Rising Dragon

China's Role in an Emerging Multilateral Global Financial System

The ongoing financial crisis is a forewarning of America's declining role as the custodian of global finance and China's increasingly important role in the world economy. The hypothesis posited and analyzed here is that a multilateral global economy, led by China, is the best alternative for a stable global financial system in the 21st century.

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The financial meltdown that began with the collapse of Lehman Brothers in September 2008 and threw the world into economic uncertainly posited important questions about the health of global finance that continue to have no good answers in sight of the ongoing debt crises in the United States and the countries of the European Union's single currency area, the Eurozone. The economic difficulties in the West are offset to a degree by the rise of new prominent players in the international system in the face of countries like Brazil, Russia, and especially, China. The particular question asked in this paper is concerned with what the role of China might be in a world that is witnessing increasing multipolarity not only in terms of relative power, but increasingly, international finance? I will begin the discussion with a brief comparison to the dominant position of the United States in the immediate postwar environment as the only country able to provide the required capital and capacity to finance the reconstruction of war-torn economies and by extension, the wrecked system of capital flows in the world. The difference today is that there has been no major war, yet the United States is gradually ceding its place as the world's trendsetter in global politics in nearly all respects and the day when it will no longer be a dominant player is on the horizon. At the same time, it is uncertain if China has the will, capacity or resources to unilaterally underpin a global financial system that will operate in a multipolar world. The solution I propose, then, is that China's growing economic dominance is better suited towards leading a multipolar, rather than a unipolar, design for a global financial system. I will focus the theoretical discussion on the gradual decline of hegemonic stability theory through America's gradual loss of influence and the assertion that a multipolar design for a stable global financial system is viable in the post-American world. In turn, the practical arguments will focus on China's massive currency reserves, foreign direct investment activities and trade policies, in order to determine what advantages and disadvantages Beijing would have in a potential bid to assert global economic leadership in the context of multipolarity, at some point in the 21st century. As an added implication near the end of the paper, I will raise the question of unfavourable demographic trends in China towards the middle and end of the century that may cause additional difficulties for meeting its potential global commitments.

The rationale for an enhanced global role by China will not come from the current viewpoints or practices of the leadership of the Communist Party. It will come from the accumulation of endogenous and exogenous factors that give China an increasingly large stake in the global economy. The trend is already visible, ever since China superseded Japan to become the world's second largest economy. Effectively, the argument is a philosophical one – the quantitative change in China's influence will demand a qualitative change in its policies: more involvement, predictability, flexibility and leadership.

Historical background

Before delving into the analysis on the role of China in the 21st century's financial system, it is important to provide a brief historical account of the system that has been dominated by the United States since the end of the Second World War and then tease out some important differences that will highlight why China will not be able to have the unilateral dominance and sway that Washington possessed in 1945 and the years after.

After the Second World War ended, European economies were frozen, illiquid and unable to meet the requirements of their populations in the way of consumption, investment and jobs. At the time, China was embroiled in a vicious civil war that would not end until 1949 and the USSR, exhausted from carrying out the brunt of the war itself, was not in a position to provide global political and economic leadership neither. South America was largely unaffected by the conflict, but its stake in global affairs was not enough to hold sufficient sway, let alone influence consequential leadership. At the time, colonies still existed as well, and the incompleteness of the state system was itself a factor that impeded the development of a center in the world that would be able to compete with American economic leadership. The picture being painted effectively is one that puts America in a position of being the only country in the world not only with the required capital reserves, but also with the required political capacity and will to design and implement a global financial system (Kindleberger, 1951, p. 35). While Britain was also an influential actor, its participation in the war and indebted position relative to the United States put it in the role of a junior partner in negotiations (Williamson, 1985, p. 75)

Prior to WWII, Europe and America represented the world's economic centers. It was thus essential after WWII for Europe to regain this position as rapidly as possible if a global financial system was to be recreated. The result was the Marshall Plan, as the first major postwar project by US foreign policy to underpin re-emerging economic relations in its favour before the nascent International Monetary Fund (IMF) and World Bank (WB) took over supervisions of the question of global payments balance (Kunz, 1997, p. 165). However, even these institutions were initially underpinned by American capital and for this reason Washington's representation in the decision-making structures of both organizations was the greatest by extension. As a result, it is possible to say that both the IMF and WB reflect American viewpoints, interests and foreign policy objectives – this is so, because both organizations are not supranational, but intergovernmental, in which the national interest forms the prism for analysis and relations.

With Britain unable to recover the capacity it possessed before WWI to lead the trends on the global financial system, it was the US dollar that assumed the role in the postwar environment. In order to recover, European economies used the dollar as a reserve currency to restore economic production, and more importantly, participate in the new order to be shaped by the IMF by virtue of dollar convertibility in relation to their own currencies (Heldring, 1988, p. 24). This paradigm formed deep economic connections between Europe and America and made the dollar effectively the reserve currency of the postwar global financial system. For the Third World and newly independent states, it would be impossible to compete through setting up a parallel system, when economic power was focused in the West – the only choice was to participate in it.

In the course of the second half of the 20th century, several major changes happened: the end of the Bretton Woods system with the collapse of the gold standard in 1971, the decline of American industrial competitiveness as major production centers developed elsewhere around the world (read: Japan, China), the opening of China to global capital flows in 1976, the collapse of the Soviet Union and the acceleration of neoliberalism as the dominant paradigm of economic organization since that time, to the current financial crisis wracking the world.

Why is China important?

In the brief survey above, I outlined the idea that the United States was able to unilaterally lead the global financial system in the postwar world, largely because it was the only economy not destroyed by war and at the same time, had the capacity to recreate, underpin and govern a global financial system. However, in the major developments in the years between 1945 and 2011, it can be said that the most sustainable positive trend has been China's gradual rise to the status of the world's second largest economy.

It is almost pointless to ask why China is important, given its position of prominence in our time. Yet, the question has merit for one main reason: the gradual decline of America, burdened by unsustainable debt, social stagnation and a falling share in the global economy, will leave a void of ideas, capacity and uncertainty on who should take up the mantle of global economic leadership; to do that, the contender must also be heavily involved in managing the maddening complexity and size of the modern global financial system. China's growing stake in the global economy means that more and more factors in global economic trends will be influenced by China's actions to the point where Beijing's voice may as well set the tone of the global economy (Fogel, 2010). As mentioned in the introduction, the philosophical nature of the quantity-quality argument applied to the United States in 1945 as well – it could not participate in the system while being passive; Washington's contemporary policies need to assume a more global character than ever before to reflect America's enhanced position, and the same trend is set to happen in China in the foreseeable future.

What is more important, however, is that China is not operating in the same devastated world that the US found itself reassembling. We are living in a world that has more people, is more interconnected and interdependent that anytime in recorded history. This condition alone makes the tasks in front of China rather more complex to manage than they have been for any other country in our known history. Outright unilateralism is no longer possible, because global interests intersect to too great a degree. The rise of Brazil, India, Russia, among other fast-growing countries coupled with the decline of relative Western economic power suggests that we are heading for a multipolar world in which the leadership of one state or alliance can and will be effectively be challenged by another state and alliance: effectively, the map of an emerging multipolar world (Khanna, 2010). It is in this kind of world that China must learn to manage, where more countries than ever before have more choices in respect to foreign policy than ever before. The challenges posed by the current financial crisis, from national debt to trade revenue and currency reserve imbalances, suggests that the nature of systemic problems is global now, and that trend will accelerate in the future. In such a scenario, solutions will also need to be global, and China must as a result, not only see systemic solutions through its own interests, but also amalgamate them with the stakes of other players in the system to an unparalleled degree of multilateralism. My forecast is not meant to represent a recipe for action or to define the scope of Chinese response in this century; the aim is simply to outline the quality of the behaviour China would need to exhibit, as perceived to be an outgrowth of the accumulation of endogenous and exogenous factors in the global economy and China's greater respective stake in them.

Theoretical considerations

The dominant role of Britain in global finance up until the onset of WWI and the clear supremacy of the United States since WWII gave rise to a school of thought, labelled hegemonic stability theory (HST). Its main premise is that a state in the system has the will and capacity, political, economic, ideological and military, to establish, lead and mange a global system through effective institutions. A hegemon must have a growing economy and a commitment to the system that will likely ensure the participation of other great powers in the system as part of it. In effect, the hegemon is the global norm-trendsetter, leader and guarantor of the system. This was the largely perceived role of the United States in the postwar world, with the exception of the competing politico-socio-economic paradigm offered by the USSR until its demise in 1991, but this perception rather intensified in the course of the 1990s and the 2000s.

This purpose of this paper is to effectively challenge HST through showing that a hegemon is not necessary to underpin global financial stability and the same end can be achieved within a multilateral framework. It is difficult to define a specific theoretical paradigm for such a multilateral design, because it will be on a bigger scale than ever before, with an unparalleled degree of complexity as well, both in the number of stakeholders (state, non-state and supranational) and the extent to which their multitude of interests intersect. I think that it will be important to observe what happens as the 21st century progresses and China's behaviour in particular to develop the relevant theoretical designs.

Currency reserves as an anchor for global finances

In recent years, China has accumulated a staggering amount of foreign currency reserves, totalling $3,2 trillion in total (Oliver, 2011). These reserves are a source of both influence and tension: it gives China a great degree of freedom in regard to domestic and foreign policy, but it is also one of the main imbalances in the contemporary system: on the opposite end is the debt crisis happening in America and Europe and a telltale sign of its intensity is the rapid decrease in currency reserves in the not only affected countries, but also emerging economies (Online, 2011).

For the unfamiliar reader, foreign-exchange currency reserves are defined as the foreign-currency deposits held by central banks and monetary institutions, as the IMF, for instance. There are a number of advantages and disadvantages associated with sizable reserves. On the side of the advantages, currency reserves give the state the ability to influence exchange rates in a way to create a favourable economic environment – be it either with the goal of stimulating domestic consumption or making exports more competitive. In connection, it is also able to better defend itself against speculative attacks against the currency. Speculative attacks represent a massive selling of a currency by investors because of some risk: be it connected to fiscal and monetary factors like budget deficits and inflation or political ones like social unrest, government collapse or a revolution. With a floating exchange rate, central banks can intervene and largely insulate the market from said speculative attacks – for the sake of focus in the discussion I will not tease out the relationship with central bank interference. Conversely, there are negative effects to holding currency reserves. More precisely, the risks are tied along two particular avenues. The first is related to a country having an excess of reserves in its accounts – the risk is that fluctuations in the foreign exchange rate of the held currency cause positive or negative shifts in the purchasing power of the reserves and small variances in the value of the currency can magnify the loss if the reserves are too large. Inflation also reduces the value of reserves, so their size must be constantly increased to maintain a relatively constant value and for the central bank to be able to have, consequently, a consistent ability to affect exchange rates. The second avenue is rather less significant, but can still be problematic – that is the fact that the holding of foreign currency reserves tends to produce lower interest returns, which may not be enough to compensate the drop incurred from the combination between inflation and currency value fluctuations.

China's currency reserves are the largest in the world. The implication is that to reduce their impact appreciably, it would take nothing less than the collapse of the dollar to fatally check the potential impact of China's currency reserves; however, it is not realistic to expect this scenario to unfold. In other words, it is possible to say that the size of these reserves is sufficient to internalize the costs described by the above relations and still not have appreciable consequences for the potential impact these funds can have on the reach and capacity of Chinese foreign policy. Even if this is the case, then, what can China do in respect to helping underpin a global financial system on a multilateral basis?

Currency stability is one of the pillars of a global financial system. In recent months and years, we have heard appeals from leading powers in the world to move beyond the dollar as the world's reserve currency (RT, 2011). Some steps in this direction have already been taken through regional approaches to bilateral or trilateral trade that happen in local currencies rather than the US dollar (Coggins, 2011). However, the dominance of the dollar will not end soon for two main reasons: the first is that commodity trading on a global scale occurs in dollars, and not only the Chinese currency reserves, but those of other countries, are also denominated in greenbacks, and for a third set of countries, their currencies are pegged to the dollar and vary with it (Drezner, 2011). The point here is that the US currency is intrinsic to the foundation of the current global financial system, and taking it away suddenly will have dangerous repercussions for both established and emerging powers. The second reason is purely pragmatic: regional trading in local currencies may work, but exchange among hundreds of members in hundreds of currencies makes transactions unbearably expensive, which is the first rationale for having a global reserve currency. The issue with the dollar, however, is that the value of global capital flows is hostage to the monetary policies hammered out by the Federal Reserve, and while it operates largely in accordance with American interests, the international costs of the uncertain state of the dollar, brought on by trillion-dollar bailout and economic downturn, puts other major countries in the system in a position of risk that they can do little to control.

The rationale for China to use its reserves for underwriting a multilaterally-backed reserve currency, something akin to the IMF's Special Drawing Rights (SDR) fictional currency, or the Eurozone, is that its security and fluctuation will not depend on the economic cycles in one country – and right now, we find ourselves in an economic crisis with an uncertain outcome and continuing downward implications – but rather, multi-pronged management will likely create better stability and predictability in this hypothetical reserve currency. The most important is that risk will be diffused, not concentrated as it is now in the hands of the Fed. This way, economic troubles in one country will have an impact on the overall system, but the shocks will be internalized and contained, rather than contributing to a degree of instability that would topple the entire system and place the whole world in a prolonged economic downturn.

The size of China's reserves can potentially mean that it will be the largest stabilizing factor to such a multilateral reserve currency system, but with the added benefit that whenever China experiences a downward economic trend, the effect will be felt across the system, but the impact on commodity prices and the domestic and international position of the other participating economies will be minimized.

An important variable to consider here is investor confidence. One has to ask, if confidence is such an important asset to the functioning of the current system, will it not be an equally, if not a more important feature of a new system? The answer is that it likely will be and to secure confidence in the new system, diversifying risk through multilateral management enhances predictability, and in turn provides clearer borders of behaviour and expectations among investors. It is expected that with more stakeholders in the system, none of which can underwrite the system unilaterally, excessive risks will not be taken; however, there can be no predictions until such a scenario becomes realized in practice. Many of the problems perpetuated in the current financial crisis cannot be resolved precisely because of a crisis of confidence. There is insufficient trust between investors and market, people and institutions, and all are connected to the financial system in important ways. Without trust between the main actors it is impossible to move forward a new paradigm of thinking about finance.

The premise of this section is to show the connection that exists between foreign-exchange currency reserves and the rational of having a global reserve currency. I hypothesized that China's reserves are large enough to internalize the negative impacts that come with currency fluctuation and low interests rates of return on such reserves, without having an appreciable impact on the conduct of Beijing's foreign policy. My position here is that a multilaterally-managed global reserve currency will restore confidence, eliminate excessive risk and disseminate it across more stakeholders, while also minimizing the impact of domestic economic problems on the international level. China in particular can be the largest stakeholder, and its economic problems will be felt the most, but this will be a shock the system would be able to handle; the alternative, as we have today, is an underperforming American economy with the dollar as the reserve currency, that creates too much uncertainty and high risk not only for America's position in the world, but also the state and non-state actors invested in the greenbacks, with the end result that the entire world is suffering from economic malaise.

Chinese domestic and foreign direct investment

Accompanying the staggering expansion of Chinese foreign-exchange currency reserves is increased investment activity domestically and internationally. The effects of economic prosperity in China are visible to the naked eye in the realization of massive infrastructure projects, such as highways, dams and high-speed rail lines and the rapid expansion of cities along the coast and increasingly, in the interior of the country (Romm, 2011). Accelerating urbanization is also a sign of this trend, as more opportunities focus on the cities and people in the countryside have a chance at a better life by moving to the city. Still cheap labour and an export-oriented economic model still afford high growth rate for China and until this is the case, high revenues will be invested in the development of Chinese cities and infrastructures at a staggering pace.

The shine of China's domestic development takes the spotlight somewhat away from Beijing's international investments, but they are no less important in their impact on the global economy. While the overall capital volumes coming from China, it is their diversification and rapid growth that provides some of the perspectives and challenges for future foreign direct investment. More precisely, the presence of China in the Middle East is enhanced by replacing the West as the chief external influence in Iran (Bulley, 2010). While Africa is home to most of the world's undeveloped states, the quietly high rate of growth on the continent is in part fuelled by strategic Chinese investments worth billions in natural resource development and manufacturing; still, time will need to pass before qualitative socio-economic change occurs in Africa as a consequence of these investment, but in the meanwhile they serve to enhance China's influence in the developing parts of the world (Economist, 2010). China is also increasingly active in Europe, building on current trade flows with the EU towards investments in services and manufacturing and there is even speculation on Chinese capital being used for solving the problems brought on by the debt crisis in the Eurozone (McMahon, 2011).

Nevertheless, it is important to provide an overarching picture of Chinese investment abroad. There is two main avenues along which Chinese investment is concentrated: resources and technology. Numbers-wise, in 2009, China invested $48 billion abroad and in 2010, the total amount was $67,8 billion, for a year-on-year increase of approximately 20% (Ling, Xiang, & Lan, 2011). While the base is rather low now, at this rate of growth, projected over 10 or 15 years, Chinese foreign direct investment can assume an exponential manner of growth on an annual basis to give Beijing stakes worth trillions (Yao, 2011). It is this potential for rapid growth that raises questions about China's capacity to manage and take responsibility for its global activities. It is a curious trend that Chinese investment in resources takes on a particularly significant share of total investment. For instance, half of total investment in 2009, or $25 billion, was invested in the resource development in Australia (Findlay, 2010). Further, China is pouring further billions into Africa, investing into arable land, oil fields and infrastructure projects. Investment in Africa is particularly controversial, because it is mixed with spotted business practices and the weak capacity of African government institutions to monitor and administer investment funds (Economist, 2010). On the bright side, Chinese investment into mining, resource development and factories improves the overall socio-economic conditions in parts of the continent where it is centered: Ethiopia, Sudan and Angola among others (Economist, 2010). On the other hand, charges of exploitation, low pay, the low quality of infrastructure projects and corrupt business practices hamper China's image in Africa, and while trade and investment are on the increase, political differences may become an important factor in retarding investment until clear rules, regulations and capacities are established (Economist, 2010). It is not easy to conceptualize Chinese interest in Africa: it is not possible to talk about colonization, because investment is more comprehensive and does not aim to outright enrich the Asian giant at the expense of the locals, despite its unbridled capitalism variety; conversely, the questionable practices of Chinese businessmen cause political tensions between investor and investee.

Another trend to watch is Chinese investment into Europe and North America. Investment inflows from China to the West are still very small – total investment in the US by 2010, for instance, equalled 7 billion and created approximately 44,000 jobs – and it is slated to increase, but because of the low base starting point, the effects will not be noticeably felt for some time to come (Ling, Xiang, & Lan, 2011). The underlying point here, however, is that Chinese investment culture is still very much a work in progress. As a relative newcomer in large-scale investment, best practices related to choice of investments, governability of the recipient states, labour relations and the very transparency of the Chinese state in managing these relations, which is rather lacking at the moment, are all areas in which China needs to accumulate knowledge. Implicated here is also development – the question being what kind of paradigm China offers, and if it can match its own interests with those of underdeveloped states? The larger point is that the investment culture that will develop from investing in emerging markets will prepare China for larger-scale strategic investment in the developed world – Russia, Europe and North America – and if current trends have staying power in the future, it is viable to forecast that investment flows into these three regions are going to intensify in the course of the 21st century.

We must not only consider foreign direct investment by China, but also investment in China by external actors. The high rate of economic growth means that hundreds of billions of dollars have entered the country in the last ten years and helped accelerate this growth even further. The economic slowdown the West has experienced since 2009 has slowed down, but not abated the rapid inflow of capital into China (News, 2011). It is beyond the scope of this paper to analyze the sectoral investment in the country, or how even or uneven it is, but the aim is to provide a broad direction of Chinese foreign policy and how that relates to the theoretical construct of a multilateral global financial system. The point being, the large surplus from the difference between capital inflows and outflows in China gives Beijing considerable policy leverage in international affairs. The question at hand is to transform this enhanced foreign policy stance towards the creation of an effectively multilateral financial system that will minimize risk and internalize shocks well.

The final portion of this section is about considering the role of foreign direct investment in respect to the capital flows underwriting a global financial system. The way it works currently, countries compete for capital flows from states and firms in which capital is concentrated – up until the onset of the financial crisis, that meant flow of capital from the West, but increasingly, also China, Brazil, Russia or Middle Eastern sovereign funds. In effect, foreign and domestic economic policies that govern growth, taxation and pricing, are meant to attract foreign capital to stimulate development and more growth. In the two decades after the Cold War, the source of capital for developing countries, including China has been the West. The case in the next stages of this century will be that while the West will still be an important source of investment for developing countries, there will be a viable choice for development paradigms in terms of the viable sources of capital. China is bound to become one of the largest investors, buoyed by its rapidly growing economy and colossal currency reserves.

The picture that emerges is that China may eventually have the largest varied stakes in global investment initiatives by size, but relatively will not be strong enough to influence the investment initiatives of other emerging and established powers. However, its stakes may be strong enough to influence the investment climate in regions around the world – that is, set trends in markets by choosing to invest in one area or another, and in this way, Beijing can indirectly influence, if not control economic growth rates around the world to varying degrees: more so in developing countries and less so in the developed world. Total Chinese investment already totals over $300 billion and it may top the trillion dollar scale by the end of the decade. That would still be far from enough to outstrip American foreign direct investment ($4 trillion in total), but it would still give China a considerable stake in global investment relations and a tangible capacity to influence the speed of economic trends on a global scale (Mather, 2011).

China's trade policy

Foreign direct investment since 1976 and cheap labour have transformed China into the world's factory, facilitating an export economy that produces cheap goods of a wide variety for the affluent markets of Europe and North America. Or, at least, that model worked for the past few decades, but seems to be faltering amidst the current crisis. While China's high annual economic growth rate has been sustained for the past decades, it is noticeably slowing, and the leadership in Beijing will be challenged in the medium term to find a new paradigm of economic growth, less based on cheap labour and a reliance on foreign markets, but more so on making the domestic market a source of economic growth through an overall rise in the standard of living brought on by the current trends.

In today's system, China is one of a few major players with a sizable surplus in the current account trade balance, with another being Germany. On a month-to-month basis this year, it is shrinking in comparison with the same period in 2010, with the latest available data for October showing that China's surplus with the United States is approximately $17,03 billion with both imports and exports slowing down as a consequence of the economic difficulties in the West unfolding their influence in China (Chin, 2011). For the same period, it is about the same amount in trade flows with the European Union. On an annual basis, China's trade surplus with the rest of the world forms one of the significant imbalances of the current financial system.

On the other hand is the American position in global trade, in which Washington has maintained a persistent deficit in its current account balance. The trade deficit is significant, varying between $200 and $300 billion over the last several years (America, 2011). Implicated here are two factors: one is the natural competitive position in manufacturing brought on by lower capital costs and cheap labour and second, the artificial suppression of the yuan by Beijing to enhance export competitiveness. Washington has no real answer to these measures by Beijing outside of persistent political pressure that is made yet more difficult by the China's advantageous position in owning a significant portion of American national debt.

The Sino-American relationship, in effect, forms one of the core dynamics of the modern financial system, but it is also one of its greatest stability threats. The American position is highly vulnerable if China decides to press its systemic advantages, but the counteract is that the entire financial system is based on American policies and behaviour – thus, China would suffer significant losses if a major shock happens; not inconsequential would be a sizable loss of American consumer absorptive capacity, which cannot be compensated by domestic consumption in China and that would be a severe hit on the export-oriented Chinese economic model.

The pressure on China to release the yuan from its artificial depression is mounting and coming not only from the United States (News B. , 2011). Other East Asian countries' competitive position, such as Japan and South Korea, are also suffering from the Chinese policy on the yuan. Conversely, China's sustained policy of price depression has stimulated the creation of a vast manufacturing sector that will be inevitably negatively impacted from a reversal of policy. In other words, the political and social costs to such a move would be tremendous. The correct response would be to heighten the standard of living for the average Chinese worker in correlation with lessening the government intervention so as to absorb the effects of a freer fluctuating currency.

Trade policy is also tied to the level of American debt. Chinese surpluses are partially used to finance American national debt, which in turn to a degree artificially sustains the credit-based consumption level in the United States that Chinese exports need to remain conversely consistent. In effect, both countries are engaged in sustaining imbalances in the financial system, positive and negative, that threaten to impact the entire structure adversely. Inflationary pressures must also be taken into account, because excessive surpluses, as is China's case, increase the money supply at a time when the financial crisis is causing declines in the volume of Chinese imports and exports, with the result that manufacturing and consumer prices are going up with economic activity going down (Nielsen, 2011). What emerges is a picture of contradictory factors that seemingly favour the loosening of Chinese monetary policy from the perspective of Chinese interests, but harbour political and social risks for not only the Celestial Empire, but also the United States and the stability of the wider financial system. At the same time, the current imbalances cannot be sustained forever, because at the point they no longer become possible to support, the system will be overwhelmed to disastrous consequences – where fundamental shifts to a new systemic quality will happen at even higher political and social costs.

In the realm of theorizing about a multilateral global financial system, the question becomes how trade flows can be internalized into it while preventing the accumulation of risky trade surpluses or deficits, and the balances associated with them, in the hands of any one major actor to the point where the stability of the whole system is threatened? I am afraid I do not have a good answer to this question, but given the above analysis, it is possible to expect that there must be an agreed to supranational framework that has to monitor the account balance of the system – seemingly, to a much greater degree than the World Trade Organization (WTO) does today, so as to permit the formation of these imbalances in the first place – and have the capacity to act to correct them, either through creating artificial demand for excesses, affecting inflationary rates in other members of the system, or political, economic and legal sanctions to prevent the disproportionate accumulation or loss of capital in any one part of the system. The regulation in a multilateral system would also need to go up to a level that effectively interferes with national economic strategies. In other words, economic growth must be even across all stakeholders if other processes are going to be kept in check, including trade flows. Effectively, economic sovereignty will be severely limited and the political will in any country to do that at this stage in our history, is impossible to find. China has the potential to lead by example – underline a multilateral arrangement that severely constraints its own economic freedom for the benefit of the entire international financial system. Other major powers would need to do the same if such an order is to survive. It seems counter-intuitive, because it would limit growth, prosperity and to a degree, capital mobility. However, it would offer a balanced approach to global economic development and financial management and very likely prevent the emergence of crises such as the one happening now, borne from the creation of price balloons, systemic imbalances and irresponsible, unchecked risky behaviour by both state and non-state actors.

The implication of price balloons

Economic crises over the last century have been preceded by a period of rapid growth, fuelled in part by increases in productivity and production, but also founded on speculative futures of higher returns that, in turn, drives investor activity in one or another avenue and creates a demand for a certain period of time, until the underlying risks (inability to pay debts, for instance), catch up to the artificially heightened position and the balloon bursts. Examples abound: the dotcom bubble of the 1990s, the housing bubble in America in the 2000s, and the unsustainable borrowing by states and private actors over the same period are only but a few of the examples in recent history.

The important point in this section is this: the global financial system, now, is built entirely on confidence. The confidence of investors in allocating money into certain areas of the world into certain types of investments and the confidence of consumers in holding money in a bank, or spending on goods, are the two sides of the same coin: confidence. It is the only variable that matters in the analysis, because the level of trust in the system defines the behaviour of all actors involved: states, financial institutions, regulatory bodies and individuals, from the lowly layman to George Soros. It is possible to measure relative risk fairly accurately, but impossible to predict the behaviour of humans, so far.

Risk-taking has always been a feature of the global financial system, and it is risk that drives expansion, growth and profits. However, taken out of bounds – that is, producing over-confidence – is in effect creating negative trust. When too much risk is assumed without the needed checks and balances to isolate its impact as much as possible, the whole system suffers, and as we witness, to the point where its total collapse is not out of the realm of possibility.

China's role in what would be a multilateral financial system, is to manage the risk that comes with dealing in finance better than the United States did over the last 70 years. Multilateralism trades rapid returns and profitable imbalances for an international framework that puts order in the pigpen: risk moves within certain bounds and is spread to more agents, economic management is effectively supranational, imbalances in the system do not threaten to overwhelm and destroy it and the impact of domestic economic trouble on the international level is minimized – all of these are the antitheses to today's economic realities and potentially, the synthesis that will usher in a new stage of global economic thought and development. The end result is that confidence is restored across all actors and over-confidence and the loss of trust in the system become very manageable problems.

Implication of demographics

China is also in an unfavourable long-term position in respect to demographic trends, brought on by the one-child policy instituted in the late 1970s to curb population growth. The current demographic structure in the country will unfold trends towards greater population aging, as senior citizens assume a greater share of the population, and not enough workers are brought in to replace them; conversely, the sex-ratio imbalance favouring the male half the population will create further social tensions. In effect, the long-term prospect for China's population is that it will level off and begin to decline gradually. The implications of a declining population have current precedents, albeit on a much smaller scale: Beijing would need to look only as far as Eastern Europe to understand the sort of challenges that come with a declining population. Countries like Ukraine, Bulgaria and Russia are among the hardest hit in the world when it comes to rates of decline relative to total population (Bank, 2010). Slower economic growth, geostrategic power positions, heightened social expenditures and an overall decline of global weight would accompany this long-term development in China. Thus, the challenge for Beijing would be to gauge the correct timing for the introduction of demographic policies that would aim for either for the maintenance of a constant population or minimal increase. Population decline has exacted heavy tolls on Eastern European countries since 1989, and this kind of costs can have huge ramifications for China.

Conclusion

The question posited in this paper was what China's role in an emerging global multilateral financial system would be? The answer I offer is that it will be primarily a role, which sacrifices national freedom for the collective good in a way in which everyone in the system is better off. On the question of currency reserves, China's vast resources can help underpin a multilateral reserve currency that is not vulnerable to the economic cycles in a single country and is managed above the national level. When considering foreign direct investment, China again has the potential to have the largest investment of any country, relatively, but not enough to be the only consequential player in the system – however, its position would give it the ability to indirectly influence economic trends and investor interests; the implications are that it can indirectly affect economic growth and development more in the developing world, and to a lesser extent in the developed world – all in the context of its own maturing investor culture. Finally, trade flows in the current system produce imbalances that, left unchecked, threaten the overwhelm the entire structure; China's role in a multilateral design, conversely, would be to lead the development of the framework that will anticipate, limit and discipline states that produce system-threatening imbalances, be they positive or negative; their existence today suggests that current oversight procedures by the WTO are not adequate. As far as HST is concerned, we have seen that historically, Britain and now, the United States, have each had their moment in the sun as the trendsetters in global finance. However, today's world is more interconnected, bigger and more interdependent than any point in known history. It is too complex for a single actor to handle and no single actor has the resources, nor the political, ideological or economic capacity to govern a world as complicated as ours. China will have the strongest relative position in this century, but it will never be able to govern unilaterally. That is why, its potential for global leadership must happen through multilateralism – for the sake of both itself, and that of the world.

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