in Beijing. The interviewee (interviewee 1) is a government official who works closely with the IMF in a Chinese financial institution.
3.5 Inadequate IMF Resources

The IMF’s scarce resources restricted its capacity to accomplish the delegated tasks as expected by the state. The scarcity of IMF resources is reflected in three aspects: expertise, financial, and institutional. First of all, in the Article IV Consultation for China, the IMF teams provided limited expertise, which lead to the analysis and evaluation on China’s economy that is lack of comprehensiveness and depth. It is because the consultation trips are usually too short for the IMF staff to see the whole picture of China’s domestic economy. Moreover, the members of consultation teams to China change almost every year. The frequent job rotations prevent the staff from getting a comprehensive understanding of China’s domestic economic, political and social states; and thus hinder them from providing accurate and thorough evaluation and advice on China’s economic policies. The problem of expertise resources inadequacy does not only exist in the above case, yet it is a general problem in the IMF.

Vito Tanzi thinks that one of the important reasons of deficiencies in IMF multilateral surveillance is lack of staff that can operate accurate and advanced technical analysis. He argued that the IMF needed to generate accurate technical analysis, so that it could convince the relevant countries and the world to believe its judgment and advice are correct. In order to achieve that,

‘...[the IMF] must have staff of clearly superior quality and reputation. That staff must be very good and must be seen as being very good. It must be able to sort out benign capital flows, promoted by differential rates of return to investments, or even by
temporary factors such as the Iraq war, from less benign ones promoted by bubbles, speculation, poor information and others. The analysis must allow the IMF to reach strong conclusions as to the policies that those who import capital and those who accumulate reserves must adopt. ... The Fund must also allocate a significant share of first-rate staff members to this activity, taking them away from bilateral surveillance and from other tasks.’ (Tanzi 2006: 399)

Among a large amount of analysis run by other institutions that generate different results and propositions, the IMF must win the competition for the best analysis in order to promote its policy advice. However, it is worrying that if the IMF - competing with universities, central banks, the financial market, think tanks, national governments and other international organizations- would be able to attract top economists who can run the winning analysis for the Fund. Tainzi pointed out that in order to promote and develop excellent analysis, the IMF would need to have access to a lot of detailed information that it did not always have. For example, it did not receive information on the composition of foreign exchange (COFER) held by some important countries, because it could not force member states to submit information and data to the Fund. (Tanzi 2006: 399-401)

Secondly, the IMF has limited financial resources to solve its member states’ balance of payments difficulties. The IMF financial resources are largely dependent on the either ‘borrowers’ or ‘lenders’. Hence the Fund faces challenges to ensure the financial resources are adequate and well used. It is unlikely China would seek IMF financial assistance, yet it does expect the IMF to solve the balance of payments difficulties of its
poor developing country members in order to maintain international financial stability. On the other hand, some emerging market economy and developing countries prefer ‘self-insuring’ to IMF financial assistance. After experiencing several global and regional financial crises, some developing countries especially in the Asian region realized that the IMF was unreliable for rescuing them from the crises. The crises taught them a lesson that financial crises could be avoided only if a country has ample international liquidity and readily available lines of credit that allow it to correct external imbalances without having to reply on outside support. (Buira 2002: 25-26; Feldstein 1999)

Woods questioned the IMF’s financial resources, even after the G20 promised to contribute $1 trillion in 2009. The new financing for the IMF was mostly credit lines that member countries had made available to the IMF if it needed them. During the global financial crisis, these credit lines were coming from existing power shareholders, attempting to tie the IMF tightly back into its traditional pattern of power and influence, with G7 countries at the top of the pile. The promised fund did not add to the IMF’s own financial resources. On November 24, 2009, some Fund members reached an agreement on a new $600 billion New Arrangements to Borrow (NAB) (from 26 countries which belonged to that arrangement before the crisis and 13 new participant countries) Yet the result represented a big boost to the ‘lender-dependent’ element- IMF focuses on the IMF’s needs at the height of a financial crisis when its own resources are not sufficient to give it enough lending power to meet the crisis, and when it uses arrangement to borrow from its wealthier members- of the Fund. The other $250 billion of the $1 trillion increase was a SDR allocation, which did inject some confidence into the international financial
system. After all, the increase of IMF financial resources achieved through credit lines and SDR allocation indicates a small increase in the Fund’s own resources. (Woods 2010:51-63) Neither ‘borrower-dependent’- when the IMF relies on borrower payments to cover its own administration expenses- nor ‘lender-dependent’ expenses assists the IMF to achieve a real multilateral lending mechanism. The IMF needs to become a more financial independent institution in order to operating its lending facilities independent of its members.

The inadequate IMF resources also explained why the IMF was not able to play an important role in correcting the single-reserve currency problem in the current international monetary system. Following Zhou Xiaochuan’s 2009 proposal of increasing the use of the SDR as a super-sovereign reserve currency, some Chinese scholars regarded increasing participation in the IMF and international monetary reforms as an effective approach to more controls in the reformed system. However, there were some dissenting voices.

First of all, the suggestion of broadening the use of SDR as a super-sovereign reserve currency was unrealistic. The SDR was not broadly issued and used in the private sector, together with the irreplaceable US dollar dominance based on the market choice, determined that the SDR was unlikely to become a major international reserve currency. Lombardi pointed out, ‘… SDRs have played a marginal role as international reserves, which is symptomatic of the decline in the IMF’s perceived importance.’ He argued that

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64 The Background of China’s concerns about the reforms of the international monetary system was explained in Chapter 6, Section 4.3: China Cannot Deal with it Alone.
the SDR reflects a passive role for the IMF, as decisions on allocations of SDRs are made by member states representing at least 85 per cent of the Fund’s voting power, and the IMF has no discretionary control over how the allocation is used. China’s purchase of the Fund’s SDR denominated assets may moderately increase the use of the SDR, yet not significant enough to effectively generate a diversification of the international monetary system. Even if the IMF plays a more prominent role by matching demand and supply of SDRs, the transaction remain mainly bilateral. (Lombardi 2011: 167)

In addition, forming a super-sovereign currency based on the SDR will face many technical problems, such as the decision on the components of the basket, the set value of the currency, the ways in which the currency enters the market, the regulation responsibilities of the circulation, and the approaches to retain the currency’s vitality and security. (World Knowledge 2009) Moreover, the IMF is unlikely to have sufficient resources- both financial and personnel- to resolve the relevant technical problems. The Fund was not designed to be, and neither does it intend to become the world’s central bank. Even if one day the IMF accumulates an enormous amount of resources to push forward the establishment of a super-sovereign reserve currency, the US would not give a pass to the implementation. (Zhao 2011) Considering the mighty US voting power in the IMF and its dominance in the financial market, the implementation of the super-sovereign reserve currency will be arduous, if it ever happens.

Therefore, Zhou’s proposal was turned down soon after it was brought forward. Zhang Yuyan, the director of the World Economics and Politics Research Centre of the CASS,
denied that Zhou’s proposal represented the authorities’ policy decisions and argued that the US dollar would not be replaced by either the SDR or any other currencies in the next 20 years. (Reuters 2009) Even Zhou’s own attitude was much softened when he was asked by the media at the 2011 World Bank-IMF Annual Meetings about the RMB joining the SDR, and stated that the RMB’s status would be decided by the market. Although Zhou’s proposal was not realistic at the time, it did disclose some of Chinese economists and policy-makers’ strong will to get free from US supremacy and the danger it may cause in the international monetary system. The Chinese economists and policy-makers did not have a high expectation on the capture of larger decisions powers in the international monetary system via devoting to SDR and IMF reform. (World Knowledge 2009;) Therefore, the Chinese believed they should help themselves if the IMF was not able to. As an alternative approach, China ought to promote the RMB in the international market instead in order to achieve the goal of a diversified international monetary system as well as becoming a larger player in the reformed system.

Around 2009-2010, there was a consensus among the Chinese economists that the authorities should promote the ‘internationalization of the RMB (renminbi guoji hua)’ as a principal strategy in their international financial policies. It was believed that RMB internationalization would reduce the risks caused by exchange rate fluctuations of the US dollar and other related currencies for China’s foreign trade companies. RMB internationalization would also confer more flexibility to China’s interest rate and exchange rate policymaking, which enables the authorities to effectively control the domestic macroeconomic hazard and improve the management of foreign exchange
assets. Moreover, RMB internationalization would increase China’s influence in the international economy and consequently strengthen its voicing and decision-making power in the international financial governance. (Yu 2009, Gao 2009, Huang 2009) Most importantly, by increasing the use of RMB and gradually making it a reserve currency, China would be in a more proactive position to reform the international monetary system to a diversified one. However, it is naive to think the ‘RMB Internationalization’ approach toward larger voicing in the international monetary governance could be carried out as a convenient substitution to the approach via SDR and IMF reforms.

The extent to which the RMB is accepted and used in the international trade and investment deals is not determined by the Chinese authorities—despite their enthusiasm for a diversified international monetary system and their favourable policies to promote the RMB—but by the market. (Gao and Yu 2010) The popularity of one currency in the international market depends on various factors. First of all, the value of such a currency ought to be stable and predictable, which requires the central bank to have a strong capacity to control the inflation and regulate the mobile capital. In China’s case, the People’s Bank of China currently does not have an independent and effective control of the monetary policies; and the exchange rate of RMB remains unpredictable.

Secondly, an international reserve currency usually requires the currency issuer country to have a developed and dynamic domestic financial market. China’s financial market is still at a preliminary stage focusing on a few basic functions. The state-owned commercial banks possess a large proportion of the market, leaving the competitions
partly open to the private banks and other financial institutions. The banks still mostly depend for their profits on traditional business such as saving and lending; and the variety of financial products is limited. Without an open and innovative domestic financial market, China would not be able to attract foreign investors to hold RMB as a reserve currency. Thirdly, the RMB needs to be more accessible if it is to become an international reserve currency, which means the RMB should be convertible under both current and capital accounts. However, the capital account is still under strict control, although there have been IMF advocates calling for capital account liberalization and domestic voices claiming that China is ready for further opening, the authorities decided to stay cautious and keep the market partly closed till the domestic financial mechanisms are mature. (Zhang 2012) After all, the RMB is not yet ready to operate as an international reserve currency; and ‘RMB internationalization’ is not a government-directed measure but a long-term market driven process.

Overall, there is a long way ahead before China reaches independence from the dollar containment and attains a stable leadership role in the international monetary system. Some Chinese economists hoped to achieve a diversified international monetary system via promoting the use of SDR and letting a stronger IMF to regulate the reformed system. Their naive hope was criticized by those who think the IMF would not make any substantial challenge to the US dominance in the international monetary system because of the traditional US dominance in the Fund. More Chinese economists tended to believe that seizing a proactive position in the reforms would more likely to lead China to a
larger governance role in the international monetary system; therefore called the
government to promote the use of the RMB in the international market.

In summary, the IMF’s inadequate resources and functions hinder it from fundamentally
reforming and diversifying the international monetary system as some Chinese scholars
and policymakers would expect. They proposed to get more deeply involved in Fund
activities and build the Fund to a bigger and more influential institution, so that China
could access larger decision-making power in the governance in international financial
economy. On the other hand, some others argued it is more efficient to promote China’s
own currency in order to access the decision-making power via direct market occupation.
Yet each approach alone is shortsighted and highly utilitarian. In particular, promotion of
RMB internationalization without matching domestic economic conditions, as an
impetuous reaction to the current ill international monetary system, is highly risky. RMB
internationalization is a long and complicated process that requires monetary policy
coordination at the international level. Therefore, even if China takes a more proactive
step toward the leadership of the international monetary system, it does not mean the IMF
becomes irrelevant. China should still appreciate the IMF’s efforts to improve the
environment of the international monetary system. This is why the Chinese delegations
repeatedly urged the Fund to strengthen surveillance on the current major reserve
currency issuer countries and put a constraint on excessive issuance and other measures
that may damage the stability of the international monetary system. In this way, the IMF
plays a subsidiary role in China’s access to larger voicing and decision-making power in
the reformed international monetary system.
The above case study shows the IMF’s role in China’s seeking of larger influence and decision-making power in the US-dominated international financial economy. Meanwhile, it also introduced the idea of ‘RMB internationalization’ as an ‘outside option’ other than the ‘IMF option’. Moreover, the internationalization of the RMB has a more implicit and strategic rather than explicit and utilitarian implication, in the sense that reforms of China’s domestic regimes will be accelerated accordingly during the process of promoting the RMB in the international market. (Xia 2011) In other words, the internationalization of the RMB may stimulate further liberalization of China’s financial sector, encourage improvements in the country’s industrial structure, and increase the domestic economic productivity. In fact, the Chinese economic leadership quite likes the idea of ‘outside option’, especially when the IMF staff engages in ‘agency slack’.

4  China’s Outside Option- Multiple Agent Strategy

As China’s involvement in the world economy deepens, it has increasingly developed economic links with multiple countries, regions and regional/international organizations. According to the analysis in the previous two sections, China sees participating in IMF programs and governance as an approach to a larger role in the governance of the international financial economy. It is due to the IMF’s unique functions as a training centre for financial methods and techniques, an international policy advisory body, a lending agent with advanced risk assessment skills, a multilateral forum to solve controversial global issues, and a superior international institution to reform and govern
the international monetary system. Driven by these functions, the Chinese government delegated various tasks to the IMF, hoping to become a more eligible, capable and influential actor in the international financial economy.

However, due to various technical and structural reasons the IMF as an agent could not perform the tasks perfectly to fulfill China’s expectation. These reasons include the IMF’s international civil servants based staffing rules that lead to a large degree of agency autonomy; the IMF’s western dominated governance structure that undermined China’s decision-making power in the Fund; the divergence between China’s preferences and those of the IMF’s that lead to undesired delegation consequences; the costly controlling mechanisms and China’s reliance on IMF expertise which further lead to delegation consequences that are out of China’s control; and the IMF’s limited financial and expertise resources that hinder the Fund from provide sufficient financial assistance to the member states and correcting the risky single-currency based international monetary system. All these reasons lead to undesired delegation consequences, that is agency slack, which makes the IMF a less effective agent to fulfill China’s goal. In summary, the IMF has played a considerably important yet limited role in China’s pursuit of greater influence in the governance of the international financial economy.

The IMF’s restricted role encouraged China to develop other links with the rest of the world economy, which are defined as China’s outside option, distinguished from its ‘IMF option’. Outside option is a termed borrowed from bargaining theory in economics (Binmore, Shaked and Sutton 1989; Muthoo 1999), scholars of international
organizations use it to explain powerful states’ bargaining power; as well as unsatisfied power’s bargaining leverage to push through institutional reforms. (Lipscy 2013) According to Stone, ‘powerful states are powerful by virtue of the fact that they have attractive outside options’. (Stone 2011: 21) The ‘opportunity cost’ of participating in an international organization is high when it can achieve its goals unilaterally. For example, in a case study mentioned earlier, the Chinese government seeks to promote the internationalization of the RMB as a unilateral solution-based outside option rather than relying on the IMF to diversify the international monetary system.

When states have attractive outside options and that their preferences are strong, they can choose not to commit to an international organization. Hence, when strong states perceive their interests to be jeopardized, their benefits to be sacrificed and their objectives to be ignored, they refuse to be constrained by the international organization; and instead, they take the outside option. Alternatively, they use the outside option as a lever to renegotiate with the international organization the terms for possible changes. The research did not find explicit evidence of China using outside option to bargain with the IMF. Yet China is engaged in various economic activities outside the IMF that could be considered as outside options.

4.1 China in Asia

China’s rise in Asia coincided with the decline of the US influence in the region. The US was unable to offer any effective support through the Asian financial crisis, which heavily weakened its reputation in the Asian region. Especially after the 9/11 attack, the
Bush administration’s militarized anti-terrorist rhetoric and the advocated ‘war on terror’ evoked strong hostility against the US in Asia, especially in the countries with large Muslim communities. (Narine 2007: 215) On the contrary, China has been advocating the ‘peaceful rise’ strategy in the region- despite some loose conflicts on the country’s east and south sea coasts- and it has mostly kept peaceful diplomatic relations with its neighbour countries in the region. In general, China has focused on devoting itself to Asian regional economic integration and seeking a regional leadership role in the regional trade and financial cooperation mechanisms. China’s growth has stimulated the Asian intra-regional trade and labour division, which also indicated a China-centred regionalism.

More importantly, China has actively contributed to the regional financial cooperate institutions, such as the CMI and its later upgraded version Chiang Mai Initiative Multilateralized (CMIM), the ADB, the ASEAN10+3, APEC, and so on. China has also engaged in bilateral financial cooperation with the neighbour countries, for example it signed several border trade settlement and cooperation treaties with the neighbours countries such as Russia, Mongolia, Nepal, Laos and Vietnam; and it also provided training programs for the Central Bank staff of other Asian countries via bilateral or ASEAN10+3 Mechanisms. (PBC 2002)

Development and proliferation of the Asian financial cooperation mechanisms mentioned above were mostly caused or motivated by the painful experience of the Asian financial crisis. The IMF’s incompetent and mostly late intervention, especially their inappropriate
policy advice on financial liberalization that eased the outflow of capital and consequently deteriorated the crisis, completely destroyed the Fund’s credibility in Asia in the late 1990s. Still today, some Asian countries refuse to get further engaged in IMF programs. For example, only half of Asian IMF members have completed the FSAP, while all European member countries, 68 per cent of countries in the Western Hemisphere, 81 per cent in the Middle East and Central Asia, and 59 per cent in the Sub-Saharan Africa had completed it by 2011. (IMF 2011) The IMF’s failure in Asia indirectly stimulated the Asian financial integration. The regional financial mechanisms mentioned above have some similar functions as those of the IMF, such as facilitating cooperation and policy coordination, providing financial liquidity, regional surveillance and so on. They were formed as a sort of rival to the IMF in Asia; and thus China’s participation and leadership in these mechanisms indirectly challenged IMF authority in the region. For example, China supported the upgrade of the CMI including a reduction of the proportion of funds that is subject to IMF review and approval from 90 per cent to 80 per cent and a transformation of the CMI into a self-managed reserve pooling. (Chin 2010: 703)

Moreover, after the global financial crisis, the ADB took over a proportion of the commitments previously to the IMF, to finance the adoption of flexible, fast-disbursing and front-loaded instruments that could provide rapid assistance to Asia’s well-governed developing countries. The ADB approved a Countercyclical Support Facility on June 19, 2009 to provide the crisis-hit Asian developing countries with budget support of up to 3 billion US dollars. (ADB 2010: 4) China fully supported the ADB’s role in regional
financing programs, since when the IMF failed its crisis prevention responsibilities, the regional institutions such as the ADB could alleviate the harm of the crisis through increasing spending and boosting regional cooperation. (Xinhua 2009) Despite the threats perceived by the IMF, China has a strong faith in Asian financial integration. The advancement of Asian financial integration is inevitable, no matter how the IMF feels about it. Yu of the CASS argued the IMF should accept and respond well to such reality in its policy and management, in order to facilitate the emergence of a new world economic structure that is highlighted by a dynamic and fast growing Asia. (Yu 2009: 520) Overall speaking, the Asian governments’ mistrust toward the IMF has limited the Fund’s role in regional financial cooperation and economic advancement. Only when the IMF genuinely understands the Asian countries’ domestic regimes, improves the Asian countries’ representation and decision-making power in the Fund, and seeks to complement Asian regional financial arrangements, will the Fund regain credibility and reputation in Asia. Till then, the IMF is playing a merely marginal role in the economic advancement and financial integration in Asia.

4.2 China and Other Emerging Market and Developing Countries

Apart from Asia, China also seeks to strengthen the economic (and political) connections with other emerging market and developing countries. China specifically feels sympathetic toward the other BRICS countries, because they all undergo high domestic pressure during the fast economic growing, as well as the suppression from the advance economies. They are the glorious national heroes in economic development; but none of them alone is able to confront the containment from the advanced economies and direct
the reconstruction of the international economic order. Therefore, they feel the need to coordinate their views, combine their power, share the pressure and protect the benefits of the emerging market and developing country community as a whole in the international economic governance. Only in this way, they could break the traditional international economic order dominated by the advanced economies, and rebuild a fairer system that is managed by both advanced and emerging market economies. (Yao 2011: 32) The Chinese authorities realized the unbalanced power distribution in the international political society, thus when they made requests and proposals in international organizations, they often called for consideration of benefits of other emerging market and developing countries.

The Chinese delegations have often made such requests and advocacy that are in favour of emerging market and developing countries in the IMF. These requests did not always refer to specific cases or policy practices, but were argued based on the assumption that the IMF generally disregarded its emerging market and developing country members. The requests did not receive specific responses, apart from the ones on IMF representation issues that threatened the Fund’s own legitimacy and required to be resolved anyway. In addition, the IMF executive directors who represented the BRICS

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65 For example, as explained in Chapter 6, they argued that the IMF should make policy decisions based on genuine understanding and concerns of each member country’s domestic political and social circumstances, especially if the targeted country is a relatively vulnerable and less developed one. (IMFC 2001:2; 2003:3) They also stated that the IMF should run stricter surveillance on the macroeconomic and financial policies of the major industrial countries and important financial centres due to their critical influences in the global system; and that if more surveillance are imposed on the developing countries, their representation in the Fund should be reflected accordingly. (IMFC2000:5, IMFC 2008b:3) Moreover, they maintained that the IMF should always fulfil its responsibility toward the poor developing countries and facilitate proper global allocation of major production factors. (IMFC 2009b: 4) Last but not least, to recall the previous text, the Chinese delegations have devoted to calling for quota and voting shares shifts to the Fund’s emerging market and developing country members and encouraging the advanced economies to facilitate the smooth implementation of the Fund reforms. However, China’s request mostly sounded general and vague.
countries made a joint statement in May 2011 to complain about the latent rule of the IMF Managing Director being European. (IMF 2011i) It was the first time the BRICS countries’ executive directors made a joint statement; however, the IMF continued with their ‘European management’.

Overall speaking, the IMF does provide a platform for emerging market and developing countries to strive for the rights and benefits they long for. However, these countries’ enthusiasm is often defeated by the IMF’s strong western dominated feature—both institutionally and culturally. Despite the achievements in IMF governance reforms, the Fund’s emerging market and developing country members yet still have relatively low decision-making power compared to those of advanced economies. Their representatives (Executive Directors and their teams) in the IMF have limited capacity in making valid proposals and negotiating with IMF staff; and the improvement of such capacity requires years of education and training for their financial sector officials, and experience of working with the Fund.

On the other hand, China’s cooperation with other emerging market and developing countries are more frequent and prolific in other areas than those in the IMF. China has joined several cooperation mechanisms to promote the ‘south-south cooperation’. Just to give a few examples, Chin joined the G20 of developing countries that pushed for more fairness in the opening trade in 2003; it supported initiatives for the ‘Global South’ through G77; and it also gained a partnership with the United Nations Development Programme (UNDP) in the South-south Cooperation project in 2004. China’s
cooperation with other emerging market and developing countries are especially productive in the international trade market. Via its trade with developing countries, China aims to secure access to the natural resources and commodities that are essential to the maintenance of China’s economic dynamism. Meanwhile, developing countries appreciate the profits from their business with China that is not attached by any political conditions. In the financial sector, China has deployed several arrangements in terms of currency swap with other emerging market economies, such as Brazil and Argentina. These swap agreements enhanced the efficiency of China’s foreign trade, as well as promoted the use of RMB in the global market. The recently established BRICS Development Bank provided an alternative source of finance for states in the developing world to that offered by the World Bank. (Mwase and Yang, 2012) In addition, Chinese outward foreign direct investment (FDI) to low income countries have increased in the past years; among all the LICs Asia and Sub-Saharan Africa became the major destination of Chinese FDI. 66 (Mlachila and Takebe 2011) All in all, instead of seeking larger decision-making power in the international political economy via cooperation with other emerging market and developing countries in a western-dominated organization like the IMF, China much prefers to base the cooperation on mutual economic profits.

4.3 China and Europe

China’s financial assistance to the crisis-hit Europe has strengthened its reputation and role in the governance of the international financial economy. Since the Eurozone crisis

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66 For more data about China’s FDI to LICs, see IMF Working Paper written by Monfort Mlachila and Misa Takebe.
started, China’s enormous foreign exchange reserves have become the most popular potential external sources of European bailout funds. Christine Lagard visited China in November 2011, calling the Chinese government for resolute decision to help the troubled Europe. Angela Merkel went to China for a three-day mission to reassure Beijing that Europe was able to tackle its mounting debt problems in early 2012. European leaders warmly welcomed China’s contribution to the crisis-hit Europe. On the other hand, Chinese officials also expressed their willingness to contribute to global efforts to bail out Europe. Chinese policymakers think that assisting Europe reflects China’s great power responsibility toward the global financial stability and economic revival, and therefore contributes to China’s reputation in the international political economy. Assisting Europe also earns China a proactive position in its relations with the EU, especially in the negotiation of China’s market economy status (Zheng and He 2011), and discussions of removing trade barriers against Chinese products (Xue 2011).

In particular, China has bought a considerably large amount of bonds issued by the European Financial Stability Facility and sovereign debts of various Euro-zone countries. The PBC governor Zhou Xiaochuan also ensured that China would boost its Euro holdings through various channels. (Financial Times 2012)

In the beginning, the Chinese government acted like a conservative creditor. It preferred to assist Europe via multilateral channels rather than assisting Europeans countries directly. For example, the Chinese government bought the specific bonds issued by the EFSF and the IMF to help the crisis-hit European countries. In this way, the purchase was secured by the EFSF and the IMF. However, China did realize that the EU, the EFSF, and
the IMF are the main directors and capital sources in the Eurozone rescue projects. China could not directly join the rescue policy decision-making process, nor could it evaluate the assisted European countries’ financial balance and structural reforms. China acted like an external participant, not a leader, of the rescue projects, and that Beijing could not make any direct intervention to the specific policy decisions. In this case China may become less interested in getting involved in a game that is run by the IMF and the EU, where the rules don not seem accessible for China. On the other hand, China’s foreign direct investment in Europe has been increasing rapidly. There is no doubt that once the Chinese entrepreneurs obtain more knowledge about European business market, more private funds will enter Europe without going through the IMF and EFSF.

China’s outside options should not be regarded merely as a bargaining leverage to push forward IMF institutional and governance reforms; neither merely substitutes to China’s delegation of tasks to the IMF. China has continued to endeavour to improve its influence in within the IMF- via pushing forward Fund governance, calling for Fund surveillance on advanced economies, voicing for emerging market economy and developing countries- so that agency slack could be overcome and tasks delegated to the IMF could be accomplished more effectively. Meanwhile, China’s outside options reflect its embracement of a multilateral governance of the international financial economy. China does not restrict itself in strengthening its decision-making power and influences in the international financial economy via the ‘IMF option’. Yet it develops multiple ways to stimulate its links with the rest of the world economy.
5 Conclusion: China and IMF- A Moderate Principal-Agent Relationship

Examination of the consequences of China’s delegation to the IMF helps us gain a thorough understanding of the relationship between China and the IMF in a principal-agent framework. Five factors point to agency slack in the interactions between China and the IMF. First of all, the majority of IMF staff members are international civil servants. They share a common professional identity, and they base their research and judgment on the universal international neo-liberal economic norms. Some policy products turn out to be more country-sensitive, especially after the Fund’s painful failure during the Asian financial crisis, yet they have not escaped from the neo-classical economic framework. The neo-liberal economic norms contradict with some of China’s stability-driven economic policies that are in favour of state-owned industries and financial institutions. Such contradiction explains why China refuses to accept IMF policy advice and why China is cautious about submitting financial data to the Fund. Secondly, the IMF’s western-dominated structure of governance in both formal and informal spheres prevents China and other emerging market economies from exerting influences on Fund policy decisions. The underrepresentation states discourage these countries to borrow from the Fund and discuss solutions to the problems in their domestic economies with the Fund. Instead, they develop their own funding mechanisms, for example accumulation of foreign reserves and sovereign wealth funds. Thirdly, the preference deviation between China and the IMF has negative effects on the IMF programs China participates in general. Fourthly, China’s reliance on IMF expertise and costly control mechanisms make agent behaviour less predictable and agency slack more
possible. Finally, the inadequate expertise resources prohibit IMF staff from carrying out accurate analysis of the Chinese economy; the inadequate financial resources prevent the IMF from performing well the role of ‘lender of the last resort’. Lacking resources and authoritative influence among some of its members disabled the IMF to accomplish the task of correcting the problems in the US dollar-dominated international monetary system.

These five reasons of agency slack in the IMF disclose the reasons why China has not become a strong principal of the IMF, and why the IMF cannot effectively assist China to achieve a higher role in the governance of the international financial economy. While China keeps trying to improve its role in the IMF by pushing forward IMF governance reforms and calling for better Fund governance that is more considerate toward its emerging market economy and developing country members, it also develops various bilateral economic relationships with other states and regions and connections with other regional/international institutions. The embedded inequality in the IMF and the international monetary system in general encourages China to proliferate alternative connections with the international financial economy. These alternative approaches are regarded as China’s delegation of authority to other institutions, in order to achieve its objectives in the governance of the international financial economy. China’s participation in Asian economic integration, including its contribution in the CMI (CMIM), ADB, ASEAN10+3, and APEC, challenges the IMF’s role in the region. China’s cooperation with other emerging market and developing countries turn out to be more dynamic and effective outside the western-dominated IMF. Finally, China’s assistance to the crisis-hit
European countries tend to be increasingly based on outward foreign direct investment instead of lending through the IMF. The ‘outside options’ compensate China’s weak principal role vis-à-vis the IMF; they work as complements rather than substitutes to China’s IMF option. In an interview with a leading Chinese scholar whose research focuses on Asian financial integration, she said ‘China never only focuses on one path, yet it keeps several options for itself. China’s efforts in the Asian financial integration is one of these options.’ This statement explicitly reveals the Chinese government’s embracement of the concept of ‘multilateralism’ in global governance.

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67 The interview was conducted in Beijing. The interviewee (interviewee 5) is a leading scholar in Chinese and Asian political economy.
Chapter 8 - Conclusion

1 Overview

The research explores the relationship between China and the IMF since 1980, when People’s Republic of China gained its legal IMF membership that was previously held by Taiwan. It fills in the relatively thin literature of China’s relationships with international organizations, among which the one of China’s interaction with the IMF is particularly limited. The inadequacy of the literature partly due to the fact that China did not become active in IMF related programs and the general international financial economy until the recent years. The global financial crisis that started in 2007 further pushed China (and other emerging market economies) to the front of global financial and economic governance. The crisis also ironically consolidated the IMF’s central role in reforming the international monetary system and stabilizing global financial economy. Facing a crisis that originated in the world’s most developed regions, while the poor countries were still suffering from poverty, the IMF sought support from the dynamic ‘middle’- emerging market economies. As the biggest and most fast growing emerging market economy in the world, China’s cooperation is desired by the IMF. Although the worst moment has passed, the world economy has not entirely recovered; hence the IMF looks forward to a long-term partnership with China (and other emerging market economies), like Lagarde’s proposal that was mentioned in the beginning of the introduction.
However, the real interactions between China and the IMF in the past three decades did not indicate a robust partnership between China and the IMF that would assist China to gain a firm leadership in the international financial economy. The research conducted in this thesis showed why the IMF cannot effectively assist China to achieve a larger role in the governance of international financial economy despite the increasing interactions between China and the IMF. The research looked into selected case studies of interactions between China and the IMF in order to explain why.

The theoretical approach to analyzing the China-IMF relationship is crucial, because an appropriate theoretical approach can correctly explain the dynamic interactions between China and the IMF. The research adopts socialization theory to explain the IMF’s impacts on China’s domestic policymaking in the early stage since PRC joined the IMF, in the cases of IMF financial assistance to the China, IMF Statistics Department’s training programs for Chinese officials, and IMF Article IV Consultation and other surveillance for China. The research showed that socialization processes of mimicking and social influence took place in the interactions between China and the IMF; yet persuasion, the final process of socialization could not be proved. The obstacles for socialization were both institutional and political, which prevent the IMF from further socializing China into accepting the neo-liberal international economic norms. Hence, socialization theory turned out to be an inadequate theoretical approach to analyzing the China-IMF relation in the long run.
Principal-agent theory overcame some of the limitations in socialization theory—such as underestimation of states’ initial objectives, overestimation of the legitimacy of the international norms, and difficulties in measuring normative factors and separating them from the material ones—and was applied as the primary theoretical framework for the China-IMF relationship especially in the later stage. Yet principal-agent theory also recognized some propositions in socialization theory, for example, both theories argue that an international institution with a distinct organizational culture and large degree of autonomy seeks to influence the state members’ (principals’) policy decisions.

Principal-agent theory has not previously been applied in analyzing the relationships between emerging market economies and international organizations. However, since the emerging market economies, especially China, have increasingly expressed their objectives and exerted more influences in international organizations, they are regarded as eligible ‘shareholders’ of international regimes. In China’s case, it has further specified its goals and interests regarding participating in the IMF in recent years; and China’s influence in the IMF has also greatly increased. These conditions further consolidated China’s principal role regarding its interactions with the Fund.

More importantly, principal-agent theory explicitly reflects China’s objectives in the governance of the international financial economy. In the principal-agent theoretical framework, China and the IMF are located in a reciprocal relationship that is based on dynamic processes of delegation: based on its objectives, China delegates tasks to the IMF so that the IMF could accomplish these tasks more effectively than if China took
unilateral or other forms of international cooperative approaches. Principal-agent theory thus correctly reflects the Chinese government’s ‘pragmatism’ in the international affairs, particularly regarding the analysis of China’s driving forces for participation in international organizations. In addition, principal-agent theory is also applied to examine the consequences of China’s participation in IMF programs, which makes it a practical approach to the China-IMF relationship.

In this thesis, the analysis of the relationship between China and the IMF in the principal-agent theoretical framework was divided into four stages. First of all, I identified China’s role of principal, and the IMF’s corresponding role of agent. China is a relatively weak and inexperienced principal, whose influence in IMF governance is contained by the strong western-dominated institutional feature of the IMF. On the other hand, the IMF performs as an influential international organization, backed by its central role in the international financial and economic governance and a wide range of advanced functions. The IMF staff have a large degree of autonomy, which makes consequences of delegation more unpredictable.

Secondly, I analyzed the reasons why China delegates specific tasks to the IMF, and what they are. Due to the IMF’s advanced information, expertise and other resources, China delegates the tasks of technical training, surveillance and policy advice, and multilateral lending to Fund staff. China’s participation in these IMF programs also reflects China’s commitment to benign international cooperation and thus contributes to China’s international reputation. Due to the IMF’s outstanding capacity in solving controversial
and complex international issues, Chinese delegated authority to IMF Multilateral Consultation on Global Imbalances and attempted to solve the imbalance problems in an international platform provided by the Fund along with the US, Euro Area, Japan and Saudi Arabia. Finally, since China alone cannot confront the US dominant power in the international monetary system and effectively prevent its US dollar-denominated assets from devaluing, it sought to improve the international monetary environment via the IMF. For example, China pushed the IMF to strengthen surveillance on advanced economies, diversify the international monetary system, and create a favourable environment for the internationalization of RMB.

Thirdly, I analyzed key factors of China’s decisions and actions on delegation to the IMF. The first factor is China’s preferences regarding the IMF’s policy decisions and policy processes. China’s preferences are reflected in the Chinese officials’ statements at IMFC meetings, because IMFC statements include the Chinese officials’ direct comments on IMF operation. The statements show that China is dissatisfied with the IMF’s policy inclination toward its developed economy members, and thus the Chinese officials called on the IMF to take into account the emerging market economy and developing countries’ benefits and real needs while it makes policy decisions. The statements also show that China does not support an overly robust IMF that goes beyond its mandate and intervenes in the member countries’ domestic affairs. China’s preferences thus deviate from those of the IMF and its major advanced economy members. The second factor is China’s role in IMF governance, including in both formal and informal spheres. It is one of the most important factors of China’s delegation decisions and the effectiveness of delegation in
general. China’s quota and voting share reflect its formal governance power in the IMF, and therefore China’s inadequate quota and voting share (compared to China’s share in the world economy and the quota and voting share of the US) together with the slow and ineffective IMF governance reforms prove China’s frail influence among the members of the EB. In IMF informal governance, China lacks sufficient techniques and information to influence IMF staff and their policy decisions outside the EB. The third factor is China’s influence among IMF staff. Assuming IMF staff understand better the real needs and problems in the development of the regions they come from, lacking staff with Chinese nationality may not sufficiently indicate that IMF policies are ignorant of China’s needs and problems, yet it makes the Fund’s China-related policy decisions less convincing.

Finally, I examined the causes of agency slack and assessed the consequences of China’s delegation of tasks to the IMF. The assessment showed that the IMF’s western educated technocrat-based staff rule and its western-dominated governance structure created a less comfortable and tolerant institutional environment for China to exert influences in IMF policies. The preference deviation between China and the IMF makes it even more difficult to generate satisfactory consequences of delegation. Moreover, China’s reliance on IMF expertise and the costly controlling mechanism also make agency slack easier. Finally, the inadequate resources in the IMF explain why the IMF cannot play the role of the lender of the last resort; why IMF surveillance and policy advice mechanisms cannot provide China with more appropriate advice; and why the IMF was not able to play an important role in correcting the single-reserve currency problem in the current international monetary system. The assessment of the consequences of China’s delegation
to the IMF explains why the IMF cannot effectively assist China to achieve a larger role in the governance of the international financial economy. It also discloses China’s alternative approach to achieve its objectives via cooperation with a wide range of foreign governments and regional and international organizations in the international financial and economic sphere. These approaches significantly complement China’s ‘IMF’ option, especially if the Fund does not undertake more thorough governance and functional reforms to improve China’s role in the Fund in the near future. They also reveal China’s pursuit of ‘multilateralism’ in the governance of the international financial economy.

2 Responding to Research Questions

This section highlights the answers to the research questions that were brought up in the introductory chapter.

1. How does socialization theory explain the IMF’s influences in China’s domestic policy?

Socialization theory explains the relationship between China and the IMF in the early stage. In particular, it explains the IMF’s influences in China’s domestic economic policy-making via three major interactive mechanisms: the IMF’s financial assistance to the Chinese government while the Chinese government faced balance of payments difficulties, IMF staff providing technical assistance to the Chinese officials of various domestic financial institutions, and IMF surveillance and policy advice regarding China’s
financial system. Johnston’s three microprocesses of socialization—mimicking, social influence, and persuasion—were applied to assess the extent to which the IMF socialized China into accepting its norms via the interactive mechanisms mentioned above.

Mimicking refers to the process by which China copies the behaviour of the IMF and the IMF’s advanced economy member countries. Mimicking is evidenced in the IMF’s technical assistance to China, as it is the first step of the Chinese officials’ learning processes in various training programs. Mimicking also exists in IMF surveillance and policy advice for China, as before the Chinese officials fully understand the essence of IMF policy advice, they simply do what they are told to or copy what other members do in order to maintain its position in the IMF. Social influence refers to the process by which China, motivated by the potential impacts on its status in the international political society, adopts the policies and policy processes that are consistent with IMF norms. Social influence is evidenced in China’s implementation of IMF policy advice, for example the changes in its exchange regime and banking system in the 1980s and 1990s. China implements such advice to fulfil its commitment to the Fund’s supervision on orderly economic growth and reasonable stability of price and exchange rates, which contributes to its reputation as a cooperative actor in the international political economy. Persuasion refers to the process by which China is convinced by IMF norms, and consequentially redefines its own interests and reform its policies among which IMF norms (that have been accepted by China as its own) are embedded in. Persuasion is the ultimate process of socialization, as it involves the power of ‘mind controlling’. However, there is little evidence showing that China has redefined its interests and
principles in the domestic financial and economic governance directly because of interactions with the IMF. On the contrary, China refused to accept IMF advice on RMB revaluation, as implementations of this would harm the benefits of China’s influential domestic (usually state-owned) industrial groups and financial institutions. The Chinese government’s interests and economic norms therefore remain distinct from the IMF’s neo-liberal international economic norms.

Hence socialization theory shows the IMF has not fully socialized China into accepting its norms. The IMF has had moderate impacts on China’s macroeconomic policy and institutional reforms, for example devaluation of RMB in the mid-1980s, unifying exchange rate rates at official and swap market in 1994, allowing foreign invested enterprises full access to the interbank market for foreign exchange and comply with the Article VIII of IMF Articles of Agreement; setting up domestic institutions to coordination with the IMF; and legislative implementations such as the Commercial Bank Law; the Law of the People’s Republic of China on the People’s Bank of China, and so on. However, the IMF still has some fundamental contradictions with the Chinese government’s propositions – for example to prioritize the domestic institutions’ benefits-which prevents the IMF from exerting further influences in China’s domestic policies.

2. Why did China get engaged with IMF programs? What are China’s objectives in the governance of international financial economy?

China’s motivation to get engaged with IMF programs:
• China wanted to learn from the IMF the methods and techniques in running a modern financial system that meet the international requirements.

• China wanted to get information about other countries’ financial economy from the IMF.

• China wanted to get (re)-connected with foreign economic institutions via participating in IMF programs.

• China wanted to accelerate the expulsion of Taiwan from the international political society by demonstrating its legal membership in the IMF.

• China wanted to show to the world that it could be a friendly member of the international political society, which would significantly enable smooth economic cooperation with foreign states.

Along with China’s economic expansion and the developing trend of the international financial economy, China’s objectives in the governance of the international financial economy have changed since it regained its IMF membership in 1980. China pursues a larger share in the governance of the international financial economy and improve the environment of the international monetary system so that it can accommodate and stimulate free development of emerging market economies. Since the IMF is the most
influential intergovernmental organization in the international financial and economic system, the Chinese government attempts to achieve its objectives via participating in IMF programs. China’s further participation in IMF programs are motivated by the IMF’s distinct functions:

- China wants to utilize the IMF’s expertise and information advance, and let these specialized resources contribute to China’s pursuit of becoming a more knowledgeable and legitimate actor in the global financial governance.

- China wants to utilize the IMF’s agenda setting power to solve multilateral issues. The example applied in the thesis is the IMF Multilateral Consultation on Global Imbalances, which brought together five countries/regions that were in the centre of the global imbalances problem. The Multilateral Consultation was expected to provide these countries with a transparent forum where multilateral decision-making is enabled.

- China wants the IMF to solve the controversial issues that cannot be solved by China on its own. The example applied in the thesis was China’s advocate for enlarging the use of the SDR, strengthening IMF surveillance on the major reserve currency issuer countries, and reforming the US dollar dominated international monetary system. China wants the IMF to fulfill this task because China alone lacks the strength to confront the US in the international financial economy.
3. How has the interactions between China and the IMF progressed?

The thesis highlighted some key events in the interactions between China and the IMF since 1980. China’s participation in the IMF has increased while Chinese officials learned and accumulated related techniques and skills in handling IMF affairs. Principal-agent theory emphasizes China’s evolving delegation of tasks to IMF staff due to the specification and advancement of its own objectives in the governance of international financial economy. China’s interactions with the IMF are constrained by various factors according to principal-agent theory, including China’s preferences with regard to IMF operation, the staffing rule of the IMF, China’s relative role in IMF governance, China’s influence among IMF staff, the IMF’s expertise and financial resources, and China’s capacity in controlling IMF practices and the costs of controlling. Generally speaking, China’s interactions with the IMF have become more frequent and complex; yet China does not welcome an IMF that overly intervenes into the member states’ domestic affairs, neither does China have sufficient power of governance in the Fund. Therefore the interactions between China and IMF remain moderate. The situation may change in the future when China becomes more familiar with the international economic affairs and if it acquires more governance power in the IMF and the international financial and economic system. Yet for now, neither China’s nor the IMF’s performance fully meets the expectations of the other.
The People’s Republic of China regained the legal IMF membership that previously belonged to Taiwan in 1980. In the first a few years, since China was unfamiliar with international economic affairs and IMF regulations and rules, it did not participate in many IMF programs. China has only ever borrowed from the IMF once—in 1984. Yet China received a considerable amount of technical assistance from the Fund, in terms of training courses in IMF institutes, IMF experts’ and lecturers’ visits to China, and periodical posts in IMF headquarters for the Chinese officials sent by the state’s financial institutions. The Chinese officials from China’s most crucial financial institutions such as the PBC, CBRC, MOF and the NBS have learned from the Fund some important techniques and skills in financial governance, and it has increasingly committed to the IMF GDDS program. In addition, the IMF also runs surveillance and policy advice programs for China, among which the most important one is IMF Article IV Consultation. It provides China with annual assessment of economic development and financial stability and advice on China’s economic policies. However, China refused to accept the IMF policy advice that refers to essential domestic economic stability and the interests of powerful domestic interest groups, such as revaluing the RMB and liberalizing interest rates.

China’s participation in the IMF has advanced both in terms of techniques and varieties of programs. China participated in IMF Multilateral Consultation on Global Imbalances along with the Euro area, Japan, Saudi Arabia, and the US, which highlighted China’s crucial role in global financial stability and China’s capability to utilize the IMF as a mediator of China’s discussion and negotiation with other states. Some Chinese officials
and scholars’ propositions during the global financial crisis reflected the Chinese government’s intention of relying on the IMF to reform the international monetary system. Zhou Xiaochuan, the Chinese Central Bank governor, called for enlarging the use of the SDR and diversifying the US-dollar-dominated international monetary system. Meanwhile, the Chinese officials sent to the IMF have improved their capability to express their opinions accurately and strongly, as seen in the statements and speeches of various Chinese officials at IMF meetings over time. In addition, China has become an important creditor to the IMF, and provided the IMF with considerate financial contributions during and after the crisis. The IMF also endeavours to convince China to continue to contribute to the IMF’s financial resources.

However, not all participation in IMF programs generated desired consequences for China. The Multilateral Consultation on Global Imbalances did not result in many effective and practical policy changes in the involved countries, as the Multilateral Consultation was not part of the IMF’s traditional functions and involved too much uncertainty and ambiguity in the whole program. Moreover, the IMF did not respond directly to China’s proposal for a larger SDR (that would include the RMB), tougher regulations for the Fund’s advanced economy member states, and eventually a more diversified and flexible international financial economy for China and other emerging market economies. China also advocates governance reforms in the IMF that are in favour of the emerging market economies. However, although the IMF has demonstrated its updated goal to increase the emerging market economy members’ representation and urged the US to strengthen regulation in its financial and monetary system, the IMF’s
western-dominated nature in both governance structure and organizational culture makes fast and effective switch of policy preferences from the advanced to emerging market economies almost impossible.

4. What is China’s governance role in the IMF? How has it progressed?

China’s role in IMF formal governance is represented by its quota and voting shares in the Fund. China was initially assigned a quota of SDR 1.2 billion in July 1980. After some adjustments, China’s quota reached SDR 6.4 billion in January 2001. Three major IMF governance reforms that were initiated in 2006, 2008 and 2010 improved China’s representation in the IMF. These three reforms mostly shifted governance power from the Fund’s advanced economy state members to the emerging market economy and developing country members. The 2006 reform included a quota share increase of 1.8 per cent to the most under-represented members: China, Korea, Mexico, and Turkey. It also included some other minor adjustments that were conducive to the representation of other emerging market economy and developing countries. China was satisfied with the 2006 reform and continued to call for further reforms that conferred on China more decision-making power in the IMF. The 2008 reform included a new single quota formula replacing the old five formulas, which increased the developing countries’ weight among all members. When the 2008 reform came to effective on March 3, 2011, China’s quota increased from 3.718 to 3.996 per cent of the total quotas, and its voting share increased from 3.651 to 3.806 per cent of the total voting shares. The Chinese delegation was
disappointed with such a tiny increase of quota and voting shares and continued to call for further reforms.

The 2010 reform promised ‘the biggest ever of influence in favour of emerging market and developing countries’ according to Strauss-Kahn, by which China, Brazil, Russia and India will be included in the Fund’s 10 largest shareholders, and China’s quota and voting shares will be increased to 6.394 per cent and 6.071 per cent respectively and making China the third largest member. Although the 2010 reform represented a significant power shift from the IMF’s advanced (especially European) economy to emerging market economy state members, the implementation of the reform has become extremely difficult. The IMF planned to implement the by January 2013, yet it has not been implemented one year over the promised deadline. The US is the biggest obstacle of the implementation of the 2010 reform. The reform will not come effective until the US press the yes button. Nevertheless, even if the 2010 reform does come into effect, China’s governance power still remains relatively inadequate to challenge the dominant role of the US and other advanced economies in the IMF. The US remains the veto power to reject any changes to the status quo, and so do the EU countries combined. The Chinese government has repeatedly called for further IMF governance reforms in several international occasions, and the IMF has also expressed its determination in improving the decision making power of emerging market economy and developing countries. However, the reality is different from the rhetoric, as the IMF’s traditional

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68 The EU countries usually have converging preferences and policy decisions in the IMF; hence they can sometimes be regard as a unified force in some policy areas.
advanced economy member states would not easily let go the governance power in the IMF and the western-dominance nature is deeply embedded in the IMF’s organizational culture.

China’s role in IMF informal governance refers to the Chinese delegation’s capability to negotiate with those of other member states in the forums and informal groups outside the EB and to shape the agenda and craft proposals before they are brought to the Board. A member state’s informal governance power depends on its experience in handling IMF affairs and its networks and real impacts in the international political society. China lacks both of the above features, and it is kept out of the discussions of the crucial informal groups such as the G7 and the EURIMF. The Chinese representatives have learned to develop networks in the IMF especially with other emerging market economies, yet it will take a long time to acquire a promising social status and refined diplomatic skills of the western advanced economies. Since it takes time to acquire larger decision-making power in IMF informal governance, China will continue to request more formal IMF decision making power represented by quota and voting shares in the IMF.

5. How does the IMF assist China to achieve its objectives in the governance of international financial economy? How does principal-agent theory explain it?

China’s participation in IMF programs leads China to get closer to its objectives in the governance of international financial economy. According to principal-agent theory, China delegates various tasks to the IMF so that the IMF could accomplish the tasks in a
more effective way than other forms of cooperation or unilateral solution. The IMF has outstanding functions that attract states to delegate various tasks to Fund staff, including outstanding expertise, political skills, and resources to perform the tasks; agenda-setting power to induce an ‘equilibrium’ among states on controversial issues; capability to govern decision-making in situations where the contract is not explicit; capability to solve time-inconsistency problem; and capability to ‘lock-in’ the validity of the political winner’s advocated policies. These five functions are utilized to different degrees in the IMF’s implementation of the tasks delegated from China.

IMF staff have taught Chinese officials a great number of techniques and skills in financial governance through various technical assistance programs, where China’s financial system has become more and more compatible with the international standard. IMF staff have provided China with policy advice, although some of it contrasts with the domestic political and economic preferences and thus not fully accepted. Yet China’s participation in IMF surveillance reflects China’s commitment to the internationally standardized good behaviour. The IMF provided China with a forum where it can discuss controversial issues with other states. Moreover, IMF lending programs assess lending risks and design loan contracts with better techniques than state governments, thus they play the role of guarantor for China’s multilateral lending. Since active participation in multilateral lending as a creditor contributes to China’s image of a responsible great power, the IMF indirectly assists China to acquire a better reputation in the international financial economy.
It was mentioned previously (in answer to question 3) that some of China’s participation in IMF programs did not generate desired consequences, for example, the Multilateral Consultation on global imbalances did not lead to effective policy changes in the involved countries; the Chinese officials’ request for more strict surveillance on the Fund’s advanced economy member states were ignored; the Chinese policymakers’ request for a larger SDR and a thorough reform of the international monetary system toward a more diversified one. These undesired consequences of China’s participation in the IMF are regarded as results of agency slack according to principal-agent theory. Agency slack took place for several reasons: 1 the IMF’s international civil servants-based staffing rules lead to a large degree of agency autonomy; 2 the IMF’s western dominated governance structure undermined China’s decision-making power in the Fund; 3 the divergence between China’s preferences and those of the IMF; 4 the costly controlling mechanisms and China’s reliance on IMF expertise which further led to delegation consequences that are out of China’s control; 5 the IMF’s limited financial and expertise resources hindered the Fund from providing sufficient financial assistance to the member states and correcting the risky single currency-based international monetary system.

3 Some Issues for Future Studies

This thesis has contributed to the literature on the relationships between China and international organizations with the analysis of the China-IMF interactions since 1980. It has also unprecedentedly used the combination of the socialization and principal-agent theory to assess the relationship between an emerging market economy and a traditionally
western-dominated international institution. The research conducted in this thesis indicates a few issues that require further studies in the future.

First of all, China’s role in the IMF will continue to change in the future. Although the extent and scale of IMF governance reforms remain moderate, the general trend of IMF governance comprises a rising emerging market economy group and declining advanced economy group. China will gradually gain more governance power in the IMF via both increases in the quota and voting shares and improvements in China’s networking and negotiating skills in the Fund. Hence the issues of power redistribution and power struggle continue, and this may get more difficult since the existing dominant states in the Fund will be asked to let go more decision making power in the EB. IMF governance reforms to strengthen the role of emerging market economies and developing countries continue to be an important factor of these countries’ cooperation with the IMF.

In addition, China continues to contribute to the IMF’s financial resources. China may not become a major creditor of the IMF within a short period of time, yet its financial potential has attracted much attention from the Fund. IMF leaders continuously encourage China to contribute financially to the Fund, which has received positive responses from China’s economic leadership. China’s increasing role of creditor contrasts with its usual object against standardized conditionality for the poor developing countries. While China gets more involved in IMF lending programs as a creditor, it increasingly considers about the return and effects of its capital, which forces China to soften its ever strong claim on economic sovereignty. Moreover, other than the lending programs, China also gets more
involved in other functional parts of the Fund, which requires updated assessment of China’s dynamic role in the Fund.

Furthermore, other international institutions also call for China’s participation and/or financial contribution, such as the European Stability Mechanism (ESM), the crisis-hit European governments, and the Asian regional financial institutions like the CMI and ASEAN10+3. China’s presence has extended to a wide range of economic cooperation all over the world. As mentioned in the last section of Chapter 7, China now sees its position in a wider picture of the global economic regime. China’s economic leadership willingly devotes itself in multilateral governance of the international financial economy with diversified cooperative mechanisms. China’s interaction with the IMF should be regarded as a fraction of its dynamic participation in the international financial economy, by which it continues to promote a multipolar and diversified global economic regime. China’s interactions with other international financial and economic institutions require updated analysis following this logic.
Appendix

List of Interviewees

Interviewee 1 (as marked in the footnotes of the thesis) is a government official that works closely with the IMF in a Chinese Financial Institution. The interviewee was conducted in Beijing in December 2011.

Interviewee 2 (as marked in the footnotes of the thesis) is a leading scholar in China’s political economy. The interview was conducted in Beijing in December 2011.

Interviewee 3 (as marked in the footnotes of the thesis) is a senior IMF official of the IMF. The interview was conducted in IMF headquarters in Washington D. C in October 2012.

Interviewee 4 (as marked in the footnotes of the thesis) is a staff member in one of the IMF’s research departments. The interview was conducted in IMF headquarters in Washington D. C in October 2012.

Interviewee 5 (as marked in the footnotes of the thesis) is a leading scholar in Chinese and Asian political economy. The interview was conducted in Beijing in December 2011.

Interviewee 6 is a leading scholar in China’s international relations. The interview was conducted in Beijing in December 2011.

Interviewee 7 is a leading scholar in China’s international relations. The interview was conducted in Beijing in September 2011.

Interviewee 8 was a senior IMF staff when the interviewed. The interview was conducted in Beijing in September 2011.

Interviewee 9 is a staff member in one of the IMF’s research departments. The interview was conducted in IMF headquarters in Washington D. C in October 2012.

Interviewee 10 is an expert of China’s economy who works in a leading US think tank in Washington D. C. The interview was conducted in Washington D. C in October 2012.

Interviewee 11 is an expert of the IMF who works in a leading US think tank in Washington D. C. The interview was conducted in Washington D. C in October 2012.
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