



Title page for Thesis

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ABSTRACT

As free capital mobility is an essential characteristic of the global financial order, whether emerging markets liberalize their capital account is a topic that has aroused wide discussion. Even though many scholars propose the general trend to liberalization because the international system constrains state behavior, some emphasize that emerging markets would make resistance because of their discontent toward volatile capital mobility. However, neither could fully explain two interesting phenomena: first, when the financial order's coercion culminated, some countries could independently maintain restrained liberalization. Second, after the order has confronted a legitimacy crisis, China unexpectedly accelerated the liberalization even if it has long maintained the restriction.

The primary aim of this project is to explain emerging markets' uneven capital account liberalization process before the subprime crisis and China's accelerated liberalization after the crisis. To achieve this, I take advantage of the new liberalism international relations theory to develop my novel arguments. The empirical studies involve a quantitative analysis that examines emerging markets' diverse liberalization scope within two decades, complemented by investigating the implementations of capital mobility restrictions in three typical cases, and a case study that focuses on China's unexpected behavior.

The key finding is that strong governance capacity helps emerging markets make the customized policies that are perceived as the 'right' to the national economy, leading to restrained liberalization. Secondly, trade globalization brings overlapped interests, motivating countries to further open the financial market. Especially when international financial institutions need support most, sending positive signals can obtain more rewards in return. The significance of this study is that it unveils emerging markets' capacity to defend their interests and the willingness to make a reconciliation. It also suggests that we should not overestimate the tension and conflict brought by emerging markets on the global financial order.

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CHAPTER 1: Introduction

Since the early 1990s, a regional financial order that was initially embraced by Western countries, has gradually extended to become “global.” This order has salient neoliberal characteristics that promote free capital mobility, tolerate exchange rate fluctuation, and recommend few government restrictions (Eichengreen, 2019). With the efforts of the US, international financial institutions, and neoliberal theorists, capital account liberalization, which generally means withdrawing the restrictions on cross-border capital movement, has been promoted as a global common practice. Importantly, as the essential system maker, the US has also become the largest privilege taker. Free capital mobility has dramatically enhanced the US dollar’s dominant position, helped its private institutions circulate investments, and strengthened the US government’s influence over other countries by means of asymmetric monetary interdependence (Oatley et al., 2013, Strange, 2015a).

How emerging markets deal with the global financial order is a topic of intense debate. Many scholars argue that the international system constrains state behaviors by rewarding some practices while punishing others, thereby countries often have no choice but to comply with the prevailing practices (Helleiner, 2005, Andrews, 1994). Recent decades have witnessed the proliferation of capital account liberalization worldwide, signifying countries’ commitment to neoliberal norms. In the period between 1992 and 2016, the amount of global capital transactions increased six times,

and over 90% of the capital flowing from Western to developing countries was absorbed by 20 emerging markets (Lubin, 2018). However, other scholars emphasize that because of volatile capital mobility and speculations, interplaying with the global financial market often brings risk and vulnerability to developing countries rather than wealth and prosperity (Helleiner and Pagliari, 2011, Wade, 2003). As emerging markets advance, in developing countries that have shown some characteristics of a developed country, economic growth has also been interpreted as the signal of a power shift, given that material strength and political importance are closely related (Gray and Murphy, 2013). From this perspective, this subgroup should have the potential to countervail external coercions and defend their interests by controlling the term and pace of their opening domestic financial markets, leading to tension and conflict of the status quo order.

My thesis investigates two puzzles when looking at the capital account liberalization process over recent decades, in order to contribute to the debate of how emerging markets deal with the global financial order. First, before the subprime crisis, the degree of liberalization among these countries had been fundamentally uneven. Some countries had followed the orthodox common practice of largely withdrawing the restrictions over capital mobility, whereas some had maintained a certain degree of restrictions. This variation is important; it indicates that some countries could resist international pressures when the influences of neoliberalism culminated and, instead, pursue their own policy choices. Importantly, the countries having maintained a certain

degree of restrictions were those that suffered the least impact from external financial crises. Second, China showed an unexpected behavior before and after the subprime financial crisis. Given that it has long maintained restrictions, many scholars predicted that it should have utilized the financial order's legitimacy crisis to further justify its "unorthodox" policies or push institutional reform at the international level. However, China accelerated the liberalization pace in 2013, which seemed to signify a larger commitment to a practice that it has long criticized. This is a critical case, because if the most powerful emerging market did not show any intention to challenge the financial order, it is impossible to expect other countries to take revisionist actions. Therefore, my thesis aims to answer two questions:

Horizontal comparison: Why did some emerging markets maintain restrained capital account liberalization before the subprime financial crisis? (In other words, what leads to uneven capital account liberalization among emerging markets?)

Vertical comparison: Why did China suddenly accelerate their liberalization pace after the subprime financial crisis?

Reviewing the existing work suggests that our understanding about this topic is still limited. The mainstream viewpoint derived from the structuralist and constructivist explanations mainly emphasize how the international economic system constrains state behaviors. However, while not denying international factors' overwhelming influence, this perspective only looks at the coercions wielded over emerging markets by developed countries, international financial institutions, or global investors. The mainstream viewpoint rarely sheds light on how recipient countries resist, which leads

to an overestimate of the convergence effect. In other words, the existing work is good at explaining the general trend to capital account liberalization, but finds it difficult to explain variations across countries. Some scholars make an effort to investigate country-specific inductive and policy analyses, but their explanations often lack external validity. Conventional understandings also cannot account for China's inconsistent behavior. Given that this country was able to resist international common practice when the influence of neoliberalism culminated, it would be easier to maintain restrained liberalization and launch challenges after the crisis rather than make a stronger commitment.

My thesis develops novel explanations for the two research questions. To explain emerging markets' degrees of capital account liberalization across countries and over time, I mainly focus on two independent variables: governance capacity and trade globalization. For the first question, the theory-building takes advantage of the new liberalism International Relations (Chinn and Ito) theory (Moravcsik, 1997) to investigate how key actors make policies based on their preference. Specifically, bureaucrats are the key actors who are responsible for making capital account policies. As the transitional cost approach contends (Brooks, 2004), given emerging markets' vulnerable economic conditions when dealing with external finance, emerging markets should hold a cautious manner in making capital account choices. However, only in countries with strong governance capacity, bureaucrats are more likely to keep make the optimal policy according to the country's particular conditions. The logic is that

strong governance capacity acts as an incentive system that makes collective goals and individual self-interest compatible, thereby enhancing bureaucrats' impartiality and professionalism in policy making. Next, I also admit that deepening trade globalization changes a country's economic conditions, which in turn reshapes bureaucrats' preference for what the "right" customized policy refers to. Combining these two factors, I argue that strong governance capacity is associated with restrained liberalization, while increasing trade globalization will accelerate the degree of reform.

As economic interdependence brings overlapping interests, emerging markets gradually have motivations to please the international community in exchange for rewarding feedback. Having said that, for analyzing China's unexpected movement after the crisis, I further develop an argument about the timing of sending external-oriented signals. Capital account liberalization is a clear positive signal that shows emerging markets' commitment to comply with the orthodox behaviors proposed by international financial institutions, developed economies, and neoliberal theorists. Even though it is well known that sending positive signals to please the international audiences can obtain rewarding feedbacks in return, the amount and terms of the rewards are changeable. If the global financial order also attaches importance to the collaborations of emerging markets, sending positive signals will receive more rewarding feedback in return. In the atmosphere after the subprime crisis, when the status quo financial system has suffered criticisms and has needed support the most, making commitments to comply with neoliberal practices can bring emerging markets

extraordinary benefits that are hard to obtain in normal times. Hence, when China accelerated its capital account liberalization process after the subprime crisis, the International Monetary Fund (IMF) highly appreciated its efforts and softened its criteria to label China's capital account “fully liberalized.” The IMF then included renminbi (RMB: China's sovereign currency) in its Special Drawing Rights (SDR), which significantly improved RMB’s international usage and helped China to achieve its long-term strategic goal.

Overall, I aim to make three contributions to enriching our understanding about the interplay between emerging markets and the global financial order. First, I will provide a deductively derived theory that not only deciphers the mechanism of policymaking, but also accounts for a variety of policy outcomes. In contrast to the conventional explanations that overemphasize the convergence effect brought by international-level factors, this theory will provide better explanatory power in interpreting the different degrees of capital account liberalization across countries and over time. Second, I will explain China’s inconsistent behaviors by focusing on the independent variables coherently. In contrast to the so-called Chinese exceptionalism, I argue that it is not distinct from other emerging markets, but rather they just have different degrees of governance capacity and trade globalization. Strong governance capacity enables policymakers to insulate a country from external pressures, but with deepening trade globalization, there is also a strong motivation to please international financial institutions in exchange for rewarding feedback. Third, further analyzing these

empirical findings' political implications, I engage with the ongoing debate in terms of whether emerging markets are doomed to bring tension and conflict that will destabilize the global financial order. I argue that emerging markets do not pose large challenges to the status quo order for two reasons: Strong governance capacity can help emerging markets keep restrained liberalization (the power of autonomy), but relying on a strong governance capacity alone cannot help emerging markets further promote their unorthodox behaviors worldwide (the power of influence). Even though emerging powers are discontent with some liberal components of the global financial order, they are increasingly and functionally dependent on the existing institutional frameworks with increasing economic interdependence. Therefore, they are also motivated to make reconciliation with established interests.

1.1 The population and time period

It is important to specify the research objects at the beginning of the thesis. Emerging markets are advanced developing countries that have shown some characteristics of developed countries (Pieterse, 2019). They have made outstanding economic growth through industrialization and are becoming indispensable places for absorbing international investment. Even though it is an economic term, it has profound political implications, as emergence of new economic powerhouses reflects capacity redistribution among countries. When these countries play increasingly important roles in the world economy, the shares of traditional developed countries will inevitably

shrink. Political scholars use the neighboring term “rising powers” to describe the countries that quickly narrow down the capacity gap with the established or status quo powers. Rather than merely looking at their economic importance, they further explore the underlying tensions and instability triggered by international power shifts (Gray and Murphy, 2013, Hurrell, 2006, Destradi, 2010), since economic strength and political importance are closely related, as countries can leverage material resources to wield international influence.

However, because there is no widely accepted guidance about which countries should be labeled as an emerging market, different agencies often have different interpretations. To avoid ambiguity, a criterion sampling strategy has been applied, to concentrate on the countries that have been included in the Morgan Stanley Capital International (MSCI) Emerging Market Index. The logic of criterion sampling is to review and study all cases that meet some predetermined criterion of importance (Patton, 1990). It involves selecting cases based on some pre-established criteria that are essential to the research. This strategy has two salient advantages: It helps identify and study information-rich cases, and provides a clear qualitative component to quantitative data (Cohen and Crabtree, 2006). Hence, I apply the criterion sampling strategy to define the population of research interest.

The MSCI Emerging Markets Index is used to measure equity market performance in

global emerging markets¹. It prioritizes financial markets and is widely accepted by global investors; therefore, it has been used to select the objectives of this analysis. It was created in 1988 with only 10 countries, and it was gradually extended to cover 26 emerging markets. It was initially used by American investors who wanted to purchase global stocks and exchange-traded funds, and several exchange-traded funds use this index as a benchmark for their own performance. Until now, it has been heavily used by institutional investors, stock pickers, and hedge fund managers to construct their investment portfolios. The latest MSCI index consists of 26 places, but Taiwan has been excluded because of data limitation, and Qatar, Saudi Arabia, Kuwait, and the United Arab Emirates have been excluded because of their economic structures. Due to the abundant trade surplus derived from oil exports, Middle East countries are capital-exporters rather than capital-importers, so their attitude toward external finance is fundamentally different from other emerging economies. Historically, Middle East countries deposited their abundant foreign reserves in American commercial banks, which led to the so-called “petrodollar” cycle and the booming supply of credit (Frank, 2003). Therefore, as Table 1.1 illustrates, my population covers 21 emerging markets.

Any criterion has selection bias, and the MSCI Emerging Markets Index is no exception. A well-known alternative index is the IMF’s emerging economy inclusion² covering 24 countries, 18 of which overlap with the MSCI. The differences in selection criteria

¹ For more information, please consult <https://www.msci.com/>

² For more information, please consult <http://www.imf.org/external/pubs/ft/weo/2015/02/pdf/text.pdf>

are that the IMF ranks countries based on economic conditions, such as export diversification and the extent of integration into the global production chain. In contrast, because the MSCI index guides global investors, it gives priority on liquidity and accessibility, rather than focusing on economic status alone. Accessibility refers to the restrictions on foreign ownership and the ease of entering and leaving the financial market, which is closely related to the research interest of capital mobility restrictions. Hence, even if an advanced country, like South Korea, became an OECD member in 1996, it is still included in the MSCI Emerging Market Index rather than the developed market index, because of its remaining restrictions on its capital market (Smolinski, 2013).

Table 1.1 The population of emerging markets

Emerging market countries			
Latin America	Asia	Europe	Africa
Argentina	China	Czech Republic	Egypt
Brazil	India	Greece	South Africa
Chile	Indonesia	Hungary	
Colombia	Korea	Poland	
Mexico	Malaysia	Russia	
	Pakistan	Turkey	
	Philippines		
	Thailand		

Source: cite from MSCI Emerging Market Index

How emerging markets deal with capital account liberalization is a topic of intense debate. In international macroeconomics, capital account is a part of the balance of

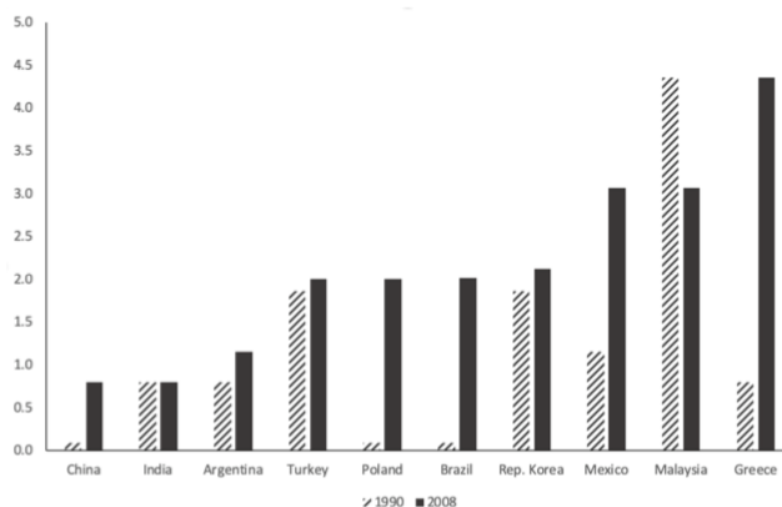
payments that records all cross-border financial transactions. In terms of capital account liberalization, developing countries generally do not oppose liberalizing the transitions that are stable and have long durations, like foreign indirect investment. The controversial component is capital account convertibility that refers to “the freedom to convert local financial assets into foreign financial assets and vice versa at market determined rates of exchange” (Schneider, 2001: 19). Even though capital account convertibility is a desirable and inevitable part of the inexorable process of globalization, it brings risks with changes of ownership in foreign and domestic financial assets and liabilities. This is the reason why many scholars claim that emerging markets should constrain short-term flows of capital when countries lack a sound financial sector (Schneider, 2001, Luo and Jiang, 2005). Hence, the rest of the thesis mainly looks at the progress on currency convertibility when discussing the term “capital account liberalization.”

Because the subprime crisis is a critical juncture to the global financial order, my thesis covers two periods orderly. The first question concentrates on the period between 1990 and 2010. These two decades are distinctive because they witnessed the unparalleled influence of the liberal global financial order. As I will further explain in Chapter 2, winning the Cold War indeed reinforced the superiority of market mechanisms and signified the dominance of neoclassical norms and policies. The US became a unipolar power with unparalleled military strength, economic scale, and ideological influence. Since the 1990s, hegemony, international financial institutions, private investors, and

scholars jointly formulated a global financial order with strong neoliberal characteristics. Neoclassic economists, especially those from the Chicago School, further promoted their arguments globally that withdrawing governmental restrictions and relocating capital worldwide is a win-win game (Harvey, 2007). Free capital mobility also became a global norm, and countries were persuaded to follow the general trend of liberalization.

In this period, emerging markets often confronted difficulty in implementing the capital account policy according to their own wishes. Given these economies' weak financial infrastructures and volatile global capital mobility, policymakers were generally conservative toward capital account convertibility (Brooks, 2004, Brooks and Kurtz, 2007). The Asian financial crisis in 1997 further exposed the vulnerability of developing countries, once the controls on capital inflow and outflow were loosened. Nevertheless, as the international system constrained states by rewarding the orthodox behaviors and punishing others, integrating into the global financial market was not based purely on emerging markets' subjective willingness. After most developed countries liberalized the restrictions on capital mobility in the late 1980s, the US and the IMF started to promote this liberalization reform worldwide. The phrase "Washington Consensus" was also used in a broader sense to refer to a more general orientation toward a strongly market-based reform package (Arestis, 2004). As an essential component of the global financial order, capital account liberalization has become a global norm, and has been adopted worldwide.

Figure 1.1 The various degrees of financial internationalization in emerging markets



Source: Chinn and Ito (2006) and made by the author

However, as Figure 1.1 illustrates, it is interesting that the degree of liberalization has been fundamentally uneven, even before the crisis. The Y-axis illustrates the situation of a country's capital account policy that ranges from 0 (fully closed) to 5 (fully liberalized). Some emerging markets have followed the orthodox guidance to largely withdraw the restrictions over capital mobility, whereas some have maintained a certain degree of restrictions. The restrictions refer to outright quantitative controls on the inflow or outflow of capital, price-based measures on financial flows and taxes, and regulations on foreign exchange derivative transactions. The countries that have restrained liberalization, such as China and India, were less negatively affected during international financial crises. In contrast, countries that had made significant progress in liberalization often confronted cyclic economic instability and deficit crises because of sudden capital mobility fluctuation. The process was even reversed in Malaysia, which had a more liberalized financial market but re-regulated capital mobility after the

1997 Asian crisis. This variation shows that, even in the period when the international pressures were overwhelming, some emerging markets could maintain a restrained liberalization to protect themselves from volatile capital mobility.

The second puzzle is a vertical comparison that when the US-led financial order confronted a legitimacy crisis after 2008, China, the most powerful emerging market that had maintained a restrained liberalization, did not take the opportunity to further justify their behavior at the international level. When the subprime financial crisis exposed the inherent weakness of the international financial system, it was widely accepted that it would lead to a revised governance structure with many resurrected or novel components (Garrett, 2010). People suddenly realized that the financial system was built according to the US's priorities rather than reciprocity. Since then, neoliberalism has lost its dominant influence in the theoretical battlefield, and the global environment has dramatically changed. Because of the long-held discontent with the liberal global financial order, many scholars claim that the components of the global financial order will confront some fundamental re-designs (Stephen, 2014, Garrett, 2010). After 2009, the US focused on domestic recovery, and even the IMF started to support capital control policies when necessary. Then, the external coercions on liberalizing the capital account decreased significantly, and emerging markets gained more autonomy in managing domestic economic affairs without being afraid of external criticism.

Table 1.2 The components of capital account policy in China in 2011

	Non-convertible	Partially convertible	Basically convertible	Fully convertible	Total
Capital and money market instruments	2	10	4	-	16
Derivatives and other instruments	2	2	-	-	4
Commercial and financial credits	-	1	5	-	6
Direct investment	-	1	1	-	2
Liquidation of direct investment	-	-	1	-	1
Real estate transactions	-	2	1	-	3
Personal capital transactions	-	6	2	-	8
Total	4	22	14	-	40

Source: made by the author

Interestingly, even though China maintained a prudent capital restriction over recent decades, it moved up a gear in capital account liberalization after the crisis. As table 1.2 illustrates, according to a report produced in 2011 by the PBC Survey and Statistics Department that evaluated the process of China's liberalization process, China's capital account had 14 convertible items, 22 partially convertible items, and four non-convertible items (People's Bank of China Statistics and Analysis Department, 2012a). However, in November 2013, the Third Plenary Session of the 18th Chinese Communist Party Central Committee (Committee, 2013) announced that it should accelerate the realization of the RMB capital account convertibility. It seems that when the global financial order confronted a legitimacy crisis, a discontented emerging

market decided to underpin, rather than undermine, the global norm of capital mobility. China is the critical case because if the most powerful emerging market did not attempt to revise the global norm and common practice, then it was even more impossible for other countries to take similar action.

Therefore, my thesis looks at the uneven capital account liberalization process across emerging markets and over time. The first question is a horizontal comparison that looks at the various liberalization processes across countries. When the global financial order's influences culminated, most countries were pressured to comply with the neoliberal orthodox practice. From this perspective, restrained liberalization is meaningful. It not only protects countries from vulnerable financial crises, but also shows emerging markets' endeavors to countervail external coercion and defend their own policy choice. In contrast, the second question is a vertical comparison that looks at the dynamics of the policy change in one critical case. The timing of the liberalization is also meaningful. Suppose it accelerated the liberalization pace before the global financial order has confronted a legitimacy crisis: this scenario fits people's general understanding that the international system constrained state behaviors in a specific direction. However, it is interesting that China sent a clear commitment to the orthodox practice when it should have an opportunity to initiate a norm reform. Hence, only by analyzing emerging markets' behaviors before and after the crisis can we have a complete understanding of how this group will impact the status quo of the financial order.

1.2 The gap in existing work

My thesis aims to answer the two questions: Why some emerging markets maintained restrained liberalization before the subprime crisis, and why China unexpectedly accelerated the liberalization process after the crisis. In terms of the first question, scholars have often emphasized the external forces wielded over developing countries, but rarely discussed how the recipient countries resisted, which has led to the overestimate of the convergence effect under the liberal global financial order.

The so-called structural explanation of international monetary relations proposes that changes in the external environment systematically constrain state behavior by rewarding some actions and punishing others (Andrews, 1994, Farrell and Newman, 2016). Primarily, dominant states can pressure others to liberalize their capital markets via trade policy or other unilateral sanctions (Norrlof et al., 2020). By controlling assessment of their critical financial markets, the US and the EU can secure foreign compliance with their preferred international regulatory outcome. This coercive power also involves national compliance with the relevant standards and codes to private-sector financial institutions and rating agencies (Drezner, 2008). International investors can leverage their “political voice” by implying their investment preference. As the “race-to-the-bottom” theory describes, developing countries compete with each other to provide a more favorable environment than others, in order to attract international investors (Drezner, 2001).

Constructivists emphasize the role of ideas to influence state behaviors. Considering the Washington Consensus's popularity in the 1990s, it has widely been believed that developing countries should adopt liberal recipes for further development (Arestis, 2004, Culpepper, 2005, Walter, 2008). Once the global norm was consolidated within narrowly constituted settings, the developed countries then promoted them globally, using market power as a critical weapon. Countries with more neoliberal economists will take more liberalization reforms, not only for practicing liberal economic ideas, but also for showing loyalty to the network of international experts (Guisinger and Brune, 2017, Chwioroth, 2007, Porter, 2005). In addition, by analyzing the mechanism of policy diffusion, scholars have also found that developing countries are more likely to liberalize their capital account when other countries have made similar actions (Simmons and Elkins, 2004). In all circumstances, states inevitably confront high costs when seeking to resist financial openness on an isolated basis.

Even though developing countries have not faced direct multilateral constraints on the discretion of capital account policy, Western-dominated international institutions have also played an important role. Since the early 1990s, the IMF has been active in pushing developing countries to make market-oriented reforms (Eichengreen and Mussa, 1998, Stiglitz, 2002, Wade, 2011). The preamble to Article IV of the IMF articles clarifies that capital movement is an essential element of the international monetary system, which requires the IMF to oversee members' behaviors. Article V, Section 3, emphasizes that

the IMF members should not use resources to support capital control policies. It was only after 2012 that the IMF (IMF, 2012) seriously recognized the risks of capital flows to macroeconomic and financial stability, and thus accepted that capital controls "can be useful." Nevertheless, it still insists that capital controls are the last resort option; member states should not treat capital account control as an orthodox practice. In the name of facilitating current account transactions, countries often confront large pressures in managing capital movement in a highly integrated global market (Stiglitz and Ocampo, 2008). However, even though these explanations clearly describe the global financial order's strong influences over state behavior, especially before the crisis, they do not explain why some countries reacted differently.

In addition, the existing work has also offered many policy analyses that are related to a sudden change of financial openness. For instance, governments suffering deficit problems want to liberalize capital mobility to absorb external resources, countries confronting inflation pressures want to limit the inflow of external finance to prevent their economies from overheating, and countries with right-wing governments tend to open their domestic markets (Alper and Onis, 2003, Higgott and Phillips, 2000, Moschella, 2015, Brooks and Kurtz, 2012, Haggard and Maxfield, 1996). However, these explanations often lack external validity, and some of them even present conflicting conclusions. For instance, financial crises accelerate the internationalization process in developing countries because they are opportunities for undertaking structural reform by empowering liberal reformists (Haggard and Maxfield, 1996). In

contrast, Gallagher (2018) argued that the painful memory of a crisis interrupts a government's further liberalization process because a crisis-affected country will be more vigilant against international investors. Even though both interpretations are valuable in their own right, their conflicting conclusions only make readers more confused about the effect of a crisis on liberalization reform.

Hence, reviewing the literature suggests that we still lack a convincing deductive theory for the first question. An explicit weakness of the explanations focusing on international-level factors is their inability to account for the cross-country variations in financial openness. Even though there has been a general trend toward capital account liberalization, the degree of openness has been fundamentally uneven across emerging markets. Assuming that the structure of the international environment has imposed uniform pressures on every nation-state, it is unclear why some have reacted differently. In other words, while not denying that the influence of the liberal global financial order is overwhelming, and emerging markets have often been forced to follow the orthodox practice, it is unclear why some countries were able to resist and restrict capital mobility. On the other hand, the weakness of existing country-level explanations is their weak generality. Even though they focus on short-term policy changes to account for the variation, it is unclear to what extent their conclusions can be generalized to explain different cases. Inductive analysis often confronts the generality problem because it receives little logical and inferential constraints in theory building (De Mesquita, 2002, Achen and Snidal, 1989). We still lack a deductive theory

that accounts for the general trend and the variations in the scope of reform in emerging markets.

For the second question, neither the general analyses on capital account liberalization nor the China study literature could offer convincing explanations. Some scholars assert “Chinese exceptionalism”: It is such a special case that it cannot be analyzed with other emerging markets by using the same theoretical framework (Ho, 2014, Zhu and Pearson, 2013). Because of its large domestic market, China has strong bargaining powers toward international financial institutions and investors, as it does not rely on them (Nölke et al., 2015). However, this viewpoint cannot convince us about why China suddenly countermanded the restrictions to please the international community. Generally, a successful capital account liberalization should rely on many conditions, including a free interest rate market, a flexible exchange rate, macroeconomic stability, and a sound supervision system (Gallagher et al., 2014). Considering China’s economic conditions at that time, even Western economists believed that it was not well-prepared for further liberalization (Lardy and Douglass, 2011). Further, based on the faction politics of China’s financial reform, provincial leaders were often proactive for large liberalization reform, whereas the central bureaucrats were generally more cautious (Shih, 2008). But in terms of the capital account liberalization, it was the Central Committee that decided to accelerate the reform pace after the crisis.

1.3 A brief theoretical overview

To explain the general trends and variations in the reform efforts, I take advantage of the new liberalism IR theory (Moravcsik, 1997) to set up three assumptions for theory building. In contrast to treating the state as a unitary actor, this paradigm assumes that the fundamental actors in international politics are individual groups, and that the state will act purposively based on their interests. To combine the domestic and international level analyses within one theoretical framework, there are three assumptions that focus on the individual, institutional, and international levels to develop a deductively derived theory. First, discovering the primary analytical agents and discussing their original policy preference toward financial openness; next, analyzing the domestic factors that condition how key actors aggregate their preference into policy outcome; and, finally, explaining how the international factors reshape their preferences, which in turn led to the adjustment of policy making.

Following these assumptions, I treat bureaucrats as the key actors in making capital account policy. The criteria to discover key actors are straightforward: They are directly related and politically influential. Hence, key actors should have motivations to support the policies that fit their interests, and their political importance shows their ability to influence policymaking. Bureaucrats are non-elected government policymakers who have professional administration skills. This group is the essential unit within any government, as they are responsible for making and enforcing policies (Grindle and

Hilderbrand, 1995, Evans and Rauch, 1999). Drawing from the transitional cost approach, I assume the bureaucrats in emerging markets generally prefer a cautious liberalization process. The rationale is that considering emerging markets' comparative weak domestic conditions and under-developed financial institutions, the concerns on the risks of instability and crisis following capital account liberalization often outweigh the passion to liberalize capital flows in a quick manner (Brooks, 2004). Considering the volatile nature of the global financial market, they must make a balance between boosting economic growth and controlling potential risks. Hence, a prudent capital account liberalization is supposed to be the "right" option to emerging markets.

To answer the first question, the focal point of analysis is, under what conditions bureaucrats can implement the policies that are perceived as "right" for the national economy. I argue that strong government capacity produces an incentive system that helps regulators maintain impartiality and professionalism. Impartiality refers to whether policymakers can keep making policies aimed at maximizing the welfare of society as a whole, rather than catering to external pressures or prioritizing the interests of individual groups. Government capacity refers to the ability of a government to make and enforce policy. The former requires a meritocracy system that can select professional bureaucrats, and the latter relies on institutional efficiency for government agencies to carry out their functions. On the one hand, strong governance capacity makes bureaucrats see pursuing collective goals as the best way to maximize their self-interest, thereby being insulated from the influences of private interests. On the other,

strong governance capacity helps bureaucrats make the optimal policies based on their professional judgement rather than simply following international common practice or textbook economic theory. Therefore, an emerging market is more likely to maintain restrained capital account liberalization if it is equipped with a strong governance capacity.

However, following the third assumption of theory building, I also admit that trade globalization accelerates the process of capital account liberalization. Trade globalization refers to cross-border transactions in exchanging goods and services, which reflect the extent to which a country integrates into the global economy. With the deepening of trade globalization, a country must have more overlapping interests with the international economic system and be more reliant on the global market. Hence, even though this factor does not undermine bureaucrats' impartiality in policymaking, changing economic conditions force bureaucrats to re-evaluate the benefits-versus-costs of further liberalization. In other words, even based on their own judgement, bureaucrats will rethink what degree of capital account liberalization is best for the national economy. Notably, this does not mean that governance capacity does not play a role in pushing the dynamics of policy change. In short, strong governance capacity helps bureaucrats observe the changes in an international economic environment and then make reactions through careful benefits-versus-costs evaluations. Considering the complexity of managing cross-border financial issues, not every developing country is equipped with the adaptability to adjust its behaviors timely.

The next is to explain why China has long maintained restrained liberalization but decided to underpin, rather than undermine, the global norm of capital account policy after the crisis. Following similar logic, I argue that deepening trade globalization leads to increasingly overlapping interests between emerging markets and the status quo order. Sending positive external-oriented signals can thus please the international community, which provides emerging markets rewarding feedback in return. In addition, I also emphasize that the timing of sending signals is critical. When developed countries and the international financial institutions need support most, showing a commitment to the global norm of capital mobility can bring emerging markets extraordinary benefits that are difficult to obtain in normal times. Hence, when China signified a stronger commitment to the global financial order by accelerating its capital account liberalization process, the IMF appreciated its efforts and finally included China's official currency into its SDR.

Finally, I argue that studies on the empirical issues can provide valuable insights into the ongoing debate about the interplay between rising powers and the liberal global financial order. Even though restrained liberalization shows emerging markets' discontent and capacity to defend their interests, we should not simply assume that these countries will trigger tension and instability. Strong governance capacity can help emerging markets keep restrained liberalization (the power of autonomy), but cannot help them further promote this behavior worldwide (the power of influence). Hence, on

the one hand, even countries that could countervail international pressures to implement unorthodox policies at home have difficulty launching norm reforms at the international level. On the other, the accelerated liberalization in China suggests that emerging markets want to make reconciliations with increasing economic interdependence and under good conditions. Because even the most powerful emerging market was able to change its attitude to support the global norm of capital mobility, we should not underestimate the possibility that the status quo order can also successfully accommodate other countries' discontent.

1.4 The methodological approach

Selecting suitable research methods to answer the proposed questions is critical. A well-designed methodological approach includes clear sample selection strategy and suitable data collection and analysis methods. First, I use criterion sampling to specify the research object, emerging markets, from the board group, and developing countries. Even though the term “emerging markets” is well known, there is no clear guidance about what countries it should cover. To avoid ambiguity, I apply the criterion sampling strategy to concentrate on the countries that have been included in the MSCI Emerging Market Index. The logic of criterion sampling is reviewing and studying all cases that meet some predetermined criterion of importance (Patton, 1990). This approach is common in quality assurance efforts for adding important qualitative components or identifying a particular population for quantitative analysis. I consult the MSCI

Emerging Market Index because these countries are essential to today's global financial market. As economic salience is a precondition for political importance, these countries are distinct from other developing countries in terms of their influence on the global financial market. Importantly, only these countries may have the capacity to countervail the global financial order. This index initially includes 26 countries, but I exclude four Central Asian countries because they are capital exporters rather than capital importers. This difference means their attitude toward capital mobility is fundamentally different (Lubin, 2018). I also exclude Taiwan because of data limitation. Therefore, the whole population is 21 emerging markets.

My thesis adopts a mixed-methods research design. Mixed methods, or method triangulation, is a research approach that has been widely used in social science. It combines quantitative and qualitative analyses in a single study in order to make full use of each method's comparative advantage. Even though a disadvantage of this approach is that it is time consuming, it can test a theory's generality and provide a wealth of detailed information. According to Creswell et al. (2008), there are six different types of mixed-methods research designs with different weights of emphasis on the methods of implementation and integration. Among them, sequential explanatory design (SED), or what Lieberman (2005) refers to as "nested analysis," was chosen because it gives priority to quantitative analysis and then uses qualitative analysis to assist in explaining the findings of the primary study. This is a confirmation approach because it generally follows the clear guidance of hypotheses for theory testing

(Ivankova et al., 2006).

SED fits my research project well. As the previous section shows, my deductively derived theory produces clear hypotheses about the causal mechanism. The dependent variable is the capital account liberalization in emerging markets, and the two independent variables are governance capacity and trade globalization. The independent variables can affect the degree of capital account liberalization, but in opposite directions. Because the theory has predicted the variations of key variables, undertaking large-N analysis at the first step is helpful to test the generality of the hypotheses. Also, a core strength of quantitative analysis is its ability to simultaneously estimate the effects of rival explanations and control variables on an outcome of interest. Because my research speaks to existing work, especially explanations focusing on international-level factors, treating them as control variables in regression models is a straightforward way to compare the credibility of different explanations. If a primary quantitative analysis supports my hypotheses, it can significantly increase our confidence to accept the theory.

In terms of the data collection in quantitative analysis, I developed a new index to operationalize the governance capacity variable. Even though there are a few widely accepted measurements for financial internationalization and trade globalization, how to precisely measure the variation of research interest is still an ongoing task. Following the guidance of Adcock and Collier (2001) for concept operationalization, I first

analyze the components of governance capacity and then use different resources to measure them. Taking advantage of the Quality of Government Expert Survey, made by the University of Gothenburg (Dahlström, 2015), I use principal component analysis to generate a latent variable about the degree of meritocratic bureaucracy to operationalize the ability of policymaking. I then use an index measuring the degree of national shadow economy provided by the IMF, as a proxy for operationalizing the degree of institutional effectiveness (Medina and Schneider, 2018). Finally, I combine these two sub-indices to formulate a coherent measurement of governance capacity. Arguably, this theoretically driven measurement can better scale the degree of government capacity across countries and over time. In addition, I also collect data for the control variables that may influence the degree of capital account liberalization according to the existing work.

The quantitative analysis method is panel data regression with fixed effects. The fixed-effects model means that groups are fixed rather than randomly assigned, and it has the advantage of being able to control time-invariant country-level omitted variables that may lead to an endogenous problem. Because the purpose of quantitative analysis is to test a theory's generality, it should maintain the degree of freedom by increasing the sample size. The time zone starts from 1990, when the IMF and Western countries began to actively promote financial internationalization worldwide, and continues to 2010, when a financial crisis had erupted in the US and the global financial order confronted a legitimacy crisis. It was only during this period that the international forces

proposed by existing work were most significant, and the restrained liberalization had the largest political implications. The results suggest that, even though emerging markets suffered large external pressures to liberalize their capital accounts during these two decades, domestic politics still played a vital role in shaping national behaviors. Briefly, deepening trade globalization is associated with increased capital account liberalization, whereas governance capacity has a significantly negative correlation with the outcome of interest. The results are still robust, even with different double checks.

Next, an intensive examination of one or more cases is an important complement that can provide details of the causal process. In my theory, governance capacity and trade globalization are institutional and international factors that affect how bureaucrats make and implement capital account policies. However, even if my research interests are statistically significant in the regression model, how the two independent variables affect the dependent variable is still a “black box” in the large-N study. Hence, a case study should be an important complement to both theory-building and statistical investigation (Achen and Snidal, 1989). SED follows a straightforward logic in integrating quantitative and qualitative analysis. As the purpose of case studies is to further explain the underlying causal process, the strategy of case selection generally obeys two rules. First, it should select cases with minimum residuals in the regression model, and, second, selected cases should be typical in terms of the degree of dependent and independent variables (Creswell et al., 2008). Notably, because SED gives priority

to theory testing, it rarely sheds light on outliers.

Following this guidance, the next phase selects Malaysia, South Korea, and China for further analysis. The rationale is that the residuals of these countries in the regression modes are close to zero, which means they are all the best-fitted cases. These are the top three countries in terms of governance capacity, according to my index, and among them, Korea has the largest extent of trade globalization, followed by Malaysia and China. They are also famous for their capital account restrictions: Malaysia controlled capital flows in 1997, South Korea re-regulated short-term financial transactions in 2009, and China maintained a slow liberalization process over recent decades. Overall, focusing on the cases that are the most similar can help us better illuminate the mechanism of how core independent variables affect capital account policy. Because of the robust results from quantitative analysis, I do not select negative cases to double check my theory's external validity.

Importantly, China not only accelerated the liberalization process, but also represents a critical case for considering whether emerging markets will challenge the global norm of capital mobility after a crisis. The logic of critical case sampling is "if it does not happen there, it will not happen anywhere." China is today's most powerful emerging market because of its large economic size and distinctive political regime. If such a country did not take the opportunity of a crisis to launch a norm reform, then we should not expect other countries to take similar actions. Critical case study is particularly

important where resources and time are limited, because it can yield the most information and have a significant impact on knowledge. Even though studying one case does not technically permit broad generalizations to all emerging markets, “logical generalization” can be made from the weight of evidence produced in a single study.

Qualitative data collection is done by analyzing official documents and consulting secondary resources, complemented by limited interviews. Unlike other open economic policies, such as trade liberalization, capital account liberalization is not a field that involves widespread public discussion. In other words, a small group of political and social elites can determine the making of capital account policy. Hence, the best way to collect qualitative data is by doing elite interviews: talking with the core individuals who have sufficient knowledge about the policymaking process. However, this method was inapplicable when studying South Korea and Malaysia cases because of the eruption of the pandemic. Even though I had a fieldwork plan in Korea, it was interrupted because of travel restrictions. Hence, I only consulted secondary resources for analyzing the two cases. Fortunately, as China has recovered quickly from the pandemic, I have spent five months at the Institute of World Economics and Politics, China's Academy of Social Science, to do fieldwork. Nevertheless, because China was preparing to organize the National People’s Congress, it was difficult to research political elites because of the then-sensitive atmosphere. Hence, I only talked with some official think tank scholars, and the main data collection method used was consulting official documents to analyze the government’s changing attitudes toward capital

account liberalization over time.

The purpose of qualitative studies is to show the extent to which governance capacity and trade globalization affects regulatory agents' considerations in making capital account policy. For each of the cases studied, I provide a chronological narrative of major changes in capital account regulations and their distinctive political economy contexts. In contrast to economic analyses that look at the effectiveness of capital account regulation, case studies investigate the politics of capital account management: how emerging markets designed, implemented, and justified their behaviors when confronting the liberal global financial order. In terms of China's unexpected practice after the crisis, the focal point was political elites' debate about the benefits of making a commitment to liberalize the capital account. Overall, the case-study analysis provides a second body of empirical evidence that contributes to the ultimate conclusions about the factors leading to the general trend and variations in the scope of financial internationalization in emerging markets.

1.5 Thesis structure

My thesis has seven chapters in total. Chapter 2 highlights the political implications of regulating capital mobility to emphasize the importance of this research project. Then, chapter 3 systematically presents my novel arguments to address the two research questions. To explain the general trend while also addressing variations in the scope of

reform, I take advantage of the new liberalism IR theory to construct a theoretical framework. I then devote the bulk of this chapter to analyzing the theoretical building blocks step by step: Who are the key actors and what are their original preferences about capital account openness? How does governance capacity help them make the policies based on their preferences? How does trade globalization reshape key actors' preferences? For explaining China's inconsistent attitude toward capital account liberalization, I further argue that the timing of sending positive signals is critical. Briefly, when international financial institutions require the most support, making a well-timed commitment can cause the receipt of more rewarding feedback in return.

In Chapters 4 and 5, I present the core empirical analyses for the first research question. Chapter 4 provides the bulk of the quantitative analysis of the central hypotheses derived from the existing work and my alternative argument, and provides the primary analysis of the generality of my theory. To operationalize governance capacity, I develop a new theory-driven index that emphasizes the role of the bureaucratic system and the institutions in extracting resources. By analyzing the cross-country time-variant data with the fixed-effects method, the empirical testing suggests that emerging markets with a strong governance capacity are associated with lower degrees of capital account liberalization, whereas trade globalization positively influences the reform process. In Chapter 5, I analyze the capital account restrictions in Malaysia, South Korea, and China, to substantiate historical details, showing that even though the liberal global financial order wields strong influences over countries' capital account policies, these

countries have discovered the risks derived from volatile capital mobility. Through carefully designed capital account policies, they have implemented unorthodox policies to protect their national economies.

In Chapter 6, I focus on a critical case, China, to undertake a detailed country-specific analysis. This chapter covers the time frame after the financial crisis to explain the most powerful emerging market's inconsistent behavior. This chapter shows that even though China has deeply integrated into the global market, it remained at a low degree of capital account liberalization for a long period. Strikingly, however, it did not attempt to challenge the global financial order after the crisis. Instead, China even further liberalized its capital account to a historically high level in 2015. I argue that with deepening trade globalization, emerging markets have more interests that overlap with the global financial order, which is a precondition to reach a reconciliation. Hence, its discontent with the coercive capital account liberalization could be accommodated by being rewarded with other benefits. When China decided to accelerate the liberalization process after the crisis, the IMF not only softened its criteria in order to label China's capital account as "almost liberalized", but also included RMB in its SDR, which helped China achieve its long-term strategic goal.

In Chapter 7, I conclude with a summary and integration of findings from the quantitative and case-study analysis presented in the thesis. I define my contribution as highlighting, theorizing, and substantiating the role of governance capacity and trade

globalization on an essential component of the liberal global financial order. In addition, I devote the bulk of this chapter to analyzing how the empirical findings can help us rethink the impacts of emerging markets on the global financial order. On the one hand, even though I highlight that restrained liberalization shows the power of autonomy, emerging markets still confront difficulties in launching challenges without the support of influential power. On the other, economic interdependence produces an opportunity to accommodate emerging markets' discontent. Therefore, I argue that emerging markets would not pose significant tension and conflicts to the status quo order.

CHAPTER 2: The political implications of regulating capital mobility

My thesis aims to answer two inter-related questions derived from the empirical issues. First, why did some emerging markets maintain restrained capital account liberalization before the subprime financial crisis? This question also seeks an explanation that accounts for both the general trend and the variations in the scope of reform. The second question sheds light on China's puzzling behavior, which helps us perceive its motivations when the global financial order needed support the most. Specifically, why did it maintain restrained liberalization before the crisis but returned to follow the orthodox practice when it should have a good opportunity to justify its behavior? Given that China is the largest emerging market with increasing political influence, it is critical to perceive its impact on the global financial market.

Before offering my novel explanations, this chapter further introduces the characteristics of the global financial order to highlight why answering the two questions is important to political scholars. I show that even though capital account liberalization in emerging markets is only an economic policy at first glance, it has profound political implications. Since the early 1990s, capital account liberalization gradually becomes a global norm and acts as a core component of the global financial order. It brings worldwide free capital mobility, enhancing the US's privilege as a hegemony builds on occupying the nub of resource mobility rather than physical

territory. The systematic constraints on state behaviors also suggest that deviating from the orthodox practice is difficult to developing countries. However, free capital mobility often makes emerging markets vulnerable, triggering those countries' discontent with this orthodox practice. Considering that emerging markets may further leverage their economic growth as political influence, whether these countries would like to “socialize” with or resist against the global norm of capital mobility is critical to the stability of the liberal global financial order. Especially after the liberal order has confronted a legitimacy crisis and the decline of the US's influence, the would-be impacts brought by rising powers have been intensively discussed among IR scholars.

2.1 The “global” financial order

Order is the sum of the norms, policies, and institutions that define, constitute, and mediate states' interactions (Bull, 2012, Ikenberry, 2004). It brings predictability and stability for international interplay and covers a range of issue areas. Among them, the global financial order refers to the worldwide framework of legal agreements, institutions, and rules that facilitate international capital mobility for the purpose of investment and trade financing (Huotari and Hanemann, 2014). The existing liberal financial order is led by the US and underpinned by international financial institutions such as the IMF, the Financial Stability Board, and the Basel Committee. Its major concerns are the settlement of capital account policy, exchange rate policy, currency internationalization, and resolving countries' balance of payment problems.

The global financial order has experienced four stages, including the gold standard, the interwar instability period, the Bretton Woods system, and the post-Bretton Woods system (Eichengreen, 2019). After the Second World War, the memory of the catastrophic Great Depression made people realize the importance of currency stability. Consequently, the IMF and the International Bank for Reconstruction and Development (the former title of the World Bank) were established and collectively referred to as the Bretton Woods institutions. They act as the lenders of last resort and aim to bolster the global financial market's stability. An essential principle of the Bretton Woods agreements was that countries would peg their currencies to the US dollar for the purpose of reducing exchange rate fluctuation. Through fixing the prices of currencies, countries could obtain flexibility in managing capital movement and effectively utilize monetary policies to serve their domestic interests (Ruggie, 2003). However, when confronting the operational difficulty illustrated by the Triffin dilemma, this “embedded liberalism” system collapsed when the US could no longer sustain the US dollar’s outflow and devaluation (Wincoff, 2014). When President Richard Nixon suspended the fixed exchange rate of the US dollar for gold in 1971, this Keynesian experiment came to an end.

Consequently, in the post-Bretton Woods system, the global financial market steps into the age of credit money: The price of a currency hinges on national credibility rather than rare metals reserves. To account for this big shift, neoclassicism, which encourages

countries to accept currency price fluctuation and withdraw restrictions on capital mobility, replaced Keynesianism to become the dominant economic thought (Harvey, 2007). Its core assumption is that the price mechanism is the driving force of marginal adjustment, and the market's "invisible hand" can optimize goods exchange to realize equilibrium. Following this logic, tolerating currency price fluctuation is more valuable than fixing exchange rates to facilitate capital exchange, and government intervention is redundant as the market can automatically correct the flaws in credit trading. Also, free capital mobility is superior to capital account restriction because only in a highly integrated global financial market can countries make full use of money to achieve prosperity. As a result, the 1980s witnessed a wave of financial liberalization in the West: the US and UK led the trend, and it quickly spread to other developed countries such as France, Germany, and Japan.

Strictly speaking, the "global" financial order was formed only after the Cold War. In the long period of the Cold War, countries were divided into three groups (Harvey, 2007, Hurrell, 2013a): one led by the US, one led by the Soviet Union, and the rest of developing countries that were generally termed the "Third World." Hence, even though the US's politicians actively proposed the liberalization programs, their influence was limited. The US could only influence its close allies but could not persuade other countries to follow their footprint. However, after the Cold War ended was the first time that the Western financial order became the global financial order. The US became the unipolar power with unparalleled military strength, economic scale,

and ideological influence. Winning the Cold War reinforced the superiority of market mechanism and signified the dominance of neoclassical norms and policies. Like the “end of history” metaphor implies (Fukuyama, 1989), the debates over which governance model is better should end as all nations should follow the wave of political democratization and economic liberalization. The phrase “Washington Consensus” has also been used widely in a broader sense to refer to a more general orientation towards a strongly market-based reform package (Arestis, 2004). In other words, since the early 1990s, the policies that a small group of countries primarily adopted were formally transferred into the new rule-based international order (Nye Jr, 2017).

2.2 Capital account liberalization: A global norm

Under the liberal global financial order, capital account liberalization was gradually upgraded as a global norm. The capital account is a primary component of the balance of payments that records the net flow of investment transactions into an economy. Capital account liberalization refers to easing restrictions on international purchases and sales of tangible and financial assets recorded in the capital account of the balance of payments (Eichengreen and Mussa, 1998). In 1961, the OECD initially adopted the Code of Liberalization of Capital Movements, which requests member states to abolish capital mobility restrictions for facilitating cross-border economic cooperation (Aizenman and Binici, 2016). In 1989, financial liberalization was legally recognized when the code was widened to cover all international capital movements, including

short-term financial transactions. In 1995, an IMF paper emphasized that it should encourage member countries to adopt full current and capital account convertibility (Fritz and Prates, 2014). Even though progress was temporally halted by the eruption of the Asian financial crisis, international financial institutions still treat capital account liberalization as an orthodox behavior. Neoliberal theorists posit that the crisis was attributed to developing countries' poor implementation and international distortion, and liberalizing state intervention is still the optimal recipe for achieving economic development (Vreeland, 2003).

Specifically, there were three forces behind the formulation of the global norm of capital mobility. First, neoliberal scholars fundamentally challenged Keynesian economics on the theoretical battlefield, holding that national currencies should be freely exchanged at the public market because free capital mobility can bring wealth and prosperity. Neoclassical economists, especially those from the Chicago School, were often at the frontline of debate (Harvey, 2007). They argued that because the price of capital is different across countries, relocating capital worldwide is a win-win game. Capital-surplus countries can discover profitable investment opportunities while capital-scarce countries can leverage the global market to achieve rapid development. This thought fundamentally challenged the "embedded liberalism" of the Bretton Woods system that proposes restricting capital mobility to protect autonomy in making monetary policy (Ruggie, 2003). Instead of prioritizing currency stability, the perspective of neoliberal theorists is that the ideal international financial arrangement

is to support abundant capital supply and a highly integrated market even at the price of exchange rate fluctuation. They believe that experiencing fluctuations is worthwhile for improving the global financial market's overall efficiency.

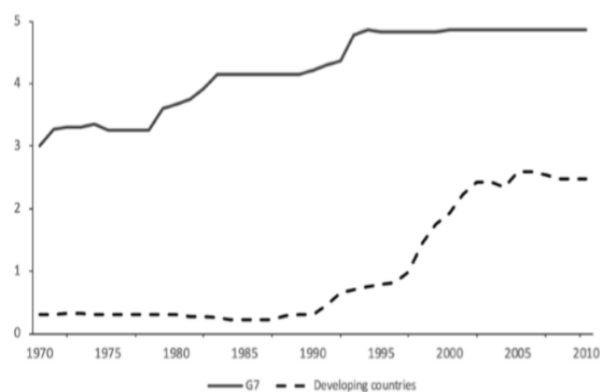
Next, the US also has had a strong motivation to act as a “norm leader” to promote the proliferation of capital account policies worldwide. Political economy scholars often emphasize the so-called Wall Street-Treasury complex (Wade and Veneroso, 1998). Due to the rise of the financial institutions in the US in the early 1990s, the private sector also became a representation of “norm entrepreneurs” devoted to accelerating free international capital movement across emerging markets (Leiteritz, 2005). The result was a unique political constellation that includes both material interests and ideological commitment toward worldwide free capital mobility. The economists and directors of investment banks also joined the advisory board of the Treasury, which brought them more political voices. They shared a belief in the superiority of market-based mechanisms and were openly hostile to the necessity of government intervention (DeLong and Eichengreen, 2001). Even though they understood that it was risky for developing countries to hastily open the financial market, this pro-liberalization alliance still insisted that encouraging countries to open only after they were well prepared wielded no pressure for developing countries and only postponed the good timing to resolve economic distortion. As a result, the US-led campaign utilized various material levers to push a normative change globally and the liberalization reform in developing countries.

Finally, international organizations also played an indispensable role. The IMF is the most relevant agency given its central position in managing international financial affairs (Chwieroth, 2008). Even though international organizations are agents of their founding states, they also have appetites for a more liberalized world. As former IMF chief economist Jacques Polak put it: “the Fund has wholeheartedly embraced capital account liberalization in its surveillance, financing, and technical-assistance activities without being hindered by a lack of mandate or from the dated provisions of Article VI” (Polak, 2018). The neoclassical economists within the Fund pushed norm advocacy, driving the Fund to become activist in promoting free capital mobility in the developing world. This enhanced the legitimacy of capital account liberalization in three ways: publishing working papers that praise the benefits of free capital mobility and criticize the inefficiency of state intervention, giving liberalization policy recommendations to individual countries, and requesting implementation of structural reform in exchange for its conditional loans (Chwieroth, 2008, Leiteritz, 2005).

Therefore, countries accelerated the process in liberalizing the regulations over cross-border capital mobility since the early 1990s, which is regarded as a process of worldwide capital account liberalization (Guisinger and Brune, 2017). As the Figure 2.1 illustrates, the last decades have witnessed a tendency of convergence between developed and developing countries. The vertical axis refers to the degree of capital account liberalization that ranges from 0 (fully closed) to 5 (fully liberalized). Salient

economic phenomena often come with profound political implications. Many scholars contend that financial internationalization signals the dominance of the liberal international order underpinned by US hegemony (Helleiner, 2010, Best, 2003, Panitch and Gindin, 2004). After most developed countries liberalized the restrictions on capital accounts during the 1980s, the US and the IMF started to actively promote this liberalization reform worldwide (Chwieroth, 2005, Mukherjee and Singer, 2010). The Washington Consensus initiated by neoliberalism theorists strongly recommending that countries minimize government intervention and reduce capital account regulations was a core component of the reform package (Harvey, 2007). It is widely accepted that financial internationalization shows emerging markets' commitment to accept neoliberalism norms and practices. As constructivists claim, behaving like others suggests "socialization" of the rules and norms of the international community, whatever the actual beliefs of that country's decision-makers (Johnston, 2008).

Figure 2.1 The convergence of capital account policy



Source: Chinn and Ito (2006) and made by the author

2.3 Privilege and discontent

However, the liberal global financial order has also triggered discontent. Even though the global financial order has been claimed to bring prosperity, the distribution of interests has been fundamentally uneven. As the primary system makers, the US also became the largest privilege taker (Mastanduno, 2009). Increased cross-border investment stimulates the demand for international currencies, which make the US dollar more widely circulated, underpinning its unique position at the top of the “international currency pyramid” (Cohen, 2018, Eichengreen, 2019). An integrated global financial market enhances the US's ability to obtain wealth by seigniorage, as when foreigners hold dollars they provide the equivalent of an interest-free loan (Strange, 2015a). In addition to these economic benefits, this financial order also enhances American power in international politics. The US dollar's dominant position represents an asymmetric interdependence in the international money relationship, enabling the US to use its financial prominence to achieve preferred foreign policy outcomes (Oatley et al., 2013, Stone, 2008). When fearing losing business from the largest financial market, other states often treat the US's regulations and monetary policies as the anchor of their own policymaking.

Hence, it is reasonable to say that the US's hegemony is unsustainable without maintaining worldwide free capital mobility. Strange (2015) points out that the US is a special hegemony that occupies the nub of resource mobility rather than occupies

physical territory. Its primacy depends on its unique military, financial, technological, and ideological powers, and each is reinforced by the other three (Walt, 2011, Strange, 2015b). Specifically, neoliberal ideology promotes a US-led global financial order that advocates minimum restrictions on cross-border capital mobility (Strange, 2015a). In a global financial order designed with strong neoliberal characteristics, the hub that provides the primary internationalization currency can easily circulate its capital worldwide and transfer the costs of adjustment to other countries (Oatley et al., 2013). By circulating money globally, US investors harvest abundant revenues, helping the state sustain the world's largest military expenditure and research investment (Kirshner, 2005). In return, American military bases worldwide enhance the US dollar's dominant position as the primary international currency (Frank, 2003, Helleiner, 2008). Therefore, considering the interlocked chain of benefits, a liberal global financial order largely enhances the US's exclusive privileges.

However, the developing world is discontent with the global norm of capital mobility. The last decades have witnessed that integrating with the global financial market often brings them risk and instability rather than wealth and prosperity. After following the orthodox practice to liberalize their capital accounts, they have experienced several boom-and-bust cycles that have had serious impacts on their development. The booms are often triggered by exogenous factors: rapid credit expansion, low interest rates in the US, and increased global risk appetites (UNCTAD, 2013). Because of the nature of pursuing larger revenues, international capital moves into developing countries for

higher interest rates but will suddenly flight out when the recipient countries expose deteriorations in macroeconomic conditions or just because the US tightens its capital supply. This indicates that in exchange for access to cheap capital, recipient countries often have difficulty protecting themselves from volatility and fluctuation. They confront inflation risks and currency appreciation in good times and fight against capital outflow in bad times (McKinnon, 1993, Stiglitz, 1993). Especially considering that developing countries have comparatively weak economic conditions and little experience in dealing with international investors, dealing with volatile global capital often makes them vulnerable.

The subprime financial crisis further exposed the inherent weakness of the global financial order, signifying its inability to cushion the vulnerability of volatile capital mobility. Even though the financial crises that erupted in developing countries have clearly indicated the risks, when a subprime crisis erupted in the center of global capitalism, it forced scholars and politicians to rethink these international arrangements. The contagion indicated that the hub's crisis will quickly become a global catastrophe in a highly integrated financial market. Because of unrestricted capital mobility, after the US implemented quantitative easing policies, the other states had to deal with hyperinflation and capital flight risks concurrently. Even a strong balance of payments position and large international reserves do not protect against adverse spillovers from financial shocks, as seen in Asia after the Lehman collapse. While not denying that the liberal global financial order can bring redundant capital supply and can contribute to

the soaring growth of the global financial market, its volatility is also costly (Helleiner and Pagliari, 2011).

These predicaments highlight why many countries are discontent with the global financial order. The win-win situation portrayed by neoliberal scholars is to a large extent an illusion: The US takes the greatest privileges while the costs go to other countries. Even though neoliberal theorists contend that the international order is built on liberal and egalitarian principles, in practice, it has also been criticized as hierarchical, imperial, and elitist (Ikenberry et al., 2018). Hence, developmental economists are often at the forefront of criticism of the unfair design of the status quo international economic order. For instance, even though the US frequently implemented capital controls during its long period of (Grindle and Hilderbrand, 1995) development, it “kicked away the ladder” when other countries wanted to use the same instrument to try to catch up (Chang, 2002); international financial institutions narrowed down the “place of development” for developing countries (Wade, 2003); and the IMF has irresponsibly used the conditional loan as an instrument to promote free capital mobility (Stiglitz, 2002). Even if they want to control the negative effects when dealing with the global financial market, they often confront large pressures as the system constrains state behaviors by rewarding some actions and punishing others. In all, these criticisms show that the discontent with the existing international order is common.

2.4 Concerning the impacts of emerging markets

Because emerging markets have been dissatisfied with an essential component of the global financial order, when they have growing capacity, this group should be able to better defend their interests. With growing economic strength and political influence, they are likely to have intentions of resisting the “socialization” of the international norms and practices proposed by neoliberalism. Especially after the subprime crisis that signifies the decline of the US and the legitimacy crisis of neoliberalism, the potential impacts brought by rising powers on the liberal international order have been intensively discussed among IR scholars. Narrowing down our attention from the whole developing world to the most advanced emerging economies shows which countries are the most important to world politics.

Conventional understanding places rising powers at a crossroads. The predominant pattern to date envisages a peaceful integration in which emerging markets are status quo powers helping to maintain the liberal institutional arrangements. However, this peaceful integration vision has also been criticized as overoptimistic. The integration scenario correctly perceives the characteristics of the liberal order, and emerging markets also have good reasons to comply with international rules, for the benefits of embracing the global market or for becoming a reputable member of international society. Nevertheless, as discussed before, there is discontent toward the global financial order as integrating into it often brings developing countries risks and

instability rather than wealth and prosperity (Lubin, 2018). Some scholars even point out that the emerging markets' discontent derives from their different philosophies about how to manage capital recourses and promote development, which is more difficult to make a compromise on with the liberal economic order (Grigoryan, 2016, Rodrik, 1998). From this perspective, with the increase of national capacity, it is unrealistic to say that emerging markets would never leverage their material powers to better pursue their interests.

In contrast, a competing viewpoint maintains that emerging markets are dissatisfied and will fundamentally challenge the rules and norms of international order. The close connections between international institutions and the power of established states has been emphasized by offensive realists (Mearsheimer, 1994), power transition theorists (Lemke and Tammen, 2003, Rapkin and Thompson, 2003) and hegemonic stability approaches (Gilpin, 1981). Briefly, the multilateral order cannot remain unchangeable if the power and influence embedded in international institutions is significantly misaligned with the real distribution of hard power. Because of the inherent opposition of rising powers to the liberal components of the international order, they attempt to export an alternative model of political and economic organization that deploys “purposive state intervention to guide market development and national corporate growth, rather than relying on self-regulated market growth” (Chin and Thakur, 2010). If emerging markets seek to create a compatible global environment for their distinctive economic model, a conflict between the incumbent powers and existing global

economic institutions will be inevitable (Rodrik, 2011).

This position has faced fierce criticism, too. On the one hand, scholars argue that with the current institutional arrangement it is hard to trigger a fundamental power shift among states, especially in the financial domain. Positive network feedback can keep “core nodes”, for instance US banks and investment firms, at the center of the network long past the point at which their internal attribute advantage has been competed away (Norrlof et al., 2020). As monetary prominence is the bedrock of US hegemonic initiatives and a key principle of the contemporary order, the system is designed with a self-perpetuating nature (Norrlof, 2010, Norrlof, 2014, McDowell, 2012, Oatley et al., 2013, Drezner, 2009). On the other hand, even if new economic powerhouses emerge, the dependence embodied in the existing rules of the institutional game tends to continue. Liberal institutionalism theorists emphasize that the open and rule-based nature of the liberal international order can alleviate conflict and foster cooperation (Ikenberry, 2004, Ikenberry, 2008, Ikenberry, 2014, Keohane, 2005). In the words of Ikenberry (2011, p. 61), “rising powers are finding incentives and opportunities to engage and integrate into this order, doing so to advance their own interests. For these states, the road to modernity runs through—not away from—the existing international order.” From this perspective, emerging markets do not have a strong motivation to launch challenges.

Recent studies aim to avoid the black-or-white responses to provide more nuanced analyses. They assume a hybrid situation that entails both conflict and adaptation. The

presumption is that even though emerging powers' statist forms of capitalist development put them at odds with the neoliberal tenets of international order, they are increasingly and functionally dependent on the existing institutional frameworks of global governance. One ongoing research topic is the rising powers' within-system challenges. Rising powers decide to continually integrate into the international order but will selectively challenge the most liberal components (Tang, 2018, de Graaff et al., 2020). Rising powers do not necessarily seek to resist the underlying principles of international order, but to pursue greater representation in the processes that define and administer international rules (Newman and Zala, 2018). For instance, they are establishing parallel orders within by supporting new institutions through which they can enjoy greater influence and status (Stephen, 2012, Stephen, 2014, Hurrell, 2013b).

Therefore, answering the two empirical puzzles can also enrich our understandings about the interplay between rising powers and the liberal international order. Clearly, these three "ideal types" are difficult to fully account for emerging markets' dynamic practice in managing capital mobility. Before the subprime crisis, the restrained capital account liberalization in some emerging markets seems to indicate discontent and unilateral resistance, which echoes with the image portrayed by realists that rising powers are doomed to bring tension and instability. Given that some countries could countervail the coercions when the influence of the liberal financial order culminated, it should have taken advantage of a legitimacy crisis to further promote its "unorthodox" practice. The established powers resisting encroachments on their traditional privileges

could even heighten tensions and provoke conflict.

However, the accelerated liberalization in China signifying that the most powerful emerging markets makes a large commitment to comply with the global norm of free capital mobility, which seems to consist with the predication of peaceful integration. After all, if the most powerful emerging market did not attempt to revise the global norm and common practice, then it was even more impossible for other countries to take similar action. Even the within-system challenge viewpoint cannot describe the sudden change, since rather than selectively challenging the most liberal components, China dramatically changed its attitude toward an international arrangement that it had long criticized. Hence, only through investigating emerging markets' dynamic practice in managing capital mobility, we can perceive the sustainability of the global financial order better.

CHAPTER 3: Theory

This chapter first answers why some countries maintained restrained liberalization and then explains why China, the most powerful emerging market that has long maintained a slow liberalization process, unexpectedly accelerated its liberalization pace after the subprime financial crisis. As chapter 2 highlights, even though capital account liberalization is just an economic policy, it represents a core component of the liberal global financial order and underpins the US's hegemony in the world. Hence, to what extent emerging markets withdraw restrictions on capital mobility is relevant to their economic stability and shows their commitment to the global norm of capital mobility.

This chapter consists of six sections. First, it lays out the framework for theory building. Taking advantage of the new liberalism IR theory, I make three assumptions that focus on the individual, institutional, and international levels, respectively. Specifically, I assume the key actors are politically important groups that can affect the procedure of policymaking. Then, even though key actors have their original policy preferences, institutions are filters that affect how actors aggregate and pursue their goals. Finally, international factors can reshape domestic politics by changing actors' political influences and preferences. These assumptions combine domestic and international dynamics to provide a coherent framework for developing my argument.

From the second to fourth sections, I follow the assumptions to construct my theoretical

framework for answering the two research questions. Taking advantage of the transitional cost approach, I treat the bureaucrats in emerging markets as the key actors and assume they should prefer a cautious move toward capital account liberalization. Then, I analyze under what conditions bureaucrats could keep impartiality and professionalism to make the policies perceived as the 'right' to the national economy. I emphasize the role of strong governance capacity because it acts as an incentive system to make collective goals and individual self-interest compatible. Therefore, strong governance capacity should be associated with restrained liberalization in emerging markets. In addition, I also shed light on the dynamics of policy change. Here I emphasize the importance of changing economic conditions, particularly trade globalization, in forcing bureaucrats to re-evaluate the benefits-versus-costs of further liberalization, leading to different policy outcomes over time. Through combining the domestic-level and structuralist analyses, I aim to show how my theories explain the variations of financial openness across countries and over time.

The fifth section summarizes how applying the theoretical framework to analyze the capital account liberalization in China. Thanks to the strong governance capacity, China has long maintained a restrained liberalization even though under strong pressures at home and abroad. However, as deepening trade globalization leads to increasingly overlapping interests between emerging markets and the status quo order, complying with orthodox practice can bring increasingly rewarding feedbacks in return. Especially when developed countries and international financial institutions need support most,

making a clear commitment to accelerating capital account liberalization – sending a positive external-oriented signal – can bring extraordinary benefits that are difficult to obtain in normal times. Hence, when China signified a commitment to the international community by accelerating its capital account liberalization process, the IMF appreciated its efforts and finally included RMB in its SDR. Finally, I clarify the potential concerns with my theory building.

3.1 The core assumptions for theory building

Setting up coherent logical constraints is critical for constructing deductively derived theory. As De Mesquita (2002) maintains, obeying the guidance of rigorous assumptions is a precondition for constructing reliable deductive theory. A widely used paradigm for analyzing economic openness is the new liberalism IR theory, which assumes that how states behave at the international level is determined by the preference of key actors at the domestic level. It focuses on the redistributive effects of economic policy on individual interests to explain what factors make countries react differently toward a uniform pressure (Moravcsik, 1997). This paradigm also has a few theoretical variants, including ideational liberalism, commercial liberalism, and republican liberalism. Even though they rest on different specifications of social demands and causal mechanisms, their essential similarity is their emphasis on domestic politics. Following the guidance, I set up three assumptions that focus on the individual, institutional, and international levels, respectively (Table 3.1).

Table 3.1 The core assumptions for theory building

Assumption	Level of analysis	Content
1	Individual	The basic analytical unit is the rational actors who can aggregate their preferences to influence policymaking.
2	Institutional	Domestic institutions condition the ways of interplay among different actors.
3	International	International factors can reshape the preferences and powers of domestic actors.

Source: made by the author

The three assumptions emphasize on different levels of analysis, which jointly constitute a coherent analytical framework. The first assumption holds that the essential analytical unit is the rational actors representing the core interests in domestic politics. This assumption includes two important pieces of information. The first is that the nation-state is a platform where different domestic groups compete to further their best interests rather than a unitary actor with coherent rationality (Migdal, 1988, Evans, 1997). Even though this is different from the structuralist approach, which treats states as similar rational actors, focusing on individual interests reflects an epistemology that is more suitable for analyzing today's foreign economic policies. This assumption also holds that the key actors are rational. Personal rationality is a fundamental element in my analysis. This means that the key actors should have a clear preference toward a particular economic policy, no matter whether their preference is formed from potential redistributive effects or past experiences. Furthermore, individuals should have a clear image of how to act accordingly to maximize their interests. The liberal theory holds Adam Smith's classical liberalism argument that individuals have the freedom to behave

according to their own will (Clift, 2014). Even though it is hasty to say that key actors have the absolute freedom to further their interest, they should be able to find effective ways to collect their voices.

The first assumption discusses the primary unit of analysis, while the second and third assumptions shed light on the mechanisms behind the reasons countries react differently toward a uniform pressure. The second assumption maintains that domestic institutions condition how interest groups collect their policy preferences to influence an outcome. Institutions play an indispensable role as the political effects of any preference change are neither simple nor even across countries (Kahler, 2013). Institutions have been shown to have a significant impact on the interplay between state and social actors, which leads to various policy outcomes. The institution is a set of formal rules or informal norms that constrain and prescribe political actors' interactions with one another. It functions as the filter, or the mediator, to alter the motivations or political powers of the state and market groups (Garrett and Lange, 1995).

There is a long tradition in analyzing the role of the institution. In comparative institutional analysis, scholars have intensively discussed how institutions play an irreplaceable role in affecting the way states engage with international economic and political cooperation, and I also assume that domestic institutions will affect the interplay between state and market forces. Certainly, it is obvious that institutions can affect policy outcomes in a few different ways. For instance, institutions can filter the

information, change the number of veto players, or institutionalize legislative participation (Drezner, 2001, Frieden and Martin, 2002, Milner, 1997). Even though these theories rest on different institutions and causal mechanisms, they reinforce the importance of institutions in analyzing open economy policies.

The last assumption sheds light on the factors that play at the international level. It assumes that external forces can reshape the preferences and powers of domestic players, which in turn leads to different policy outcomes. This assumption shows the applicability of the new liberalism IR theory in taking international-level factors into account. Even though domestic politics is important, we cannot simply assume that it is a closed system either, because in an era of globalization, no state can completely isolate itself from the global environment (Drezner, 2009). Especially in developing countries, the pressures for openness reform also come from outside (Katzenstein, 1977). Hence, my analysis does not deny the value of structural explanations. In particular, I agree that changes in the external environment systematically constrain state behavior by rewarding some actions and punishing others. However, I insist that their impact can only be substantiated by influencing the considerations of domestic key actors.

Overall, simultaneously analyzing the influences of institutional and international factors in one theoretical framework also shows its innovative effort to combine domestic and systematic level analyses to avoid the risk of theoretical reductionism.

Because my analysis assumes the primary analytical unit is domestic individuals, the states cannot be identified simply as unitary actors. In other words, understanding how systematic factors such as global norms or economic globalization affect policy outcome should be combined with the dynamics of domestic politics. In this case, it is inappropriate to assume that the state has coherent rationality and can independently evaluate the costs versus benefits of policy change. Hence, the center of analysis should always be the interplay between different domestic interest groups. The third assumption is that international factors can reshape the preferences of domestic politics, which in turn affect the policy outcome.

3.2 Preference for capital account liberalization

After clarifying the footstone of theory building, the first step is to specify the primary actors who are vital to the implementation of capital account policy. IPE scholars often treat the state as a platform where market interest groups and political actors interplay to influence the policy outcome. The way to specify the key market actor is straightforward: Look at the potential redistributive effect of an economic policy and assume the most directly affected interest group is the active actor. The logic is that this group should have the strongest motivation to influence the policy to maximize their benefits. Political actors are those who have the potential to influence policymaking, including government bureaucracy, political parties, or individual political leaders. Overall, scholars have long discussed their role in influencing economic openness, as

Katzenstein (1977, p.72) maintains,

the actors in society and state [that] influence the definition of foreign economic policy objectives consist of the major interest groups and political action groups. The former represents the relations of production (including industry, finance, commerce, labor, and agriculture); the latter derives from the structure of political authority (primarily the state bureaucracy and political parties).

Following this logic, the market forces in emerging markets that should be keen on capital account liberalization are banking and manufacturing sectors. The banking sector is closely relevant because it directly participates in capital reallocation by collecting savings and providing credit supply. They care about the degree of financial openness because accelerated capital account liberalization is doomed to impact on many aspects of the macroeconomy, including interest rate, inflation rate, and the payment of balance sheet. In addition, the manufacturing sector is not only economically and politically important, but also require capital accumulation for research and development. Particularly, emerging markets are often identified as “newly industrialized countries” by development study scholars (Weiss, 2000) as rapid industrialization has largely promoted their unparalleled development. Industries in this sector share a few similarities: relying on capital investment to produce goods and services, requiring significant investment on fixed assets, and emphasizing research and development to improve production efficiency (Gereffi and Wyman, 2014). As a deep integration with the global financial market can bring developing countries abundant cheap capital, technology, and other resources, market participants are proponents of economic openness because of these direct benefits (Grilli and Milesi-Ferretti, 1995).

However, I only treat market forces as a fixed constraint rather than an active actor. The advantage is that focusing on the representatives of the political authority alone can highlight the most important considerations in making capital account policy, but the tradeoff is that we may neglect the competition within the market forces and underestimate their influences on government behaviors. Nevertheless, this tradeoff would not affect the validity of my inference because of two reasons. First, it is reasonable to hold market forces' preferences as constant and homogenous. For banking sector, even though conventional understandings assume that they would be potential losers, recent studies find that even the traditional banking sector can find new ways to innovate business in a more liberalized financial market (Rothstein and Stolle, 2003, Rothstein, 2011). Hence, they only oppose the entry of foreign banks to set up branch banks but support capital account liberalization to bring redundant cheap credits (Pepinsky, 2013). For manufacturing sectors, as accelerated capital account liberalization can bring foreign investment and the opportunities to engage with advanced international corporations, they often have strong motivation for promoting deep integration. Second, while not denying market forces have political voices, the primary way for them to influence the policy outcome is by wielding pressure on the government. In other words, it is the representatives of the government authorities who collect different opinions, make a balance on different groups, and then make the final decision. Hence, focusing on state regulators alone not only simplifies the theory but also gives priority to how government react to the constraints of the market.

Therefore, the key actors in my analysis only refer to political action groups. There is a long tradition in analyzing to what extent domestic policymakers determine the pace of capital account liberalization in emerging markets (Alesina et al., 1993, Leblang, 1997, Leiteritz, 2010). Their principle interest is defined as the motivation to maximize their political power or to capture economic rents, thereby capital account choices reflect the government's autonomy vis-à-vis the domestic and international forces. I treat bureaucrats, or, in other words, regulatory agents, as the key actors who can influence emerging markets' degree of financial internationalization. On the one hand, bureaucrats are government policymakers who hold functional and managerial positions in a government (Peters, 2014). In modern society, this group plays essential roles in making and enforcing policies in central or local government agencies (Weber, 1947). On the other, government bureaucrats are also self-interested as rational entities and aim to increase their political authority. In contrast to politicians, bureaucrats are non-elected officials and do not directly serve any particular interest group. In order to get promotion opportunities within the system, bureaucrats need to perform professional administration skills in policymaking by maximizing society's welfare (Rothstein and Stolle, 2003, Rothstein and Teorell, 2008).

Then, figuring out bureaucrats' original preference toward capital account liberalization is critical. It is not hasty to say that their attitude determines how emerging markets deal with international finance basically. The "transitional cost" approach is a

compelling theory to explain why developing countries have systematically stayed behind developed countries in opening up their capital accounts (Brooks, 2004, Brooks and Kurtz, 2007, Brooks and Kurtz, 2012). Simply speaking, policymakers are clear and rational actors who will make cost-versus-benefits calculations. Transitional costs imply the array of economic dislocations and vulnerabilities that may follow economic reforms, which is prevalent in emerging markets. Even though the long-term benefits of liberalization are promising, cautious policymakers tend to slow down the pace of openness to cushion the impacts of short-term risks. Brooks (2004:391) provides a comprehensive explanation about policy makers' primary attitude toward capital account liberalization:

Leaders in developing nations under certain circumstances confront potentially greater short-term risks of economic disruption and systemic financial crisis: if they liberalize capital flows in the context of weak or repressed domestic financial sectors or if their governments possess inadequate resources with which to defend their currency, rescue banks, or alleviated the social costs of liberalization. Among the advanced industrial nations, by contrast, transitional crises are less likely to occur, due to better developed regulatory institutions and stronger financial sectors.

Hence, policy makers in emerging markets have sufficient reasons to control the pace of capital account liberalization. It is not to say that this group fundamentally opposes the interplay with external finance nor understands further liberalization benefits. Economic theories and the experiences of advanced economies have reminded us that taking advantage of foreign capital should allow a country to grow more quickly in the long run. However, the controversial issue is the pace of openness. Further

liberalization inevitably brings high economic and social costs, which makes the government confront risking punishment. The recent empirical analysis also supports the view that opening capital accounts will have the most harmful effects on financial stability in the initial years (Jaiswal and Kubendran, 2021). Even if with the help of increased efficiency in credit supply, the governments in developing countries are still difficult to compensate the potential losers. Hence, considering emerging markets' comparative weak domestic conditions and under-developed financial institutions, the concerns on the risks of instability and crisis following capital account liberalization are likely to outweigh the passion for liberalizing capital flows in a quick manner. In the words of Brooks (2004:398):

Not only are the transitional costs of financial liberalization more severe in developing countries, but such costs are also more likely to occur there as well, due to their weaker economic conditions and market structures...Consideration of these costs leads us to expect less developed countries that are most vulnerable to the loss of political and economic confidence following financial liberalization to be the slowest to advance toward openness, even if they have the most gain from opening.

Therefore, even though bureaucrats also support financial openness, they should be more conservative than market forces in terms of the pace of reform. After all, market forces are pure profit pursuers while the government must balance economic profits and potential risks. In the words of Rothstein (2008), market interest groups are “self-regarding” while the state or regulatory agents are “other-regarding” and have broad scopes of interest. The market largely supports liberalization of restrictions because it can borrow money at lower prices, diversify investment portfolios, and engage in

international business in more depth. In contrast, regulatory agents must have more comprehensive considerations involving stability and social justice. Even though boosting economic growth is a nice transcript for policy makers, an economic crisis can be devastating to the national economy, which will directly terminate bureaucrats' political careers.

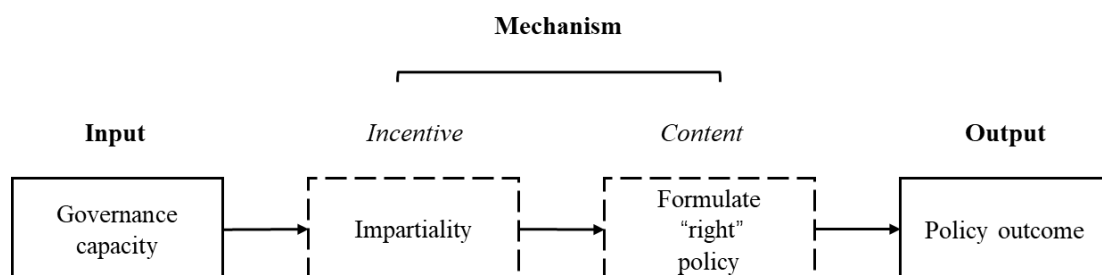
3.3 The role of governance capacity

The previous section introduces who are the key actors in making capital account choices and what their primary attitude should be. However, relying on above discussions alone leaves a striking empirical anomaly: even though emerging markets should move rather cautiously after considering their domestic conditions, the last decades have indeed witnessed the uneven liberalization process among them. It is puzzling because supposing the policymakers all keep in mind the instability as the transitional costs approach presumes, we would not see the radical liberalizations in many emerging markets, let alone the cyclical financial crises. Hence, the benevolence or professionalism of bureaucrats is only a 'best scenario' in theory. Even though we have understood what the optimum choices 'ought to be' to emerging markets, we cannot simply assume that every country could make a nice implementation without any deviation. In other words, a more nuanced analysis should shed light on under what conditions can bureaucrats make the 'right' policy in dealing with the external finance.

This section emphasizes the role of institutions to explain emerging markets' different

reactions. Following the second assumption, I argue that strong governance capacity acts as a filter that determines which countries could move more cautiously in the process to capital account liberalization. As Figure 3.1 illustrates, I take two steps to explain the mechanism of how governance capacity affects the incentive and content side of policymaking. First, strong governance capacity underpins an incentive system that makes collective goals and individual self-interest compatible, helping enhance bureaucrats' impartiality and professionalism in policy making. Second, strong governance capacity will then affect the content of policymaking. With the help of their professional knowledge, bureaucrats are more likely to formulate customized policies according to countries' specific conditions rather than simply following global common practices or textbook economic theories. Overall, without strong governance capacity, bureaucrats are difficult to make the "right" policies they perceive as the best for the national economy.

Figure 3.1 The causal chain of governance capacity on the policy outcome



Source: made by the author

Existing work on the "supply side" of government building has intensively analyzed the components of governance capacity. Even though some people claim that the term should include normative values such as liberal reform or civil liberties (Kaufmann,

2003), most scholars focus on the functions per se. Generally, governance capacity refers to a government's effectiveness in formulating and implementing policies, regardless of the political regime (Khan, 2015, Fukuyama, 2013, Gisselquist, 2012, Stockemer, 2014). Policymaking capacity depends on an efficient bureaucratic system to recruit and manage bureaucrats. Because this group represents the primary unit within any government, whether the bureaucracy system can absorb professional experts is crucial. The ideal type is the "Weberian bureaucracy" (Evans and Rauch, 1999), which has been identified as an essential factor for long-term sustainable development. On the other hand, policy implementation capacity refers to whether a government can efficiently carry out its functions by mobilizing social resources (Grindle, 2004, Grindle and Hilderbrand, 1995). It depends on the formal procedures for supervising government operations and the scale of resources that the government can utilize in total. In all, policymaking capacity relies on the micro-level meritocratic bureaucracy system, and policy implementation capacity relies on macro-level institutional effectiveness. The weakness of either part will undermine the overall performance of governance capacity.

Governance capacity is critical because it determines the incentive and content of policymaking. Drawing from the Rawlsian anti-utilitarian theory of justice, the utility of policy should always come second to treating every citizen with equal concern and respect. I concur with Rothstein (2011) in stating that in making economic policies bureaucrats should have a strong commitment to keeping impartiality. Impartiality is a

procedural norm that means making policies for the welfare of society as a whole rather than catering to the interests of small groups (Rothstein and Teorell, 2008). Political economy scholars have long argued that actual policies inevitably deviate from ideal policies because of the influences of strong interest groups (Lake, 2009). In any society, not every interest group and social class have the same degree of political influence. Economically outstanding groups find it generally easier to collect their political demands than vulnerable groups as they can participate in rent-seeking activities or undertake political patronage. Hence, sustainable development requires state regulators to remain impartial and be insulated from strong social actors' influences (Wade, 2004, Evans, 1995). It requires regulators to comprehensively consider the potential impacts on diverse perspectives and make the policies that they perceive as the best for the social welfare. In contrast, if regulators and strong social actors have engaged in a closed relationship, the policymaking may be biased even at the expense of society as a whole.

It is necessary to distinguish impartiality and independence in policymaking. In the scholarship of public administration, scholars often analyze how institutional design formally makes a specific public sector agency independent of external pressures (Yesilkagit and Christensen, 2010, Christensen and Lægreid, 2007, Verhoest et al., 2004). For instance, the central bank is often delegated to have the autonomy to make monetary policy (Bodea and Hicks, 2014). However, I emphasize that impartiality says little about independent operation but concerns the mindset of regulatory agents. As

Cupit (2000: 12) writes, “to act impartially is to be unmoved by certain sorts of considerations such as special relationships and personal preferences. It is to treat people alike irrespective of personal relationships and personal likes and dislikes”. In brief, without impartiality, even an independent government agency can make policies for the interests of small groups (Cupit, 2000, Rothstein and Teorell, 2012). This criterion is an insufficient but necessary condition for producing promising output.

I argue that strong governance capacity buttresses impartiality. The underlying logic is that in countries with strong governance capacity, regulators see pursuing collective goals as the best way to maximize their self-interest. I do not attempt to make any unrealistic assertion that strong government capacity makes regulators selfless and only aims to promote national development. Instead, as the first assumption implies, regulators are rational and still want to maximize their personal benefits. It must be difficult for them to always keep impartiality if doing this is not rewarding. However, when domestic institutions can provide support for meritocrats and fairly reward their endeavors, these conditions will strongly motivate them to serve the public. As Evans (1995) says in praise of the benefits of “Weberian bureaucracy,” meritocratic recruitment is conducive to forming a network of elite bureaucrats who have the expertise and commitment to manage public affairs. The procedure of recruitment is critical, as long-term career commitment also encourages them to further improve their agency-relevant expertise (Rauch and Evans, 2000). With the help of a supportive institutional context, bureaucrats are confident to make reliable economic policies and

expect that continuing to do so will reward them with promotion opportunities in return.

Given that the primary goal of bureaucrats is to increase their political authority, strong government capacity makes collective goals and individual self-interest compatible.

On the contrary, weak governance system will fall prey to special interests invariably.

Governance capacity represents a structural, coherent system that means any component's weakness will dilute the overall effect. For instance, loose recruitment

procedures cannot guarantee the quality of human resources, and a constrained institutional environment discourages regulators from making policies that have activist

functions. If career promotion is based on personal ties rather than working performance, bureaucrats will have little incentive to make their best endeavors. In

other words, in countries with weak governance capacity, maintaining impartiality provides few personal benefits to policymakers. Consequently, they will tend to

exchange their political authority with interest groups' material resources, which results in rent-seeking or political patronage activities to achieve personal gains (Kurer, 2005).

In the worst-case scenario, they will make policies for satisfying strong social groups' interests but at the expense of the national welfare, which leads to the misuse of political

authority (Treisman, 2000). In the case of integrating into the global financial order, even though bureaucrats may understand that maintaining some restrictions is necessary,

they may support further integration rather than taking the pressure to push for a restrained liberalization. In all, impartiality is enhanced by conferring a distinctive and

rewarding status to making policies that are perceived as the best for the national

welfare.

Next, supposing a group of bureaucrats are equipped with an impartial mindset, the following concern lies with the content of policymaking. I argue that strong governance capacity encourages bureaucrats to make the “right” policies that are customized according to country’s specific economic conditions. As the liberal global financial order defines, mediates, and legitimates state interactions in managing capital mobility, policymaking inevitably suffers external constraints. Remarkably, the US and international financial institutions promoted the Washington Consensus in the early 1990s worldwide—a policy package that includes a series of privatization and liberalization reforms (Arestis, 2004, Best, 2003). The established powers claimed that adopting the prevailing international practices would facilitate inter-state cooperation and bring wealth and prosperity (Culpepper, 2005, Panitch and Gindin, 2004). Under the liberal global financial order, liberalization policies are identified as “orthodox” (Harvey, 2007); therefore, pursuing different policies would inevitably cause a country to confront criticisms at home and abroad (Brooks and Kurtz, 2012). The overwhelming external pressures highlighted by structural and constructivist theories suggest that deviating from the international general direction is never an easy job. If policymakers aim to defend their “heterodox” choices, they need to defend why taking an alternative path can produce better results than the “best practices.”

Strong governance capacity is essential again because it enhances the effectiveness of

policy outcome. Effectiveness means the appropriateness of efforts undertaken to produce desired outcomes. First, the more professional bureaucrats are, the more likely they are able to identify mismatches between textbook orthodox practices and a country's particular circumstances. Governance capacity hinges on a micro-level bureaucracy system and a macro-level institutional context. In countries with strong governance capacity, meritocratic recruitment guarantees that bureaucrats should have an excellent educational background and have passed through strict entry examinations (Evans and Rauch, 1999). As professional experts, they are more likely to recognize that one-size-fits-all practices do not meet every country's conditions, especially in the global finance domain. Specifically, even though free capital mobility can increase capital reallocation efficiency, this policy package requires sufficient capital surplus, sound financial institutions, and a free exchange rate regime. If a country has not met these preconditions, hastily implementing the orthodox policies will bring them vulnerability rather than prosperity (Grindle, 2004). Theoretically, when professional bureaucrats find their home country is not well prepared to fully integrate into the global market, they should have the motivation to make some restrictions that are perceived as optimal for the national economy.

What is more, even though emerging markets tend to implement the policies that deviate from the orthodox practices, strong governance capacity also underpins the expectations to achieve promising outcomes. Fukuyama (2017) suggests that a government has basic and activist functions. Basic functions such as providing health

care, welfare, and education services, which do not require very complex governance skills. In contrast, the activist function means that a government intervenes in resource reallocation to accelerate its pace of economic development. This function often refers to policies that are heterodox in the eyes of neoliberalism, such as industrial policy, interest rate policy, and capital account policy. He emphasizes that not every government function requires the same degree of expertise to carry out. Basic functions such as providing education or welfare services do not involve complicated procedures, whereas formulating industrial development policies or managing capital mobility requires very specific, professional knowledge (Fukuyama, 2017). Hence, if an incapable government is over-ambitious in its activist functions, its efforts will only lead to unexpected worse consequences. However, if a strong government takes full use of activist functions to mobilize resources, it may find an effective way to realize rapid development (Thurbon, 2016). In this regard, strong governance capacity signals that a government can produce promising outcomes even if deviating from orthodox behaviors. Therefore, countries with strong governance capacity should be more confident to implement the policies that perceived as the optimum to national economy.

Overall, this section supplements the transitional costs approach by analyzing under what conditions can emerging markets make the 'right' policies. Considering the self-interest nature of policymakers and the complexity of managing capital account, it emphasizes the linkage between domestic institutions and state behaviors. Simply speaking, if bureaucrats hold the transitional costs outweigh the benefits of further

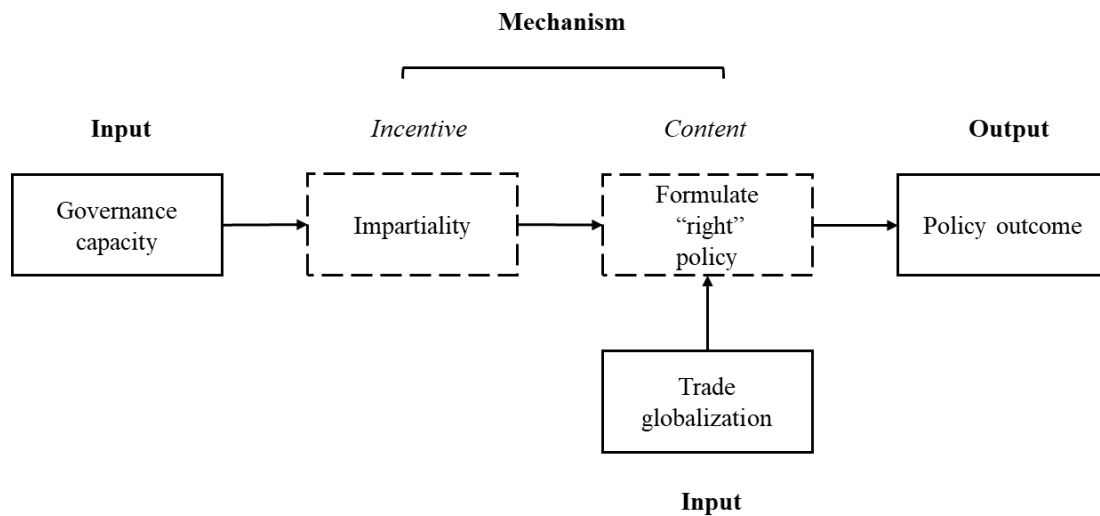
liberalization, strong governance capacity helps the country to move in a more cautious manner. Hence, when making a horizontal comparison, emerging markets with strong governance capacity tend to perform a lower degree of capital account liberalization.

3.4 The dynamics of policy change

The degree of capital account liberalization in the emerging markets is the outcome of bureaucrats' policy preference and their capacity to make the preference practicable. By taking advantage of the transitional cost approach, I maintain that emerging markets generally tend to control the pace of liberalization in hesitance of the unmanageable risk and instability triggered by volatile capital movement. The previous section further analyzes the role of a strong governance capacity in underpinning policymakers' impartiality and professionalism. It emphasizes that bureaucrats are more likely to pursue the policies perceived as the right to national economy in countries with a strong governance capacity.

Nevertheless, the theory does not treat bureaucrats' preferences as constant. When bureaucrats promote restrained liberalization, strong governance capacity enables them to regulate capacity mobility, even when confronting pressures at home and abroad. Consequently, when the macroeconomic conditions change, the optimal capital account choices must be adjusted accordingly. As such, the factors that affect bureaucrats' preferences most will need to be taken into account.

Figure 3.2 Combining the changes in the international economic environment



Source: made by the author

Following the third assumption, this section further analyzes to what extent changes in the international economic environment will affect bureaucrats' preferences of capital account liberalization. As Figure 3.2 illustrates, even though changes in the international economic environment would neither affect the regulator's commitment to remain impartial nor their professionalism in policymaking, the exogenous factors would force bureaucrats to re-evaluate the benefits-versus-costs of restricting capital mobility. In essence, capital account liberalization is a way of opening the domestic market to interplay with the global economy. In this regard, the effects of this openness must depend on global economic conditions. Assuming that further integration with the global economy can bring attractive benefits to the emerging markets that are otherwise difficult to achieve, it would accelerate the liberalization even though some restrictions have been long maintained. In contrast, by presuming that the global economy is

suffering from a crisis and instability, the emerging markets would reregulate capital mobility despite having opened their market. In other words, regulators would change their original policy preference with regard to what is the right of the national economy. This is based on their rational and independent judgment and leads to the dynamics of the capital account liberalization process in the emerging markets.

Notably, this does not mean that governance capacity does not play a role in pushing the dynamics of policy change. Although this institutional level factor cannot directly reshape bureaucrats' preferences, it can help them to re-evaluate the benefits-versus-costs of capital account liberalization. In short, enhanced impartiality means bureaucrats need to maintain strong commitments to ensure they make policies that are advantageous for the majority of citizens rather than catering to the interests of small groups. Professionalism means that once bureaucrats have observed the changes in an international economic environment, they are more likely to make timely adjustments according to the current situation, even if it means setting out experimental policy innovations. Considering the complexity of managing cross-border financial issues, not every developing country is equipped with the adaptability to adjust its behaviors timely. In other words, understanding the role of government capacity also provides a basis for comparative analysis. The emerging markets that could take advantage of the external changes are often those with a strong governance capacity.

The remainder of this section explains the dynamics of capital account policy by observing how bureaucrats re-evaluate benefits-versus-costs. When they observe that

the benefits of free capital mobility have increased and the costs of maintaining the restrictions are heavy, emerging markets would tend to accelerate the liberalization pace even though some of the restrictions have long been maintained. The most important structural change was triggered by deepening trade globalization. Trade globalization refers to the extent to which a country has integrated into the global market rather than the amount of international trade. According to the KOF Index of Globalization (Gygli et al., 2018), which is the comprehensive dataset for measuring globalization, trade globalization is operationalized by considering the proportion of exports and imports of goods and services in a nation's GDP as the scale of trade transactions. It indicates the extent to which an economy has been embedded into the ecosystem of the global network.

Trade globalization is a prerequisite to accelerating capital account liberalization. Economists found that international trade increases would affect financial regulation in substantive ways (Quinn and Inlanc, 1997, Chinn and Ito, 2006). More and more overlapping interests between domestic and international firms are caused by deepening integration; therefore, withdrawing restrictions is conducive to international business and contributes to increasing revenues. The most influential argument is that of McKinnon's order of liberalization theory: trade liberalization comes before and facilitates financial liberalization because it is relatively safe and develops the necessary knowledge and institutions to deal with the global economy (McKinnon, 1993).

In addition, trade globalization increases the cost of maintaining a restrained liberalization. Technically, with increasing international business, companies can transfer money in the name of trading goods and services; however, this increases the difficulty of restricting capital mobility. From the perspective of market participants, they are more likely to wield pressure on policymakers via posing an exiting threat signal. When market forces deeply participate in the global market, it creates an incentive to move to the most favorable business environment (Neilson et al., 2014). Even though the emerging markets are still attractive to global investors because of their cheap labor forces supply, their relatively restricted financial environments mean they are concerned about long-term development opportunities. According to the race-to-the-bottom theory, capital is doomed to move from relatively restricted markets to more flexible ones. As a result, this pits nations against each other in a bid to produce more favorable business environments (Drezner, 2001). Consequently, market entities are unable to leave their home countries immediately. However, trade globalization enables them to make an exiting threat signal, thereby forcing the government to reevaluate the cost of restricting capital mobility.

Therefore, by including the international level analysis, I argue that trade globalization would reshape the bureaucrats' original preference for capital account liberalization. Even if a strong governance capacity helps them to insulate from special social interests and retain impartiality, they must reevaluate the benefits-versus-costs of financial internationalization. This is because the regulators also regard increased tax revenues

from domestic economic activities or large amounts of foreign direct investment as achievements in their public administration efforts (Peters, 2014). If maintaining capital account regulation pushes domestic corporations to leave the country or reduces the country's attractiveness to multinational corporations then the costs of this policy should be higher than their original expectation. Consequently, the effects of trade globalization are independent of that of the governance capacity. For the benefit of the whole nation, bureaucrats would even tend to accelerate the pace of financial internationalization through rational, professional judgment.

3.5 Capital account liberalization in China

As well as constructing a theoretical framework for analyzing the emerging markets' uneven capital account liberalization process, I look in more detail at the case of China. China's capital account liberalization process deserves more attention and investigation for two reasons. First, China is a critical case due to its large market size, distinctive political regime, and state-led development strategy. If it is assumed that the country most likely to challenge the international financial order decides to comply with the prevailing rules, a theoretical generalization that it is impossible to expect other developing countries to take revisionist actions can be made. Second, there is a striking vertical comparison when looking at its degree of capital account liberalization before and after the crisis. Despite the fact that China has long maintained the restrictions on currency convertibility and capital mobility, it largely withdrew many restrictions in

2014 at the cost of exchange rate fluctuations and massive capital outflows. As such, investigating China's long restrained liberalization process, as well as the sudden acceleration process, is both empirically important and theoretically interesting.

This section summarizes how applying the theoretical framework can explain the dynamics of policy change in China. With the help of a strong governance capacity, China's bureaucrats can formulate a solid commitment to establishing the policies perceived as the right of the country. In the long period since the early 1990s, China's government gave priority to economic stability by taking into account its weak economic institutions and volatile capital mobility. Even though the benefits of integrating into the global financial market were explicit and the costs of deviating from orthodox practices were considerable, China still maintained a restrained liberalization under the guidance of its policy preference. Namely, it encouraged long-term direct foreign investments while restricting the investment in the equity market and controlling free capital convertibility.

However, this does not mean that bureaucrats' preferences are unchangeable. Deepening economic interdependence motivated them to rethink the benefits-versus-costs of regulating capital mobility that led to the adjustment of state behavior. Due to the global market flourishing, the interdependence among the economies is deep and multifaceted. Deep economic interdependence and resultant societal interactions make it difficult for rising powers to engage in power transition conflicts. After all, the

emerging markets have found excellent development opportunities by integrating into the global market and international society (Hodzi and Yu-Wen, 2018). As neoliberal theorists often claim, their road to prosperity runs through, not away from, the existing institutions (Ikenberry, 2008, Ikenberry, 2016). In China's case, it became a world manufacturer and obtained massive foreign investment by becoming a World Trade Organization member. To facilitate its flourishing global trade, there are many claims at home to further liberalize the restrictions on capital mobility.

In addition to these direct economic benefits, capital account liberalization is a positive signal to the international community. As the externally oriented lock-in theory claims, pleasing outside audiences can bring distinctive benefits to transitional economies that are otherwise difficult to obtain (Milewicz and Elsig, 2014). In short, countries can increase their reputation and receive recognition from international organizations, developed countries, and global businesses by following the prevailing international practices. In the global finance domain, positive signals are establishing market-oriented reforms that comply with the orthodox behaviors proposed by the IMF, global investors, and neoliberal scholars. For instance, withdrawing the restrictions on capital mobility and foreign investments on the domestic equity market, and a flexible exchange rate policy. In return, these policies can help the emerging markets to obtain abundant foreign investment, higher grades in rating systems, such as Standard & Poor, and increased support from international financial institutions (Lubin, 2018).

Establishing this kind of signal is more meaningful to China because of its role in promoting RMB internationalization. As analyzed in chapter 6, in contrast to China's lion's share of the global trade market, the RMB's usage was extremely limited because it was treated neither as an official reserve asset nor as an anchor for pegging local currency. Importantly, currency internationalization is never a purely economic phenomenon. An essential breakthrough would be to encourage RMB to join the SDR basket structure. As it occupies an indispensable share in the public sector's balance sheet, RMB would naturally become an international official reserve currency. The IMF monopolizes the authority to govern the SDR and reviews the basket structure every five years. This essential international financial institution has long promoted capital account liberalization in developing countries. It rejected China's application to join the SDR in 2010 because it did not regard China's capital account to be fully convertible. Therefore, if China aims to promote RMB internationalization, it should appease the IMF by signifying its commitment by agreeing to the global norm of capital mobility.

To analyze the sudden acceleration after a crisis, a novel argument relating to the sending of positive signals and its timing is put forward. The logic being that this cooperation involves two players from different sides: the signal sender and the external audience. Furthermore, the extent to which rising powers could obtain economic benefits is dependent on the willingness of established powers and international financial institutions to redistribute. The larger the potential rewards, the higher the chance of emerging markets to send positive signals by complying with the prevailing

practices. The timing is important as the external audience prefers to redistribute extra benefits when these signals are actually required. In normal circumstances, sending positive signals like 'socialization' with prevailing norms indicates loyalty to the international community, which would also revive a certain degree of reward in return (Milewicz and Elsig, 2014). Nevertheless, I further argue that when the international community or international institutions have confronted a difficult situation or a legitimacy crisis, sending positive signals displays timing assistance or cooperation. In the latter scenario, the external audience must have a strong willingness to redistribute more benefits to reward the signal sender's commitment.

This argument explains why China suddenly accelerated the liberalization process after the financial crisis. The subprime crisis exposed the inherent weakness of the global financial system that caused a catastrophe in the US, undermined the orthodoxy of neoliberalism, and questioned the legitimacy of the IMF in governing global financial affairs. The world suddenly realized that the financial system was built on U.S. primacy rather than reciprocity, thereby echoing John Connally's famous words, "the U.S. dollar is our currency but your problem." Discontented states called for a reversion of the global financial order, and even close U.S. allies proposed changing the U.S. dollar's dominant position. Moreover, people were critical of the Fund as it failed to supervise the speculation risks in the core founder. Furthermore, it could not lead the world in overcoming the crisis. Thus, after the subprime crisis when developed economies and international financial institutions actually required the emerging markets' collaboration,

sending positive signals could bring them more rewards.

Therefore, China sent a positive signal when the IMF needed collaboration the most. As the largest foreign holder of U.S. Treasury Bonds and the second-largest economy, its support, rather than challenges, became critical to the system's sustainability. In other words, sending positive external oriented signals at a time of crisis can better reflect how this would-be revisionist is a reliable partner and credible player. By making an explicit commitment to accelerating the liberalization process, China supported the IMF at a time when it deserved the emerging markets help the most. In return, the international financial institution appreciated China's determinations to underpin rather than undermine the structure of global finance. Finally, the IMF softened its criteria to label China's capital account as fully liberalized and, as a result, included RMB as a component of the SDR package. Overall, the specific analysis on China's accelerated liberalization echoes the previously constructed theoretical framework. That is, strong governance capacity helps bureaucrats ensure that policy is perceived as the right to the national economy, whereas changing global economic conditions reshapes what the right policy refers to.

3.6 Discussion and conclusion

Chapter 3 presents novel theories for answering the two research questions. The theories offer explanations for the uneven capital account liberalization process across

emerging markets (horizontal comparison) and account for China's restrained and accelerated liberalization before and after the subprime crisis (vertical comparison). The main argument is that strong governance capacity helps bureaucrats to create policies perceived as the right to a national economy. Nevertheless, changing economic conditions would force them to reevaluate the benefits-versus-costs of further liberalization, thereby leading to the dynamics of policy change. Before moving to empirical testing chapters, it is necessary to clarify the potential concerns with theory building.

First, bureaucrats are treated as the main actor while paying little attention to other political groups and market forces. Because of the possible competitions within a government and the influences of other actors, such as special interest groups, it seems risky to only focus on one group (Frieden, 1991, Quinn and Toyoda, 2007). However, this is a reliable treatment as the optimal policy choice to political authority should be more conservative than that of the market participants. After all, the market entities are pure profit pursuers, whereas regulators need to develop more careful considerations. Even when the most liberal politicians overestimate the benefits of liberalization reforms and underestimate the potential risks they still need to respond to the demands of different social classes. Therefore, when analyzing their original policy preference on capital account convertibility, political groups should be more cautious than market participants when making the evaluation. In addition, while not denying that market forces have political voices, the primary way to influence the policy outcome is by

wielding pressure on the government. In other words, it is the representatives of the government authorities who collect different opinions, weigh up different groups, and then make the final decision. Thus, the representatives of political authority are treated as unitary actors and the market forces are only treated as fixed constraint.

Second, another controversial aspect is that this theory may neglect the cross-country difference. Unlike the structuralist approach, which assumes states have similar rationality, it holds that bureaucrats' original preferences toward capital account policy are uniform across the countries. Thus, it seems unrealistic to claim that all emerging markets prefer to retain financial openness, especially considering their different political systems, development models, and external relationships. However, this treatment is reliable because all the emerging markets confronted significant pressures to liberalize their capital accounts when they were not well prepared. This was especially significant before the subprime crisis when the influence of neoliberalism culminated and the international pressures were overwhelming, as often emphasized by structuralists and constructivists. In the second chapter's discussion regarding the characteristics of the global financial order and the uneven distribution of benefits, it was noted that the emerging markets' discontent with the global norm of capital mobility was a common phenomenon. Indeed, I agree that a ruling party's identity or a country's development mode may affect the baseline of policymakers' preferences, but the strategy is to analyze their influences in theory testing rather than in theory building since a theory cannot simultaneously include too many factors.

More importantly, it should be reemphasized that emerging markets are mainly concerned with the degree or pace of liberalization rather than financial openness that is fundamentally its opposite. I agree with the conventional economic theories that taking advantage of foreign capital helps developing countries grow more quickly, especially for those suffering from depressed financial institutions and limited domestic savings. Thus, developing countries do not oppose stable capital supply, such as foreign direct investment, but concern short-term volatile capital flows that would lead to risk and instability. Regarding currency convertibility, it is emphasized that the focal point of the debate relates to the degree of openness rather than the complete closure of the financial market. Professional bureaucrats should understand the benefits of currency convertibility while worrying about the array of economic dislocations and vulnerabilities that may follow economic reforms. As the transitional cost approach claims, policymakers in developing nations under certain circumstances confront potentially greater short-term risks of economic disruption and systemic financial crisis. Consequently, considering the emerging markets' comparative weak domestic conditions, concerns regarding the risks of a crisis following capital account liberalization are likely to outweigh the passion to promptly liberalize capital flows.

In addition, even though bureaucrats should undertake restrained liberalization for the interest of the national economy, I do not make an unrealistic rosy story that the policymakers are benevolent or good in nature. Despite the fact that restrained

liberalization should be an optimal strategy for emerging markets, political economy analysis often maintains that there is a gap between the ideal policy and the implemented policy. The reasons for this are that policymakers may either engage in rent-seeking exchanges or lack the professional knowledge to handle complex situations. Therefore, as the first assumption of the theory building implies, regulators have a rational self-interest in maximizing their personal benefits. This interpretation particularly highlights the role of strong governance capacity in making feasible capital account choices. Strong governance capacity acts as an incentive system that offers policymakers impartial and timing rewards once they have created adequate policies. Until domestic institutions can provide support for meritocrats and fairly reward their endeavors, these conditions would strongly motivate them to serve the public. Under this condition, collective goals and individual self-interest can be compatible.

Emphasizing the role of a strong governance capacity does not mean that a state-led development mode is proposed either. A neighboring theory may be that the developmental state strategy in East Asian countries focused on a special historical period when the state played a leading role in setting up industrial policy and governing credit allocation (Chang, 2003). However, in my analysis, strong governance capacity implies that bureaucrats should be pragmatically oriented rather than state-oriented. This helps bureaucrats maintain impartiality and form the right policies through a professional benefits-versus-costs evaluation. Briefly, restrained liberalization is attributed to the careful evaluation that short-term costs outweigh the long-term benefits.

If the benefits outweigh the costs with changing economic conditions, especially with deepening trade globalization, strong governance capacity also enhances the adaptability to make a timely adjustment. In other words, strong governance capacity can help bureaucrats to pursue the right policy, but it cannot directly determine the content of the policymaking.

Finally, it is necessary to highlight the scope condition of the theories to increase their internal and external validity. I admit that my theories may be difficult to explain the degree of capital account liberalization in developed countries. Politically, these economies are rule makers rather than rule takers. Economically, they are capital exporters rather than capital importers (Lubin, 2018). As a result, developed countries do not need to worry about the systematic risks and volatile capital flight triggered by the fluctuations in external financial markets, and their policy preferences are fundamentally different from recipient countries. Furthermore, it may be difficult to extend the theories to explain the financial openness process in all developing countries. Because of the emerging market's relative advanced development, these economies have absorbed over 90% of the capital flowing from developed to developing countries (Cerdeiro and Komaromi, 2019). As a result, ironically, the countries most affected by these crises are also the 20 emerging economies. As other developing countries have had little experience in dealing with the global financial market they did not formulate a clear, consistent preference toward capital mobility regulation. Furthermore, economic importance and political power are closely related. When analyzing

resistance toward external coercion and the potential impact on the global financial order, only the behaviors of the would-be great powers are significant.

CHAPTER 4: The role of governance capacity and economic globalization

This chapter empirically tests the first question. As my deductive theory directly puts forward causal mechanisms by following the three assumptions of theory building, this chapter is a confirmation study to test the proposed hypotheses of how the two independent variables influence the dependent variable. Specifically, it tests whether strong governance capacity is associated with restrained capital account liberalization while deepening trade globalization accelerates the liberalization process. A sequential explanatory design has been adopted for theory testing because of its two advantages: testing the theory's generality and selecting well-fitted cases for further qualitative analyses. The logic is that if the quantitative empirical results show significant correlations between the independent variables, it can largely enhance our confidence to accept the theories. Then, it is reasonable to select typical cases to enrich the causal mechanisms' details.

This chapter is organized as follows: it first introduces the research design, emphasizing the sample population and the period covered by empirical analyses. Second, applying the principal component analysis (PCA) method, a new indicator is established to operationalize the quality of governance capacity across countries and over time. By analyzing the weaknesses of existing measurements, a strict procedure is followed to build a theory-driven index. Third, it discusses theoretically related economic and

political factors and then treats them as control variables. Quantitative analyses are good at directly comparing the explanatory powers of my theory with alternative explanations. Finally, in applying the panel data analyses, the findings suggest that governance capacity and trade globalization are two systematic factors that strongly affect policymaking in emerging markets but in opposite directions.

4.1 Research design

The theory chapter presents a deductively derived theory to explain the general trend and variations in the scope of capital account liberalization in emerging markets. Treating bureaucrats as the key regulatory agents that determine policy outcome, I argue that governance capacity and trade globalization are core institutional and international factors that jointly determine the reform scope. On the one hand, governance capacity affects the incentives behind and content of policymaking. Strong governance capacity helps state regulators keep impartiality and buttresses them the professionalism to make policies that are perceived as 'right' for the economy, like maintaining certain restrictions on capital account convertibility. On the other hand, deepening trade globalization has overlapping interests. It increases the costs of restricting capital mobility and the benefits of promoting further integration, which forces policymakers to re-evaluate the benefit-versus-cost of maintaining regulation. Hence, according to the hypotheses of my theory, an emerging market's degree of capital account liberalization is dependent on its quality of governance capacity and depth of trade

globalization.

However, depending on either quantitative or qualitative analysis alone cannot fully explain the causal mechanisms. As the qualitative study focuses on individual countries, it is difficult to verify a general theory covering all emerging markets. In this regard, a core advantage of quantitative analysis is its ability to simultaneously estimate the effects of rival explanations on an outcome of interest. For instance, competing theories, like structural or economic explanations, are treated as control variables. This method not only accounts for endogenous problems but also directly compares the validity of competing theories. If primary quantitative analysis supports the hypotheses, it can significantly increase our confidence to accept the theory. However, even if the regression results are robust, the causal chains are still a “black box” to readers. The casual mechanism suggests that governance capacity and trade globalization affect the policy outcome via the intervening variables' impartiality and “making the right policy.” Intervening variables are difficult to observe but constitute an essential component of the causal chain. Hence, even though qualitative analysis rarely sheds light on generality, they are important for providing further information to enrich our understanding of the details.

Combining the advantages of quantitative and qualitative analysis, a mixed-method research design has been adopted for theory-testing. According to Creswell et al. (2008), there are six types of mixed-method research design with different weights of emphasis

on method implementation and integration. Among them, SED, or nested analysis, prioritizes quantitative analysis and then uses qualitative analysis to explain the preliminary study's findings (Lieberman, 2005). This confirmation approach follows the clear guidance of hypotheses for theory testing (Ivankova et al., 2006). Specifically, SED directly tests the relationship between the dependent variable and independent variables, according to the hypotheses. Then, it follows a straightforward logic to integrate quantitative and qualitative analysis by investigating typical cases. As case studies are used to further explain the underlying causal process, the strategy of case-selection generally obeys two rules: it should select the cases with minimum residuals in the regression model, and the selected cases should cover the research interests in terms of the degree of the dependent and independent variables (Creswell et al., 2008). Notably, as a confirmation approach focuses on theory-testing rather than theory-building, shedding light on the outliers for theory revision is not a priority.

Hypothesis 1: Strong governance capacity is associated with a low degree of financial openness in emerging markets.

Hypothesis 2: Deepening trade globalization is associated with a high degree of financial openness in emerging markets.

To test the relationship between the dependent and independent variables, two testable hypotheses have been put forward, according to my theory. I argue that the independent variables can affect the degree of capital account liberalization in emerging markets but in opposite directions. First, strong governance capacity should associate with low financial openness, whereas in-depth trade globalization should associate with greater

financial openness. As institutional factors condition the incentive and content of policymaking, and international factors only affect regulators' policy preferences, the independent variables represent different sources of influence that can independently affect the policy outcome.

Importantly, the quantitative analyses only cover 21 emerging markets' degree of capital account liberalization during the period between 1990 and 2010. The sample population and period of study have been narrowed to increase the validity of theory-testing, although one disadvantage is the inevitable constraints on applicability and external validity. Nevertheless, there is no intention to expand my theory to explain liberalization behaviors in all developing countries. As analyzed in the previous chapters, other developing countries neither have experiences in dealing with global finance nor have the capacity to countervail external pressures. Additionally, the study concentrates on an important time in the history of modern global finance, and with the culmination of the influences of neoliberalism, directly testing my arguments' explanatory powers with explanations that focus on international-level factors is more meaningful.

4.2 Measuring governance capacity

This section introduces my novel measurement for governance capacity because adequately measuring the independent variables is a precondition for providing convincing regression results. As Adcock and Collier claim, "a measure has content

validity when no key elements are omitted from the indicator, and no inappropriate elements are included in the indicator" (2001, p. 538). According to their guidance, the criteria for good measurement of an abstract concept are precisely capturing its core elements, following a strict procedure to operationalize the elements, and showing transparency in aggregating the elements (Adcock and Collier, 2001). Simply speaking, a theory-driven measurement should grasp the content and meaning of the concept.

However, on reviewing the existing measurements, few of them can precisely measure governance capacity. One of the most relevant and common indicators of governance capacity is the World Bank Governance Indicator (WGI) that aggregates six dimensions of government quality, including the degree of corruption, transparency, independence, educational background, and so forth. The most potent criticism of the WGI is its lack of theoretical justification and measurement validity. Even the producers themselves admit that they do not follow rigorous theoretical constraints to combine the six related dimensions, and analysts are free to provide their own definitions (Kaufmann et al., 2011). Obviously, the extent to which this arbitrary manipulation relates to the governance capacity of policymaking and enforcement ability is uncertain.

Another famous indicator is tax compliance that measures the proportion of government tax collection in the whole economy because it shows a government's ability to gather financial resources to support its functions. However, the tax rate is more likely a reflection of the government's willingness, rather than their capacity, to penetrate

society (Ottervik, 2013). In other words, countries with strong governance capacity may decrease tax rates to stimulate economic growth. In contrast, countries with a weak governance capacity may set high tax rates to extract resources from society. A government with a right-wing ruling party may decide to decrease revenue from taxation, but it cannot indicate that governance capacity is becoming weak. Hence, tax collection is not an objective indicator to operationalize governance capacity across countries. Due to the weaknesses within existing measurements, it is necessary to develop a new, theory-driven indicator that precisely operationalizes the concept.

Following the Adcock and Collier (2001) framework, my indicator is constructed over three steps. The first step is to develop the systematic concept from the broad constellation of meanings and understandings associated with the government. The purpose is to put forward a working definition to specify the core components constituting my research interests. Second, by developing the sub-indicators operationalizing each ingredient, different dimensions of governance capacity are aggregated to operationalize the core elements. Specifically, “Weberian bureaucracy” will be operationalized along with the “institutional efficiency” of the functions of public sectors, which will then be combined to formulate an indicator entitled “governance capacity.” Finally, the scores produced by the operationalization are allocated to several cases to ensure that the proposed indicator has measurement validity, which is “achieved when scores (including the results of qualitative classification) meaningfully capture the ideas contained in the corresponding concept” (Adcock and

Collier, 2001, p. 530).

Focusing on the “supply-side” of government building, my argument is that the quality of governance capacity depends on institutions managing bureaucrats and the institutional context supporting the functions of public sectors. The theory chapter has intensively explained the underlying logic. Briefly, governance capacity reflects a coherent incentive system that motivates policymakers to keep impartiality and remain insulated from the influences of strong individual interest groups. It consists of recruiting junior bureaucrats, the criteria for rewarding career promotion within the bureaucracy system, and the institutional support for implementing policies. The former refers to the “Weberian bureaucracy” proposed by economic sociologists. Meritocratic recruitment is conducive to forming a network of elite bureaucrats who have the expertise to manage public affairs, and long-term career commitment encourages them to further improve their agency-relevant expertise (Evans, 1995, Evans, 1997). If these discrete functions operate smoothly, regulators see pursuing collective goals as the best way to maximize their self-interest, which is conducive to making and enforcing policies.

The latter looks at whether institutional context can provide enough support for a government to carry out its functions (Grindle and Hilderbrand, 1995). It refers to whether a government can efficiently enforce the policies it has formulated. Efficiency determines whether a government has the confidence to carry out activist functions,

such as industrial policy, capital redistribution, and other state-oriented economy policies (Fukuyama, 2017). If an incapable government is overambitious in implementing policies it cannot smoothly carry out, this practice will only lead to more distortions. Hence, government capacity depends on a micro-level bureaucracy system and macro-level institutional efficiency. The weakness of either component will undermine the overall capacity of a government.

The elements of “Weberian bureaucracy” and “institutional context” have been operationalized in two steps as both are latent variables and should rely on multivariate analysis techniques. Evans and Rauch (1999) made the first meaningful attempt to operationalize the bureaucracy system by using their data to develop an indicative measurement to operationalize the extent to which a bureaucratic system employs meritocratic recruitment and offers a rewarding long-term career. Even though they provide useful guidance, the major weakness is that their survey data only cover limited countries and does not include up-to-date revisions. Hence, the Quality of Government Expert Survey from the University of Gothenburg (Dahlberg et al., 2013) has been consulted to construct a new sub-indicator. Even though this panel data has no time variation, it is widely accepted and covers over 150 countries. Because the structure of the bureaucratic system is relatively stable, and my analysis only focuses on the time between 1990 and 2010, it is acceptable to assume that it can capture the characteristics of the bureaucratic system across countries. After all, the classic work also relies on time-invariant data to undertake a panel data analysis covering countries' behaviors

across three decades (Evans and Rauch, 1999).

Table 4.1 The selected questions from the Quality of Government Expert Survey

	Hardly ever						Almost always
	←						→
	1	2	3	4	5	6	7
1) When recruiting public sector employees, the skills and merits of the applicants decide who gets the job?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2) Public sector employees are hired via a formal examination system?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3) Senior public officials are recruited from within the ranks of the public sector?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4) Once one is recruited as a public sector employee, one stays a public sector employee for the rest of one's career?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5) The salaries of public sector employees are linked to appraisals of their performance?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6) When found guilty of misconduct, public sector employees are reprimanded by proper bureaucratic mechanisms?	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Source: cite from The Quality of Government Expert Survey

As Table 4.1 illustrates, six survey questions have been selected to operationalize the extent to which a country's bureaucratic system exhibits Weberian characteristics. These questions jointly reflect how much a bureaucratic system resembles meritocracy. Specifically, the first two questions look at recruitment standards. If junior officials are recruited via formal exams and their expertise, they are more likely to show professionalism in managing public affairs. The third and fourth questions look at bureaucrats' commitment to their work. If senior positions are often promoted from within the system, this group must have stronger intentions to cultivate their expertise

rather than selecting externally. The last two questions measure judgment criteria. If the system can objectively reward and punish bureaucrats' performance, they must be more careful in making and enforcing policies. As the Table 4.2 illustrates, the correlations of these variables are all positive, suggesting that they grasp the characteristics of a government in a similar direction.

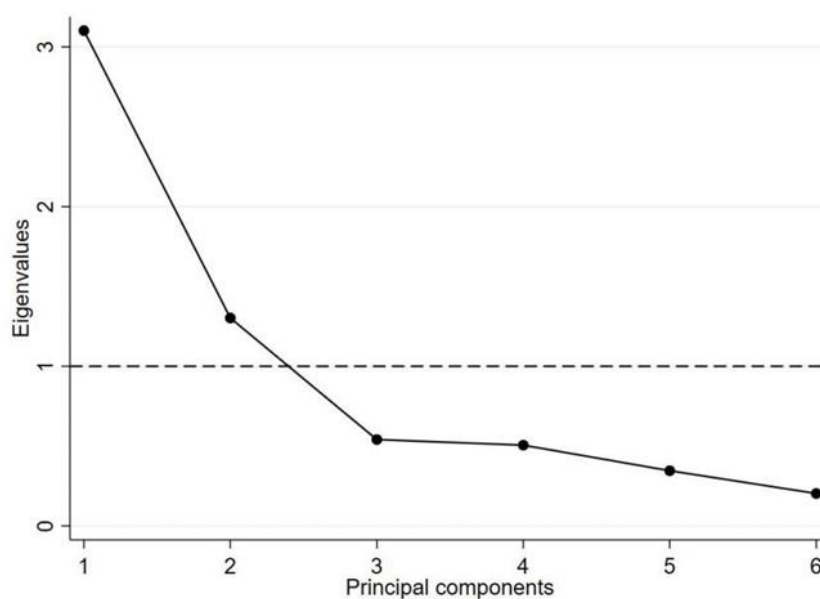
Table 4.2 The correlations of survey questions

	(1)	(2)	(3)	(4)	(5)	(6)
(1)	1					
(2)	0.3443	1				
(3)	0.6182	0.4868	1			
(4)	0.2491	0.5217	0.5987	1		
(5)	0.6059	0.1751	0.4083	0.0323	1	
(6)	0.6768	0.2639	0.4207	0.2623	0.4941	1

PCA has been applied to produce the variable “Weberian bureaucracy.” PCA is a kind of multivariate analysis that uses an orthogonal transformation to convert a set of observations of possibly correlated variables to a set of values of linearly uncorrelated variables. This is a theoretical-driven, confirmatory approach because its core assumption is that the correlations among a series of observable variables can be explained by principal components both logically and empirically. As the selected questions above observe how a government motivates and manages its bureaucrats, the higher the marked score, the better the performance of the bureaucratic system. The positive correlations among variables also fit the expectation that they are all affected by some principal latent components. Applying PCA, Figure 4.1 illustrates that only

the eigenvalue of the first two components' excess, 1, is a threshold determining whether a component can significantly explain the correlations. Hence, this enables us to further analyze the correlations of these two eigenvectors.

Figure 4.1 The eigenvalues of principal components



Source: made by the author

Table 4.3 indicates the loadings for each principal component and demonstrates that the first component positively correlates with each observable variable and accounts for over 50% of the within-group variation. This means that the increased value of this eigenvector will lead to a higher score for each survey question. Theoretically, it refers to the overall characteristics of Weberian bureaucracy. The second component has positive loadings with questions (2) to (4) and negative loadings with the remainder. According to the survey questions, it is assumed that the questions with negative loadings refer to the performance evaluation criteria, while the remainder refers to the

procedure of promotion. As PCA is under the constraint that it is orthogonal to the primary component, this eigenvector compares the two characteristics. Hence, the second indicator reflects the extent to which a government prioritizes its evaluation criteria rather than promotion procedure. The original data ranges from -3 to 3, and it has been rescaled to the range of 0 to 6.

Table 4.3 Principal component loadings

	Comp1	Comp2	Comp3	Comp4	Comp5	Comp6
(1)	0.8406	-0.3318	-0.0445	0.0165	-0.3196	0.2808
(2)	0.6245	0.5042	0.4679	0.3671	-0.0319	-0.0317
(3)	0.8336	0.2185	-0.0371	-0.3847	-0.2073	-0.2549
(4)	0.5943	0.6711	-0.2715	-0.1262	0.2743	0.1774
(5)	0.6394	-0.5673	0.3298	-0.2214	0.3335	0.0179
(6)	0.7404	-0.3434	-0.3691	0.3972	0.1151	-0.1629

It is difficult to directly observe the extent to which institutional context supports the functions of public sectors. An indirect way is to use the proxy “shadow economy,” which is defined as the aggregate of the legal economic activities that should be included in the National Income Account but because of evasive behaviors are not. As Teobaldelli and Schneider (2013, p. 9–10) claim, “market economies are connected with the evasion of taxes and social security contributions as well as the avoidance of regulations (official working time, safety regulations), and social security fraud.” Even though the tax rate reflects countries’ willingness to penetrate society, only tax compliance reflects countries’ effectiveness to enforce rules and regulations. Because

the shadow economy erodes government income and impedes public sectors from carrying out their functions, every country should make efforts to delimit it. Hence, a large black hole in the National Income Account can reflect weak institutional efficiency. Economists in the IMF have applied the structural equation model to estimate the proportion of the shadow economy in every country since 1990³, which is by far the best measurement to operationalize this latent variable (Medina and Schneider, 2018). Taking advantage of this dataset, it has been treated as a proxy to measure the quality of institutional context.

$$\textit{Government capacity} = \textit{Weberian bureaucracy} * \textit{institutional efficiency}$$

Finally, combining the two sub-indicators results in the “governance capacity” indicator. The two sub-indicators have small positive correlations (0.11), which means that even though the increase of one indicator will positively affect the other, they still, to a large extent, reflect two distinctive dimensions of governance capacity. The former conditions the quality of micro-level bureaucracy, and the latter reflects the extent to which a government can efficiently carry out its functions. Hence, the indicator “institutional context” is a proportion, which can also be interpreted as how the macro-level institutional context mediates the effect of Weberian bureaucracy. The final indicator, governance capacity, is time-variant panel data covering over 150 countries.

³ The PCA of the shadow economy is based on observable variables, including tax burden, regulatory burden, the Index of Economic Freedom, the Business Freedom index, unemployment rate, GDP per capita, official employment rate, rate of GDP, and change of local currency per capita.

Table 4.4 Rankings of different indexes

Ranking	My Index	Governance efficiency	Taxation to GDP
1	Korea	Chile	South Africa
2	Malaysia	Korea	Hungary
3	China	Malaysia	Greece
4	India	Czech Republic	Turkey
5	Indonesia	Hungary	Chile
6	Thailand	Greece	India
7	Turkey	Poland	Egypt
8	Brazil	South Africa	Poland
9	Chile	Turkey	Thailand
10	Philippines	Thailand	Korea

Following the last step of concept operationalization, 21 emerging markets are allocated scores to show whether the indicators are close to our expectations about the real world. The Table 4.4 shows emerging markets' degree of governance capacity in 2010. The top five countries with good governance capacity are South Korea, Malaysia, China, India, and Indonesia as they are more well-developed than other emerging markets. Additionally, Table 4.5 compares the different indicators related to government in 2010. As aforementioned, the government efficiency index is atheoretical, while the taxation rate only reflects a country's willingness, rather than its capacity, to mobilize resources from society. Hence, using these measurements, it is also intuitively difficult to rank countries' governance capacity in a precise manner. Overall, my indicator is more precise than other measurements in terms of indicating the deployment of government

functions as it is a theoretical-driven indicator that considers the micro-level bureaucracy system and macro-level institutional context simultaneously.

4.3 Data and control variables

To examine whether governance capacity and trade globalization have significant effects on financial openness in emerging markets, the following specification for empirical analysis was used. The dependent variable, *Capital account liberalization*_{*i,y*}, reflects the degree of financial openness for country *i* in year *y*; the independent variables are *Governance capacity*_{*i,y*} and *Trade globalization*_{*i,y*}. A rich set of control variables have also been considered in the specification. $X_{i,y}^I$ catches the influences of international interdependence, including a country's linkage with the IMF, the U.S., and international organizations. This group of control variables also reflects the external pressures on liberalizing the capital account. $X_{i,y}^P$ controls domestic political conditions, such as a government's partisanship and political regime. $X_{i,y}^E$ helps us consider domestic economic conditions that may affect the degree of financial openness, including the size of total GDP, GDP per capita, saving rate, financial deepening, and the development of the domestic stock market. Furthermore, $X_{i,y}^S$ represents the conditions of macroeconomic stability, including the inflation rate, the proportion of foreign reserves to GDP, outstanding international public debt, the balance of the current account, and whether a country was experiencing a financial crisis in a particular year.

*Capital account liberalization*_{*i,y*}

$$\begin{aligned} &= \beta_1 \textit{Governance capacity}_{i,y} + \beta_2 \textit{Trade globalization}_{i,y} + \gamma_1 X_{i,y}^I \\ &+ \gamma_2 X_{i,y}^P + \gamma_3 X_{i,y}^E + \gamma_4 X_{i,y}^S + \alpha_{i,y} + \varepsilon_{i,y} \end{aligned}$$

The dependent variable is the degree of capital account liberalization. More recent political scientists have used the Chinn-Ito (KAOPEN) index's measure of capital account openness, which is widely considered to be the best operationalization of capital controls. This index uses four binary categories from the table in the IMF's Annual Report on Exchange Arrangements and Exchange Restrictions, including the restrictions on multiple exchange rates, requirements to surrender export proceeds, and current and capital account restrictions. This index has the advantage of reflecting the intensity of capital controls. The KAOPEN index aims to operationalize the long-term effect of capital account openness; therefore, the original index applies five-year averages to show the trend of changes. In other words, the degree of capital account openness in a given year also includes data for the previous four years. However, Karcher and Steinberg (2013) criticize that KAOPEN may inaccurately measure the intensity of capital account restrictions in any single year. Therefore, they produced a revision indicator entitled CKAOPEN to offset the multi-year average influence (Karcher and Steinberg, 2013). Nevertheless, KAOPEN has been prioritized in this study to examine the long-term trend of financial openness in emerging markets, but CKAOPEN has also been used as a robustness check by using alternative measurements.

In addition to governance capacity, the other independent variable is trade globalization. According to my theory, trade globalization increases the linkages between domestic and multinational corporations and, thereby, empowers their political voice to influence the policy outcome. In this regard, the best measurement should be the extent of involvement in the global production network or global value chain. However, because the global production network is a novel phenomenon that emerged in the late 1990s, there is no adequate data to measure this dynamic over the last decade. Instead, the de facto trade globalization indicator in the KOF Globalization Index has been consulted, which refers to exchanging goods and services over a long distance. Specifically, to measure the degree of a global-oriented economy, it uses the export and import of goods and services as a share of GDP. To account for the geographical distribution of trade linkages, it takes advantage of the Herfindahl–Hirschmann trade partner concentration index to measure trade partner diversity. This index favors countries whose export and import structure is globally oriented compared to countries that primarily trade regionally. Overall, this indicator could adequately reflect the depth and breadth of the linkages between domestic companies and their international counterparts.

My empirical analysis also includes four groups of theoretically relevant control variables. The first group includes the influences of international interdependence, which reflect the different mechanisms of how international factors influence countries' pace of liberalization. These control variables are derived from structuralist and constructivist theories that hegemony, international financial institutions, and the

network of neoliberal scholars jointly pushed the worldwide convergence of capital account policy. First, as external pressure from the U.S. is often a driving force for economic liberalization in developing countries (Wade, 2011), a closed relationship with the U.S. will lead to a high degree of financial liberalization. If a country has more reliance on the U.S.'s economy, this asymmetric interdependence also increases the U.S.'s influence. In this study, the proportion of bilateral trade with the U.S. has been used as a proxy for measuring the U.S.'s influence, and the data has been downloaded from the World Bank database.

As IMF often uses conditional loans to push developing countries to liberalize the market (Stiglitz, 2002), the net amount of IMF loans operationalizes the pressure, i.e., the higher the amount of net IMF loans, the higher the degree of financial liberalization. The data is constructed according to the public information on the IMF's official website. It is undeniable that the IMF's influence goes further than conditional loans because the experts can wield pressure on member states by publishing documents and agenda-setting. However, the panel data on this influential source is hard to grasp, and the public statements, for instance, the director's attitude toward capital account liberalization, often wield uniform pressures on developing countries. The IMF's influence has only been specified by looking at the most tangible aspect. Furthermore, as scholars emphasize the role of norms and ideas, the peer pressures of international technocrats will force governments to adopt policies that are close to the ideal type of hegemonic norm (Simmons and Elkins, 2004).

Theoretically, because neoliberalism was dominant between 1990 and 2010, countries that are more active in participating in international organizations are more likely to have a high degree of financial liberalization. Therefore, the *de jure* political globalization indicator has been consulted, which refers to how a country engages in international political cooperation. This is measured using the number of multilateral treaties signed since 1945, the number of memberships of international organizations, and treaty partner diversity. Constructivists also often discuss the socialization of emerging markets, which means that those rising powers accept the norms and rules of the status quo of international order. A social globalization indicator has also been used, which measures the mobility of human capital, culture, goods, international students, internet access, and so forth. This indicator should have positive correlations with liberalization. Due to the efforts of neoliberal scholars, the expertise network, and media, liberalizing the restrictions became the orthodox, prevailing practice adopted by many countries before the legitimacy crisis. Once people have an intensive dialogue with the international community, they should also have the incentive to support the general trend, which, in turn, wields increasing pressure on the government.

The second group controls the conditions of domestic politics. The political regime includes essential institutions that could determine how regulatory agents deal with other social groups. However, the effect of democracy on financial openness is controversial. Even though many people claim that political liberalization triggers

economic liberalization, it is also possible that democratic regimes associate with the restrictions on cross-border capital mobility in developing countries. Specifically, democracy means that the majority of middle-position voters have strong political influences, and in developing countries, if the majority of people belong to the working or industrial class and financial openness further increases social inequality, they tend to support the government in restricting the inflow of external finance. As recent studies also indicate that the influences of democracy are unclear, this control variable has been included in the equation but does not have a specific expectation toward its effect.

The partisanship of the ruling government is also important. Generally, left-wing governments tend to restrict capital account liberalization, whereas right-wing governments are inclined to make market-oriented reforms (Quinn and Inclan, 1997). The rationale is that left-wing ideology prioritizes social justice and equality, so those governments tend to support welfare policies and reallocate capital movement. In contrast, right-wing governments prioritize economic growth and market efficiency as they mistrust the effectiveness of state-oriented policies. This group tends to liberalize restrictions so that the market plays a dominant role. The database of political institutions (Cruz et al., 2016) includes information that measures the partisanship of governments across countries and over time. In this study, it has been used as a category variable with four levels: 1 means no clear tendency, 2 is left-wing, 3 is central-wing, and 4 refers to right-wing.

The third group considers domestic economic conditions that may affect the degree of financial openness, and all of the data has been downloaded from the World Bank database. In addition to political considerations, economists have intensively discussed the factors that would directly influence countries' pace of market-oriented liberalization. GDP and GDP per capita are primary variables for evaluating a country's macroeconomic performance. The larger the national GDP, the higher the probability that the country has a large domestic market and strong bargaining power over international counterplayers. Hence, it is supposed to maintain a restrained liberalization according to its preference rather than catering to the appetite of international capital. In contrast, GDP per capita reflects the level of economic development; generally, more developed countries tend to have a freer financial market. Saving rate refers to the proportion of domestic saving to domestic GDP; it is assumed that this variable has a positive coefficient because when domestic residences and companies can deposit a large amount of surplus capital, they have stronger incentives to invest outside. Finally, the global financial development database was consulted to extract the variables measuring domestic credit to private sectors and the stock market's total value to national GDP. It measures the depth of financial development. Its influence is that if domestic companies can easily access financial resources in the domestic financial market, it will restrain their motivations to push the government to liberalize capital account restrictions. The latter measures the importance of direct investment in the national economy. If an economy relies more on the stock market, it should encourage cross-country exchange, leading to a considerable extent of financial

openness. These economic factors should not have significant variances over time and are supposed to wield long-term influences on a country's essential position on financial policy.

In contrast, the last set of variables captures short-term influences as they are more likely to fluctuate. As many scholars have claimed, liberalization decisions are often triggered by short-term economic fluctuation rather than long-term economic structure.

The balance of payments is a summary of all monetary transactions between a country and the rest of the world, which can signify the stability of a nation's economy. Haggard and Maxfield (1996) emphasized that if a country experiences deficit problems, it often has no choice but to liberalize the domestic market to attract capital inflow. The same logic also applies to the number of foreign reserves. If an economy has sufficient foreign reserves, it should face fewer pressures to import foreign capital. The amount of outstanding public debt refers to a government's long-term bonds, notes, and money market instruments placed on the international market. If a government relies on the international finance market, it should also encourage international investors to obtain more capital resources in the future (Steinberg, 2016). In this case, a country tends to liberalize the domestic market according to the wishes of foreign investors. Finally, in contrast to the balance deficit that refers to the potential of instability, the financial crises database has been included to account for the eruption of the economic crisis. This index records the frequency of economic crises over the last few decades. However, inductive analyses show that the effects of financial crises are still ambiguous. Some

countries use capital control policy tools to protect themselves during a crisis, whereas others undertake market-oriented structural reforms to regain the confidence of global investors.

Table 4.5 Descriptive statistics of the variables

Variable	Observation	mean	min	Std.	max	Between	Within
KAOPEN	429	-0.170	1.264	-1.910	2.360	0.000	0.942
CKAOPEN	422	-0.050	1.302	-1.823	2.426	0.850	1.002
Governance capacity	438	2.186	1.084	0.197	4.640	1.104	0.090
Governance efficiency	252	0.250	0.527	-0.727	1.338	0.520	0.139
Taxation revenue	307	0.152	0.044	0.048	0.276	0.039	0.018
Trade globalization	435	48.891	14.046	15.826	85.294	11.891	8.013
International cooperation	435	76.924	14.233	26.182	96.322	9.468	10.771
Socialization	435	51.948	15.131	14.919	79.956	13.592	7.282
IMF program	438	0.132	0.339	0.000	1.000	0.119	0.319
US dependence	435	0.146	0.164	0.001	0.797	0.164	0.029
Partisanship	438	1.183	1.080	0.000	3.000	0.634	0.886
Democracy	438	5.968	5.141	-7.000	10.000	4.815	2.041
GDP ln	437	2.509	0.423	1.469	3.785	0.417	0.121
GDP Per Capita	437	5.285	5.144	0.095	31.997	4.207	3.069
Saving rate	438	0.245	0.097	0.000	0.523	0.083	0.052
Direct credit	438	0.517	0.395	0.000	1.665	0.356	0.185
Stock market proportion	408	45.437	47.975	0.012	265.564	43.060	22.379
Inflation rate	438	0.412	2.272	-0.060	27.004	0.897	2.095
Foreign reserves	429	0.101	0.088	0.008	0.504	0.055	0.069
Current account balance	425	-0.010	0.050	-0.145	0.175	0.034	0.038
Crisis	438	0.219	0.414	0.000	1.000	0.136	0.392
International public debt	384	5.531	7.930	0.046	80.047	5.561	5.697

Table 4.5 presents the descriptive statistics of each variable. In addition to the mean, minimum, and maximum values, it is interesting to shed light on the between- and within-group variations. Because panel data are multi-dimensional structures involving measurements over time, observing these values can help people understand the data

structure. Notably, in terms of governance capacity, within-group variation is much smaller than between-group variation. This implies that the governance capacity of emerging markets is relatively stable over time, but the differences across countries are striking. This is not surprising as the quality of domestic institutions is relatively stable over time. Even looking at alternative measurements and the World Bank's governance efficiency and taxation revenues, between-group variations are larger than within-group variations. In contrast, the within-group variation of trade globalization is large, which means the few last decades witnessed a significant international integration of economic activities in most countries. This comparison has profound implications as governance capacity determines the benchmark level of financial openness, whereas in-depth trade globalization accelerates the changes over the last few decades.

4.4 Empirical analysis and robustness checks

This section presents the results of empirical analysis that includes the baseline results, results with alternative measurements, and robustness checks. To deal with the issue of possible unmeasured heterogeneity, country-fixed effects have been included in all regressions. This manipulation is necessary because the differences between emerging markets are too big to be included in the control variables alone. Time-invariant country characteristics, such as geography or culture, may be correlated with the explanatory variables, which necessitates the fixed-effect method to control unobservable cross-country variations. Specifically, given the argument that governance capacity influences the incentive of bureaucrats and the content of their policymaking in general,

many country-level factors can significantly influence how the bureaucracy system utilizes strong governance capacity. For instance, scholars of comparative policy economy have intensively discussed that state-oriented tradition, developmental mindset, industrialization history, and Confucianist thought will influence how regulatory agents think of the relationship between state and market (Steinberg, 2016, Wade, 2018, Fine, 1999). In other words, some countries' idiosyncratic factors will have effects, but we cannot precisely operationalize all of them. Hence, the country-fixed effect is necessary to control the noises of these unobservable variables.

Table 4.6 reports the baseline results of my empirical analyses. In general, OLS results shown in the regression models confirm my hypotheses that governance capacity and trade globalization significantly affect the degree of capital account liberalization but in opposite directions. Column (1) contains the benchmark results, which only includes two independent variables, and shows that governance capacity is negatively associated with capital account liberalization, whereas trade globalization significantly increases openness. Four groups of control variables are included in the models. Column (2) shows the result when including the variables capturing international interdependence. International cooperation and social globalization variables are negatively associated with the dependent variable, and the correlations of a variable IMF program and U.S. dependence are insignificant. Column (3) includes the control variables measuring domestic political institutions and demonstrates that partisanship is insignificant, whereas the degree of democracy is significantly associated with lower capital account

Table 4.6 Impact of government capacity and trade globalization on KAOPEN: OLS

	1	2	3	4	5
<i>Independent variables</i>					
Governance capacity	-2.614*** (0.492)	-2.036*** (0.580)	-2.443*** (0.595)	-3.508*** (0.623)	-2.922*** (0.639)
Trade globalization	0.098*** (0.006)	0.110*** (0.007)	0.112*** (0.007)	0.096*** (0.007)	0.095*** (0.007)
<i>International pressures</i>					
International cooperation		-0.011 (0.006)	-0.010 (0.006)	-0.007 (0.006)	-0.008 (0.007)
Social globalization		-0.009 (0.010)	-0.004 (0.010)	0.009 (0.015)	0.013 (0.016)
IMF program		-0.013 (0.107)	-0.025 (0.106)	0.003 (0.103)	0.003 (0.105)
US dependence		-0.562 (1.317)	-0.816 (1.316)	-0.281 (1.532)	0.271 (1.619)
<i>Domestic politics</i>					
Partisanship			-0.020 (0.040)	-0.027 (0.039)	-0.013 (0.043)
Democracy			-0.055** (0.018)	-0.054** (0.017)	-0.050** (0.017)
<i>Economic conditions</i>					
GDP				-2.737** (0.994)	-1.894 (1.195)
GDP per capita				0.142*** (0.016)	0.124*** (0.018)
Saving rate				2.124** (0.854)	2.805** (0.915)
Direct credit				-0.295 (0.233)	-0.233 (0.253)
Stock market proportion				0.005** (0.002)	0.002 (0.002)
<i>Instability</i>					
Inflation rate					-0.010 (0.018)
Foreign reserves					-1.224 (0.803)
Current account surplus					-3.923** (1.117)
Crisis					-0.184

					(0.094)
International debt					-0.003
					(0.006)
Country Fixed Effects	Yes	Yes	Yes	Yes	Yes
Observations	429	429	428	402	420
Adj R-squared	0.6976	0.703	0.7095	0.7508	0.6528
Robust standard errors in parentheses			***p<0.001, **p<0.01, *p<0.05		

liberalization. Like other empirical works, the results also show that democracy is negatively associated with capital account liberalization at a statistically significant level. When including the economic conditions in Column (4), GDP is negatively associated with financial openness, signifying a country's lesser dependence on the external market. GDP per capita and saving rate significantly increase financial openness, indicating a country's requirement for overseas investment. The coefficient of foreign reserves and direct credit is insignificant, whereas the larger proportion of the stock market promotes the degree of reform. Finally, when including short-term instability factors in Column (5), the GDP and stock market proportion coefficient becomes insignificant. The current account is negatively associated with capital account liberalization, echoing the conventional understanding that a worse balance sheet often leads to accelerated liberalization.

Table 4.7 displays the first robustness check for the above results by adding a time-fixed effect on all regressions. This logic is that not every year is uniform, and sometimes, countries will react differently in particular years because of sudden changes in the external environment. As 1997 witnessed the Asian financial crisis and 2008 saw the implosion of the Lehman Brothers, a famous U.S. investment bank, it is reasonable to assume that countries will be more cautious in some years than others. Additionally, as the governance capacity variable has small variations as time goes by, controlling possible endogenous problems across time can also enhance its testing validity. The results show that after adding a time-fixed effect, governance capacity still

Table 4.7 Robust check with time fixed effect

	1	2	3	4	5
<i>Independent variables</i>					
Governance capacity	-3.291***	-3.094***	-3.480***	-3.524***	-2.752***
	0.546	0.562	0.576	0.595	0.606
Trade globalization	0.123***	0.122***	0.123***	0.112***	0.115***
	0.007	0.007	0.007	0.007	0.007
<i>International pressures</i>					
International cooperation		-0.006	-0.006	0.006	0.013
		0.007	0.007	0.007	0.008
Social globalization		-0.001	0.003	0.076***	0.087***
		0.014	0.013	0.019	0.019
IMF program		-0.009	-0.023	0.049	0.033
		0.103	0.102	0.100	0.101
US dependence		2.462	2.096	1.125	3.296
		1.393	1.387	1.681	1.690
<i>Domestic politics</i>					
Partisanship			-0.008	0.003	0.029
			0.037	0.038	0.040
Democracy			-0.053**	-0.064***	-0.063***
			0.017	0.016	0.016
<i>Economic conditions</i>					
GDP				1.843***	2.466
				0.828	0.866
GDP per capita				-3.604***	-2.024***
				0.971	1.131
Saving rate				0.149*	0.116**
				0.020	0.021
Direct credit				-0.659**	-0.623
				0.245	0.257
Stock market proportion				0.004*	0.001
				0.002	0.002
<i>Instability</i>					
Inflation rate					-0.019
					0.018
Foreign reserves					-2.705**
					0.818
Current account surplus					-3.222**
					1.077
Crisis					-0.275**

					0.094
International debt					0.005
					0.006
Country Fixed Effect	Yes	Yes	Yes	Yes	Yes
Time Fixed Effect	Yes	Yes	Yes	Yes	Yes
Observations	429	429	429	402	371
Adj R-squared	0.7443	0.7443	0.7501	0.7792	0.7943
Robust standard errors in parentheses			***p<0.001, **p<0.01, *p<0.05		

negatively associates with the dependent variable, whereas trade globalization maintains its positive effects.

Interestingly, the control variables' coefficients become statistically significant after adding the time-fixed effect. Once the influences of countries' economic conditions are controlled, social globalization positively correlates with liberalization reform, suggesting the persuasiveness of constructivist theories. Direct credit has a negative correlation, suggesting that if domestic firms can access abundant capital supply at home, their motivation to borrow foreign loans decreases. The coefficients of foreign reserves become negative, suggesting that countries with large amounts of reserves are more likely to insulate from the pressures accelerating the liberalization pace. A crisis has significantly negative correlations, indicating that emerging markets tend to restrict capital mobility to save their economy when suffering a financial crisis.

A stronger robustness check has been undertaken in Table 4.8. Even though the data structure does not confront the non-stationary issue, a lagged dependent variable (LDV) was included to account for temporal dependence. The rationale is that as the road to capital account liberalization is a general trend, the degree of capital account liberalization in the previous year would affect the degree this year. Hence, the LDV was added to control the endogenous problem and the influence of autocorrelation as it affects the standard errors of the independent and control variables. The results suggest that the effect of autocorrelation is strong as the coefficient of many variables becomes

Table 4.8 Robust check with LDV

	1	2	3	4	5
<i>Independent variables</i>					
KAOPEN_lag	0.675*** (0.033)	0.672*** (0.033)	0.666*** (0.033)	0.616*** (0.037)	0.576*** (0.039)
Governance capacity	-0.895* (0.390)	-0.894* (0.402)	-0.966* (0.422)	-1.228** (0.465)	-1.033* (0.477)
Trade globalization	0.047*** (0.006)	0.048*** (0.006)	0.049*** (0.006)	0.050*** (0.006)	0.054*** (0.007)
<i>International pressures</i>					
International cooperation		-0.004 (0.005)	-0.005 (0.005)	-0.001 (0.006)	0.004 (0.006)
Socialization		0.012 (0.010)	0.012 (0.010)	0.030* (0.014)	0.039* (0.015)
IMF program		0.031 (0.072)	0.029 (0.072)	0.030 (0.075)	0.031 (0.076)
US dependence		0.346 (1.004)	0.301 (1.012)	-0.047 (1.331)	1.187 (1.368)
<i>Domestic politics</i>					
Partisanship			-0.022 (0.026)	-0.022 (0.028)	-0.013 (0.031)
Democracy			-0.011 (0.012)	-0.019 (0.012)	-0.022 (0.013)
<i>Economic conditions</i>					
GDP				-0.632 (0.754)	-0.107 (0.895)
GDP per capita				0.053** (0.016)	0.046** (0.017)
Saving rate				0.511 (0.619)	0.773 (0.670)
Direct credit				-0.326 (0.183)	-0.301 (0.205)
Stock market proportion				0.001 (0.001)	0.000 (0.001)
<i>Instability</i>					
Inflation rate					-0.021 (0.017)
Foreign reserves					-1.220 (0.627)
Current account surplus					-1.072

					(0.826)
Crisis					-0.138
					(0.071)
International debt					0.005
					(0.005)
Country Fixed Effects	Yes	Yes	Yes	Yes	Yes
Time Fixed Effect	Yes	Yes	Yes	Yes	Yes
Observations	408	408	408	386	358
Adj R-squared	0.8838	0.8833	0.8833	0.8825	0.8843
Robust standard errors in parentheses			***p<0.001, **p<0.01, *p<0.05		

insignificant once this variable is included. Even though the P-values of governance capacity decrease, it remains at a significant level, suggesting its systematic effects on capital account liberalization. Trade globalization always has strong positive correlations with the dependent variable, indicating that deepening economic interdependence accelerates the liberalization pace. When looking at the control variables, GDP per capita remains significant in the robustness checks, and social globalization also has strong positive correlations once the influences of economic conditions are controlled. After testing with different regressions, it is reliable to say that my hypotheses highlight two variables that systematically influence the degree of financial openness across countries and over time.

Finally, to further check the results' robustness and the validity of my theory-driven index, different measurements were used to replicate the regressions in Table 4.9. The first two columns replace the dependent variable with CKAOPEN. In contrast to KAOPEN, CKAOPEN excludes the multi-year average effect and prioritizes short-term changes; it is claimed that this measurement is better in terms of precisely capturing the variations over time. Nevertheless, because it includes a short period, this index has not been widely used by scholars, but it has been used in this study as a further robustness check, and columns (1) and (2) show that governance capacity and trade globalization significantly affect our research interest. In columns (3) and (4), the governance capacity index has been replaced with the World Bank's governance efficiency index. Unlike my index that focuses on government functions, this index

Table 4.9 Robust check with alternative measurements

Dependent variables	CKAOPEN	CKAOPEN	KAOPEN	KAOPEN	KAOPEN	KAOPEN
	1	2	3	4	5	6
<i>Independent variables</i>						
Governance capacity	-3.444*** (0.622)	-2.655*** (0.725)				
Governance efficiency			0.335 (0.243)	0.357 (0.261)		
Taxation					2.418 (2.340)	1.099 (2.775)
Trade globalization	0.124*** (0.007)	0.120*** (0.008)	0.100*** (0.007)	0.093*** (0.007)	0.114*** (0.007)	0.098*** (0.009)
<i>International pressures</i>						
International cooperation		0.013 (0.010)		0.012 (0.012)		0.040*** (0.010)
Socialization		0.066** (0.023)		0.066** (0.019)		0.084*** (0.025)
IMF program		-0.037 (0.121)		0.229* (0.104)		0.026 (0.121)
US dependence		2.562 (1.998)		1.593 (1.968)		8.797*** (2.056)
<i>Domestic politics</i>						
Partisanship		0.043 (0.047)		-0.027 (0.048)		0.068 (0.051)
Democracy		-0.054** (0.019)		0.001 (0.019)		-0.023 (0.019)
<i>Economic conditions</i>						
GDP		-1.935 (1.335)		-3.152* (1.467)		-0.277 (1.599)
GDP per capita		0.084** (0.025)		0.088*** (0.020)		0.122*** (0.027)
Saving rate		1.876 (1.015)		3.163* (1.222)		3.576*** (0.989)
Direct credit		-0.632 (0.301)		-0.380 (0.300)		-0.407 (0.326)
Stock market proportion		0.000 (0.002)		0.002 (0.002)		0.001 (0.003)
<i>Instability</i>						
Inflation rate		-0.029 (0.021)		-0.669* (0.309)		-1.184*** (0.271)

Foreign reserves		-1.760		-1.341		-2.736**
		(0.959)		(0.775)		(0.922)
Current account surplus		-3.846**		-2.033		0.644
		(1.276)		(1.306)		(1.418)
Crisis		-0.288*		0.004		-0.215
		(0.112)		(0.118)		(0.116)
International debt		0.000		-0.008		-0.001
		(0.008)		(0.006)		(0.007)
Country Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Time Fixed Effect	Yes	Yes	Yes	Yes	Yes	Yes
Observations	421	364	252	231	304	270
Adj R-squared	0.6979	0.7399	0.8262	0.8783	0.6995	0.7844

Robust standard errors in parentheses ***p<0.001, **p<0.01, *p<0.05

does not construct the components and includes some normative values, such as accessibility and transparency. While not denying that these characteristics are valuable, it is unclear what their influences are on the effectiveness of making and enforcing policies. The results suggest that this variable's coefficient is insignificant. Furthermore, the taxation revenues variable in columns (5) and (6) has been used because many scholars assume it can reflect a government's capacity to penetrate society to extract resources. However, I emphasize that this index only shows willingness, rather than capacity, to mobilize resources, and the results confirm my expectations that this does not have a significant influence.

4.5 Conclusion

This chapter sets out to examine the generality of my proposed theory for the degree of capital account liberalization in emerging markets. First, a novel indicator was produced for measuring governance capacity, and panel data analysis was then applied with fixed effects for empirical analysis. I argue that my indicator is more precise than other measurements because it is theoretical and considers the micro-level bureaucracy system and macro-level institutional context simultaneously. Through controlling for other theoretically relevant variables, my theory shows strong external validity in terms of the statistically significant coefficients of the independent variables. Quantitative analysis also confirms that my theory has better explanatory power than other competing arguments. Therefore, the results confirm that governance capacity and trade globalization are two systematic factors that jointly determine emerging markets'

financial openness process.

The control variable with the most robust result is GDP per capita, which remains a significantly positive correlation in all regression models. It suggests that a country's development level influences how it deals with international finance. Interestingly, social globalization has significantly positive correlations only after adding a time-fixed effect and controlling the influence of economic conditions. This sudden change cannot be explicitly explained, but it shows that the influences of ideas proposed by constructivists are conditional. Compared to the domestic institutional factor and economic interdependence, the effect of social exchange is less robust.

Furthermore, the quantitative analysis also provides valuable guidance for further qualitative research. SED follows a straightforward logic to integrate quantitative and qualitative analysis. As the purpose of case studies is to explain the underlying causal process further, the strategy of case selection generally obeys two rules: first, it should select typical cases with small residuals in the regression model; second, selected cases must capture our research interests with intensive information (Creswell and Clark, 2017). Following the guidance, South Korea, Malaysia, and China have been selected for further analysis because the residuals of these countries in the regression models are below 2, which is the widely accepted threshold for identifying outliers, which means they are fitted well in the regression models.

CHAPTER 5: Regulating capital in the time of uncertainty

In the previous chapter, I take a confirmation approach to test my hypotheses' explanatory power with alternative competing explanations. The results suggest that governance capacity systematically affects emerging markets' degree of capital account liberalization, explaining why some countries maintained restrained liberalization even when the influences of the global financial order culminated. Next, even though the quantitative analyses can increase the theories' credibility, we still have limited knowledge about the historical details. As controlling capital mobility inevitably confronts criticisms at the international level, not every country would like to confront the pressures. Hence, it is necessary to combine case studies to enrich our understandings of how governance capacity has an effect. In this chapter, I select Malaysia, South Korea, and China as typical cases for further analysis. Among them, Malaysia controlled external capital mobility during the 1997 Asian financial crisis, South Korea re-regulated short-term financial investment after the 2008 subprime crisis, and China maintained a certain degree of restrictions over the last decades. Even though these countries have different political regimes and levels of economic development, they all restricted cross-border capital mobility even under solid international pressures.

Nevertheless, before taking an in-depth analysis, I must admit the difficulties in undertaking case studies for my research. According to my theory, strong governance capacity acts as an incentive system that motivates bureaucrats to keep impartiality and

encourages them to make the policies that are perceived as the ‘right’ policies for the national economy rather than simply following the international standard practice. Because the causal mechanisms lay on regulatory agents’ calculations, the best way to collect data is through the elite interview — directly speaking with policymakers to unveil their considerations. However, this method is inapplicable. Because Malaysia made capital controls two decades ago, it is hard to trace the historical process, even by reaching out to today’s bureaucrats. Chinese officials are reluctant to receive interviews from outside. Especially when I undertook my fieldwork in May 2019 when China was preparing for the National Congress meeting, officials were sensitive to talk about national policies, whether publicly or privately. The most feasible case is South Korea, and I planned three months of fieldwork in Seoul in June 2020. However, the pandemic made the research plan impossible, and my potential interviewees also refused online interviews. Hence, the difficulties of accessing essential information leave me no choice but to make a compromise.

Therefore, the case studies mainly draw from online public information. I attempt to consult multiple data sources, including secondary literature, government official documents, international organization's agenda-setting, and politicians' open statements. Because of the difficulty in analyzing regulatory agents’ considerations, I instead focus on the historical details to show how strong governance capacity and administrative skills helped bureaucrats deviate from the textbook economic theories and make pragmatic policies during the time of uncertainty. This chapter consists of five sections.

It first introduces the logic of case selection and then analyzes the capital control policies in Malaysia, South Korea, and China in the sections that follow. Finally, it summarizes the three cases. The case studies indicate that even though the three typical cases have different economic conditions and political regimes, they implemented a similar strategy to protect themselves in a volatile global financial market with the help of professional bureaucrats.

5.1 The criteria of case selection

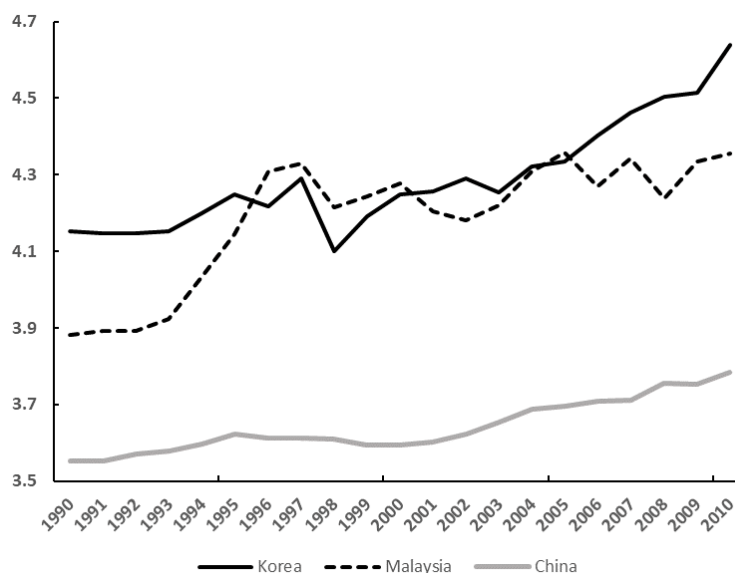
I investigate Malaysia, South Korea, and China to analyze how emerging markets regulate capital mobility even under solid external pressures because of three reasons. First, they are typical cases according to the regression results. Typical cases mean they are better fitted in the regression modes, and the variation of the dependent variables can be explained mainly by independent and control variables. Especially, their residuals, within most of the years, are below two, which is a statistic threshold to distinguish typical cases and outliers. Typical cases often involve rich information for maximizing our understandings of the population. Because I adopt a confirmation approach to justify my theory rather than expand its external validity, I do not shed light on outliers to discover why some countries show large residuals.

Second, these are the top three countries in terms of the degree of governance capacity.

My theory-driven index combines meritocratic bureaucracy and institutional efficiency

to operationalize a government’s policymaking and enforcement capacity. As the Figure 5.1 illustrates, Korea almost has the most substantial governance capacity over the last decades, followed by Malaysia. Between 1995 and 2000, the Malaysian government’s governance capacity even exceeded South Korea's top rank. These two countries also show strong correlation between high economic growth and superior bureaucracy (Kohli, 2004, Baimenov and Everest-Phillips, 2015). China always occupied the third position, and the two decades witnessed a gradual improvement in the overall grade. According to my theory, the strong governance capacity implies that these countries are more likely to countervail the international pressures to undertake "unorthodox" capital account policies at home when comparing with other emerging markets.

Figure 5.1 The governance capacity of Malaysia, South Korea, and China



Source: made by the author

Interestingly, the three countries are also famous in terms of regulating capital mobility (Stiglitz and Ocampo, 2008). To avoid redundancy, I refer to the restrictions on capital

account as cross-border financial regulations, capital controls, and capital flow management measures. The restrictions include:

- Strictly control the inflow or outflow of capital mobility.
- Financial flow and tax measures based on price.
- Foreign exchange derivatives trading regulation.

Table 5.1 Types and Objectives of capital account regulations

Country	Capital Management Techniques	Objectives
Malaysia 1998	Inflows Restrictions on foreign borrowing Outflows 12-month repatriation waiting period Inversely proportional to length of Exchange controls Domestic financial regulations Restrictions on access to Ringgit Encourage to borrow domestically	Maintain political and economic Kill the offshore Ringgit market Shut down offshore share market Help reflate the economy Help create financial stability Insulate the economy from
Korea 2012	Inflows Taxation on foreigner's interest and Outflows Tighter derivatives for exporters Domestic financial regulations Taxation on bank foreign reserve Prohibit domestic firms issue foreign Tighter foreign reserves liquidity	Maintain political and economic Help create financial stability Insulate the economy from Maintain foreign reserve stability Stabilize Korean Won exchange rate
China	Inflows Strict regulation on sectoral FDI Regulation of equity investments Outflows Restrictions on repatriation of funds Strict limitations on borrowing Exchange controls Domestic financial regulations Strict limitations on residents and	Incremental capital account Insulate economy from contagion Increase political sovereignty Preserve domestic savings and Help keep exchange rates at

Source: cite from Stiglitz and Ocampo (2008) and made by the author

Economists claim that capital account liberalization can be further categorized as

"walls" and "gates" (Klein, 2012, Fernández et al., 2015) China's capital account restrictions are like "walls," which means it remained static in restrictions most of the time to ward off the instability brought by international financial markets. In contrast, Malaysia's and Korea's capital account policies are like "gates" because their financial markets are open to international investors most of the time but tend to implement some dynamic controls when they confront economic risks. Economists emphasize that dynamic controls are more complex and challenging to implement than static controls (Blanchard et al.). Countries that can successfully regulate capital mobility in the short term can also easily extend the range of their restrictions. As the table above illustrates, even though they implemented different types of capital control policies at different times, the purposes are all crushing the instabilities triggered by volatile cross-border capital mobility, especially the short-term speculation investments.

Hence, the three countries are typical cases in terms of their small residuals, strong governance capacity, and the implementation of capital account restrictions. Investigating the typical cases can better illuminate the association between dependent and independent variables. In contrast to economic analyses that look at the effectiveness of the financial techniques, this section investigates the politics of capital account management — how emerging markets designed, implemented, and justified their capital account restrictions in the liberal global financial order. My analyses follow a logical sequence: initially, the governments identified emerging risks triggered by the volatile global financial market. Then, even though the orthodox suggestion is to permit free capital mobility, they decided to control capital mobility. These unilateral actions

inevitability triggered many criticisms. Thereby countries should countervail the pressures through explanations or justifications. Finally, this unilateral resistance has produced satisfactory results and even led to the re-evaluation of the global norm, which signified the values of defending their interests in the liberal global financial order.

5.2 Malaysia in 1998

Malaysia confronted a severe financial crisis due to massive capital outflows. Dating back to 1997, when the Thai baht suffered sudden devaluation, panic triggered massive capital outflow in other Southeast Asian countries (Buckley and Fitzgerald, 2004). Among them, Malaysia experienced significantly declining exchange rates and lower asset prices. Because Malaysian assets can be traded at the Singapore-operated Central Limit Order Book without the approval of the Malaysian government, international speculators repeatedly borrowed ringgit-denominated assets and sold them down (Shari, 2002). Consequently, the ringgit (Malaysian currency) was devaluated dramatically, and the index of the Kuala Lumpur Stock Exchange went down from 1,200 to 260 points. Devaluated currency vastly increased the burden of debt payment for Malaysian companies, and banks also found themselves without foreign reserves to stop the massive capital outflow. As a result, the country's economy was at the edge of collapse if there was no solution to cushion the continually deteriorating situation.

Malaysia is famous in terms of its heterodox behavior in handling financial risks. The

orthodox option, which other crisis-affected countries have adopted, was to receive the IMF's conditional loan and undertake economic structural reform. The IMF experts attributed financial risks to countries' inherent economic distortion, thereby recommending that governments receive conditional loans to pay off external debts and then delimit credit supply and fiscal expenditure to undertake neoliberal structural reform (Abdelal and Alfaro, 2003, Mazlan and Mohd Harif, 2003). Initially, the Malaysian government showed a willingness to take the orthodox recipe under the leadership of Deputy Prime Minister Anwar Ibrahim. The government decreased the interest rate of the ringgit to a tight money supply and publicly announced to cut down 18% of government spending in the annual budget. It also made a clear commitment that Malaysia would continue maintaining exchange-rate flexibility and free capital mobility. However, this plan could not help the country to get rid of the shadow of economic risks. As a result of capital outflow, domestic consumption and investment demand continued to decline, and the pessimistic outlook further reduced investors' confidence in economic recovery.

Then, the Malaysian government decided to make unorthodox policies at home to protect themselves. Mainstream economic theorists could not understand the unilateral actions contrasted with the global norm of capital mobility. It involved increasing government spending to stimulate the economy, capital controls to prevent capital outflows, and a restructuring package to intervene in the financial sector (Mazlan and Mohd Harif, 2003, Buckley and Fitzgerald, 2004). The package consists of a series of

policies aimed to delimit short-term capital outflow. Specifically, since most currency speculation is conducted in the offshore market, the government stipulated that all sales of ringgit assets must go through authorized domestic intermediaries, which makes offshore transactions illegal. To control the capital outflow from the stock market, the government requested that all repatriation of investments held by foreigners, the assets must be held over one year. To protect the economy from contagion, the government restricted residents from exchanging currency and encouraged domestic companies to borrow and invest domestically. In all, these policies shown Malaysian government's efforts to insulate its domestic economy from external volatile financial market, in order to countervail the attacks of international speculators and recover economic stability.

However, an interesting thing is that why Malaysia could implement the politics that deviated from the common practices. As the liberal global financial order constrains state behaviors by rewarding some actions and punishing others, these anomalous behaviors inevitably suffered criticisms. Primarily, the IMF's spokesman publicly criticized the Malaysian move as a disincentive, as restricting capital mobility is not helpful to rebuild investor confidence (Buckley and Fitzgerald, 2004). Oxford Analytica emphasized that capital account control would undermine Malaysian growth (Kaplan et al., 2009). An article in Forbes International warned that Malaysia had destroyed foreign investors' confidence and must bear the cost of their mistrust for years (Roche, 1998). In addition, it was unsurprised that private financial institutions also reacted strongly (Kochhar, 1999). Moody's, the most influential rating agency,

downgraded Malaysian securities. Morgan Stanley has dropped Malaysia from its investment index, saying it would be permanently excluded from the index and that its previous inclusion had been a mistake. As a result, even though the costs of political favoritism are hard to estimate, the pressures have indeed shown the price of adopting contested autonomy. It is not hasty to say that when the government initially implemented these unorthodox policies, it could not get any support from the international community.

From this perspective, Malaysia's behaviors indeed signify the role of strong governance capacity – bureaucrats can keep impartiality and implement the policies that are perceived as the 'right' to the national economy, rather than simply following the prevailing international practices. Even though the difficulty of doing elite interview impede us to unveil key actors' internal considerations, there are many clues to confirm Malaysia's meritocratic bureaucracy and institutional efficiency. Among Southeast Asian countries, Malaysia is the only one that has a government with a high degree of centralization (Watts and Rovinsky, 1999). Structurally, the public sectors consist of three groups, including the Premier group that refers to elected political leaders, professional and managerial groups that are known as *Perkhidmatan Tadbir dan Diplomatik* (PTD) and supporting agencies. Even though political leaders have strong influences over policymaking, they need to consult the suggestions of bureaucrats because PTD holds comprehensive powers over policy formulation at the federal level (Bin Ali, 2003). This group is strictly selected with professional expertise, and the

impartial career promotion mechanism protects them an incentive to serve the public.

The Malaysian government has carefully designed and implemented capital account restrictions with the help of a strong governance capacity. The policymaking generally involves several stages, including identifying the problems of economic operation, formulating suitable policies within central agencies, and implementing the policies with the coordination of supporting groups (Abdullah, 2016). Even though the Federal government is responsible for supervising the making of macroeconomic policies, it actively collaborated with professional groups at the Economic Planning Unit, Ministry of Finance, and Bank Negara Malaysia (the Central Bank of Malaysia). During the time of uncertainty, the professional bureaucrats also formed the National Economic Action Council to deal with the emergency. They took over six months to discuss the design of capital account policy, with several rounds of internal reporting and consulting the recommendations from different social groups. The Central Bank also undertook a comprehensive information campaign by setting up a 24-hour hotline to answer questions. This campaign aimed to reassure international investors and make a clear signal that Malaysia is open to global market even if it restricted short-term capital mobility (Abdelal and Alfaro, 2003).

Therefore, the professionalism in policymaking brought Malaysia confidence to defend its capital account regulations, even confronting considerable pressures. Although not intending to challenge the global norm nor push institutional reform publicly,

Malaysian regulatory agents insisted that this unilateral action would be best for their national economy and made many clarifications publicly. The Malaysian government believed that its capital control policies could prohibit short-term currency speculation without sacrificing linkage with the global trade market (Krugman, 1999). In August 1999, almost one year after the implementation of heterodox policies, Prime Minister Dr. Mahathir Mohamad explained in an interview justifying Malaysia's nonconformist behavior⁴:

Currency control as imposed by Malaysia is not generally understood by the international financial community. Their criticisms are therefore based more on their textbook models than on proper examination of what Malaysia has done...We are prepared to face challenges and we believe we can handle most of them. Whether we fail or succeed, we hope we have provided the world with an experience that will be useful for case studies in the management of a country's economy under stress.

Economists have intensively debated the effectiveness of Malaysian capital control policies. Even though some neoclassical scholars, like Merton Miller, continue to treat the controls as an unmitigated disaster, people generally agreed that this unorthodox policy helped Malaysia recover more quickly than other crisis-affected countries (Athukoralge, 2001, Kaplan et al., 2009). The restrictions on short-term currency transactions prohibited speculative capital outflows, which contributed to the stability of the domestic market. Private institutions also recognized this successful unilateral experiment. International rating agencies began to restore Malaysia's credit rating at the

⁴ For more information, please consult

https://mir.com.my/lb/econ_plan/contents/press_release/capital.htm

end of 1999, and the Morgan Stanley Capital International (MSCI) Indices again included the Malaysian market in May 2000. In May 1999, Malaysia openly issued a \$1 billion bond at the international market, signifying global investors had regained confidence toward its economy.

This case study shows how Malaysia defend its interests at home by making unorthodox policies. What is more important, the success of this unilateral resistance even forced the international community to rethink the effectiveness of capital control. People realized that if Malaysia followed the orthodox route, it could not segment domestic and international financial markets to provide breathing room for economic recovery. The Wall Street Journal (WSJ) contended that there never was any doubt that preventing money from fleeing Malaysia could provide short-lived relief (Edwards and Frankel, 2009). Even the IMF started to think about the applicability of this unusual behavior in other countries. According to its World Economic Outlooks (WEO)⁵:

[T]he introduction by Malaysia in early September of exchange and capital controls may also turn out to be an important setback not only to that country's recovery and potentially to its future development, but also to other emerging market economies that have suffered from heightened investor fears of similar actions elsewhere. (WEO, October 1998, p. 4)

⁵ For more information, please consult

<https://www.imf.org/en/Publications/WEO/Issues/2016/12/30/World-Economic-Outlook-May-1998-Financial-Crises-Causes-and-Indicators-2535>

5.3 South Korea in 2012

South Korea is the most developed country in the MSCI Emerging Market Index. People may be concerned with why this country is an emerging economy, given its high GDP per capita and OECD membership. Interestingly, the critical point determining Korea as an emerging market is particularly the restrained capital account liberalization. Prof. Ha-Joon Chang, a developmental economist at Cambridge, maintains that Korea has not fully met the threshold of a developed economy because of its capital account restrictions (Smolinski, 2013). MSCI looks at six criteria for classifying developed economies, and one measure is the restrictions on capital mobility and foreign equity investment. Even though Korea has withdrawn massive restrictions in the middle of the 1990s, it still maintained its arsenal of capital account management. According to S&P Dow Jones Indices (Smolinski, 2013), South Korea is prosperous enough and has a significant international business, but its only drawback is the lack of “ease of currency trading.” The MSCI research team emphasizes that the reason why South Korea cannot be classified as a developed market is that the limited convertibility of the won in the offshore currency market is still a major concern.

South Korea has suffered a great deal from volatile capital mobility. During the Asian financial crisis, the national economy was also at the edge of collapse because of the sudden massive capital outflows. During the subprime crisis in 2008, even though the asset bubble has erupted in developed countries, emerging markets were also victims

because of the carry trade. The carry trade is a speculative activity that typically involves borrowing currencies in countries with low interest rates and selling them in countries with high interest rates (Jylhä and Suominen, 2011). Korea experienced volatile currency transactions at the offshore markets. When the Fed announced a quantitative easing program, a vast amount of money was pumped into emerging markets to pursue higher return rates. When the Fed increased the interest rate to the tight money supply, investors would again sell Won to buy in the US dollar (Mundy and Jung-a, 2012). The result is that the direction of the carry trade, rather than countries' economic performance, impacted the depreciation or appreciation of the national currency. In addition, as South Korea has sizeable derivative trading markets, the fluctuation is even more volatile when international traders use the tools of financial leverage. In 2009, the contagion effect of the subprime crisis put several Korean banks at the edge of bankruptcy, and around 520 domestic export companies lost over US \$2 billion.

South Korea was arguably the first country to re-regulate capital mobility after the crisis. When developed countries announced their quantitative easing program to save economies, the mainstream position was to permit free capital movement. Fed Governor Bernanke said that even though the global economy must experience a short period of fluctuation, it would recover quickly when the asset bubble returned to its

reasonable value zone⁶. Other affected emerging markets like South Africa and Thailand also follow the orthodox practice to liberalize the restrictions on capital outflow (Gallagher, 2018). Korea, however, experimented with a set of unorthodox policies aiming to control capital flow and exchange rate fluctuation. Although the Korean government followed the orthodox route in 1997, both the government and the population had vivid memories of the catastrophe caused by volatile capital outflow. Hence, in late 2009, the government levied restrictions on bank holdings of derivative products, forwards, and liabilities. Between 2009 and June 2010, the Korean government implemented comprehensive capital controls to strengthen the bank's foreign liquidity management and limit the bank's short-term debt (Mundy and Jung-a, 2012). Korean firms were encouraged to borrow domestically to safeguard against external debt risk.

Like Malaysia in 1997, departing from then orthodox behavior inevitably made the Korean government confront considerable pressure. There was significant opposition to the measures from international institutions, developed economies, and private financial sectors. In its 2010 Article IV report to South Korea, the IMF clearly stated an opposite position as it believed that capital controls were, to a significant possibility, ineffective⁷. It maintains that the best practice remains to work on floating exchange rates and monetary tightening, which is typical of neoclassical economic ideas. The US

⁶ For more information, please consult <https://www.ft.com/content/a45e89f2-d38b-11de-9607-00144feabdc0>

⁷ For more information, please consult <https://www.imf.org/external/pubs/ft/scr/2010/cr10270.pdf>

Treasury criticized that this unilateral action was neither practical nor conducive to the recovery of the global economy (Tett, 2011). Foreign and domestic banks threatened to leave Korea. As their operations involve managing short-term capital for foreign currency transactions and the investment in bond market, the upcoming restrictions may push them to move businesses to Hong Kong. Domestic coordinators also worried about the adverse effects on the competitiveness of Korean financial markets.

Nevertheless, the Korean government still implemented unorthodox policies even under considerable pressure. Gallagher (2018) intensively analyzes Korea's capital account re-regulation and summarizes a set of supporting factors, like pilot regulatory agents, the memory of the Asian financial crisis, and abundant foreign reserves. However, the strong governance capacity is still critical in helping the bureaucrats make the policies that are perceived as the best according to the economic conditions. As a typical developmental state that has achieved outstanding economic miracles since the 1960s, the Korean government is famous for exerting activist functions by reallocating capital mobility and designing industrial politics (Beeson, 2004). Even though the influence of the developmental mindset decreased after Korea became a member of the OECD, a political legacy is an institutional context responsible for recruiting, training, and rewarding professional bureaucrats (Kalinowski, 2017). These institutions enhance the communication channels between the Blue House and regulatory agencies and motivate bureaucrats to make full use of their expertise in policymaking.

Therefore, considering the risks of deviating from the orthodox policies, Korea has made intensive preparations to design the regulation policies. From 2009–2012, the Ministry of Strategy and Finance (MSF), the Bank of Korea (BOK), the Financial Supervisory Service (Hitt and Brynjolfsson), and the Financial Services Commission (FSC) worked together to design the regulation policies. These agencies gathered the most talented financial and economic experts in Korea, who received systematic education in Western countries and had first-hand experience managing Korean economic issues. Specifically, Jae-wan Park, who graduated from the Harvard Kennedy School, was then minister of MSF. Dong-soo Jin was the head of the FSC, who has a degree in economics from Boston University. Joong-soo Kim governed BOK and had been educated at the University of Pennsylvania. The most well-known expert is Hyun Song Shin, who assisted the Blue House for making international economy politics, used to be a professor at Princeton University. Even though these technocrats are familiar with the textbook economics knowledge, they contended that if Korea follows the orthodox route to increase the interest rate, it would further fuel the asset bubble.

At the same time, interestingly, these experts are also good at utilizing textbook economic theories to justify the rationale of implementing heterodox policies in Korea. Korea has shown no intention of challenging the liberal financial order nor directly reframing the global norm of capital mobility. Richard Yetsenga, HSBC's head currency strategist in Hong Kong, expressed that "It is amazing how little the term capital control appears. Countries seem to be favoring language which makes the introduction of

measures less controversial" (Pilling, 2010). This manipulation precisely reflects the logic of defending interests at home while avoiding direct competition at the international level. Considering that the IMF and international investors are hostile to the term "capital control," Korean bureaucrats and politicians instead used the term "macroprudential measures" to accommodate the international community's sentiment to buy heterodox policies easier. When being interviewed by the Financial Times, Mr. Lee Myung-bak, former Korean President, insisted that "macroprudential policies" are under the umbrella of the orthodox route (Pilling, 2010):

I won't define any country's measures as capital controls...all measures are part of international co-operation rather than an exception...I do not envisage any country taking actions that can be regarded as being blatantly and obviously out of line with international co-operation principles.

Finally, when evaluating the effectiveness of the capital account regulations, it is uncontroversial that this unorthodox practice successfully protected South Korea from worse risks and impacts. Since late 2009, capital inflows returned to the financial market, and the speculation in derivative and foreign exchange markets was contained due to the countercyclical policies. An unexpected outcome was that this successful experiment motivated people to rethink the global norm of capital mobility. When hosting the G20 committee in 2012, Korea proposed to permit countries to adopt macroprudential regulations to cushion capital flows (Gallagher, 2018). This suggestion won support from both the Financial Stability Board and some developed economies like France. The IMF's opposition has also become less apparent. The IMF's 2012 Article IV states that the unorthodox measures have a "somewhat positive effect" on

managing the risks derived from short-term external debt⁸. Overall, like an article in the Financial Times says (Tett, 2011), "what Korea is essentially doing is launching an intriguing experiment...testing ideas to see whether it is possible to grow a new regulatory and financial culture." Jeffrey Chwioroth, a constructivist scholar at the London School of Economics, also claims that unorthodox Korean reaction was becoming a "new normal," globally, that reshapes the contours of fair policy (Chwioroth, 2012).

5.4 China's long-term restrictions

The last case discusses the restrained capital account liberalization in China. Capital account regulation can be categorized as either "gates" or "walls." The former means capital mobility and exchange fluctuations are usually permitted, but countries will close the door ("walls") in emergence. The cases of Malaysia and South Korea belong to this category because they have a relatively liberalized financial market before confronting economic instabilities. In contrast, China and India are two popular countries that have long maintained significant restrictions on cross-border capital mobility. I select China for further analysis because of its economic size and political importance.

The process of capital account liberalization in China was accelerated in the mid-1990s.

⁸ For more information, please consult <https://www.imf.org/external/pubs/ft/scr/2012/cr12275.pdf>

By accepting the IMF's Article VIII and joining the WTO, China promised to gradually withdraw the capital mobility restrictions that may impede international trade (Hu, 2001). Nevertheless, the liberalization process is slow and selective. China liberalized the restrictions on the current account, the capital inflows and outflows by non-residents, and encouraged foreign direct investment. However, it strictly controlled short-term capital mobility, equity and derivative instrument investment, and exchange rate fluctuation. To increase the efficiency in policymaking and implementation, China established an independent agency responsible for guiding foreign reserve management — the State Administration of Foreign Exchange (SAFE), aiming to control risks and limit short-term debt borrowing. Hence, China's capital account regulations are increasingly strategic and flexible. It restricted capital outflow and welcomed capital inflow when the government was concerned about the capital flight while confining capital inflow and opening the door for capital outflow when the economy risked overheating. Overall, China is nearly the emerging market with the lowest degree of capital account liberalization over the decades.

It is not surprising that China's restrained liberalization process has also suffered criticisms. Especially before the subprime crisis, when most countries embraced the liberal menu, any anomalous behavior could easily catch people's attention. Even though people have more tolerance, as China was a transitional economy from state-led to market-driven, they still criticized that the transforming process is too slow (Prasad et al., 2006). One voice is that the restrictions will quickly become ineffective

when China has embedded into the global economy. After liberalizing the restrictions on goods and services trading, China would confront a loophole of capital mobility under the umbrella of current account transactions (Sheng, 2013). Another argument is that the capital account restrictions will cause economic distortion, provide an incentive for corruption, and prevent efficient pricing and allocation of capital, decreasing its attractiveness to global investors (Hung, 2009). In addition, developed countries often criticized that capital controls come with currency exchange rate manipulation, bringing China an unfair competitive advantage in international trade.

Nevertheless, China still insisted on its unorthodox practice, even under criticisms and international pressures. Even though it was far from challenging the dominant norm of free capital mobility, China contends that capital management techniques constitute an integral part of its development strategy. Hence, the objectives of the control policies are to achieve some goals that cannot be obtained otherwise: to retain foreign reserves, channel limited capital accumulation to the most desired use, and isolate the economy from the contagion of international financial crises (Zhang, 2013b). The development-oriented mindset among Chinese officials motivates them to find pragmatic ways to achieve rapid economic growth rather than being bound by specific values and norms. Dr. Yongding Yu, a University of Oxford graduate, used to be a member of the advisory committee of China's central bank and the director of the Institute of World Economics and Politics, China's Academy of Social Science. His attitude toward the capital account liberalization reflected a general understanding among China's senior

government officials (Yu, 2015):

Capital account liberalization is not a historical trend, and no tenable economic theory can prove the necessity and inevitability of capital account liberalization. The idea of capital account liberalization is not so much based on scientific argumentation and historical experience as it is based on the belief in a certain ideology.

It is undeniable that there are many factors that may influence the process of liberalization. As a Socialist economy in transition, it has a long tradition in regulating capital mobility. Nevertheless, regulating the capital inflow and outflow is a technical issue, especially after China has gradually integrated into the global trade market. After China's economy has absorbed abundant capital inflow through trade surplus and foreign direct investment, making a balance between inflation risk and economic growth requires the government to effectively manage its capital account (Prasad and Rajan, 2008). Hence, it is unsurprised that the heads of the central economic agencies are always carefully selected by the Organization Department of the Communist Party of China Central Committee. The bureaucrats who work at the SAFE should pass strict civil service examinations based on their professional knowledge, and their promotion opportunity is mainly based on whether they can effectively utilize their professional knowledge to control the risks while promoting economic growth (Chen and Qian, 2014). Without these professional policymakers and a cadre system, it is difficult to make effective capital account regulations over the last decades.

When assessing the effects of China's capital account regulations, the general

conclusion is that the benefits still exceed the costs. Slowing the process of a market-oriented reform inevitably led to inefficient resource allocation, possible corruption, and unwanted evasion. However, regulation policies granted China a stable financial market, critical to its sustainable development over thirty years. The control of foreign debt accumulation prevents the risk of debt crisis of domestic enterprises. The control of capital inflows prevented asset prices and speculative bubbles in the stock market. Control of capital outflows has protected China from the devastating wave of capital outflows that have triggered several crises in other emerging markets. Exchange rate and derivatives control restrain RMB speculation. Simply speaking, comparing with the economic losses of ineffective resource allocation, it is uncontroversial that safeguarding from financial crises is more valuable.

Interestingly, what goes beyond the expectation of Chinese officials is the formulation of the so-called "Chinese model." Developmental economists attribute China's successful development miracle to three factors (Prasad and Rajan, 2008, Tseng and Cowen, 2005): a large amount of FDI into important sectors, the absence of external crises or volatility, and stable urbanization progress. It suggests that other developing countries should take after China to take a pragmatic, experimental approach toward capital account liberalization. In other words, capital account liberalization should be given a lower priority. The efforts to generalize the applicability of China's eccentric behaviors undermine the global norm of capital mobility and the credibility of the IMF's structural reform proposal.

5.5 Conclusion

Given that free capital mobility is a global norm and constitutes the US's exclusive privileges, implementing capital account liberalization is a common practice before neoliberalism has confronted a legitimacy crisis, showing developing countries' commitment toward the liberal global financial order. From this perspective, restrained liberalization processes or capital control policies have been recognized as nonconformist behaviors. However, from the perspective of emerging markets, restrained liberalization is an optimal scenario. On the one hand, they still opened a window to access external capital. On the other hand, emerging markets can protect themselves from the volatile global financial market. A healthy financial liberalization requires many preconditions, including sound supervision institutions, sufficient foreign reserves, a vibrant domestic economy, and a controllable debt ratio (Gallagher et al., 2011, Roberts, 2019). Without meeting these conditions, the volatile capital inflow may cause hyperinflation risk, and capital outflow may trigger a financial crisis.

I select Malaysia, South Korea, and China for detailed investigation because they have implemented capital control policies, regardless of static or dynamic controls. Malaysia and South Korea utilize episodic management skills, while China has maintained a selective liberalization process over the last decades. Even though the selected cases have different economic conditions and political regimes, they all implement the

policies that are perceived as the best for their national economy rather than simply following the general guidance derived from the textbook economic theories. Evaluating the policy outcomes suggest that capital account restrictions have helped these countries to protect themselves from the volatile financial market. It is also interesting to note that the emerging markets that maintained capital account restrictions have suffered fewer external impacts over the last decades.

Even though regulating capital mobility is an economic phenomenon, the analyses focus on how countries countervail the external pressures to defend their own policy choice with the help of strong governance capacity. When capital account liberalization is institutionalized as a global norm, deviating from the widely accepted practices, countries will suffer political pressures at home and abroad. Because of the difficulty of doing interview, it is difficult to trace how domestic institutions influence the considerations of bureaucrats. Despite the difficulty, I still make attempts to show the clues that how meritocratic bureaucracy and institutional efficiency influence the policymaking. The case studies show that three countries have confronted similar political and market pressures, making rebuttals to justify their unorthodox choices. They initially deviated from the standard practice triggering hectic criticisms from developed countries, international financial organizations, and private investors. These countries have all confronted threats of material losses and mistrust of the international society, signifying that the liberal global financial order indeed constrains state behaviors by rewarding some practices and punishing others.

Nevertheless, the analyses show that the best way to overcome international pressures is to prove that even taking the alternative, "unorthodox" policies can produce promising outcomes. With the help of meritocratic recruitment and professional administrative skills, the policymakers have sufficient knowledge to combine the textbook economics theories with countries' specific economic conditions. Hence, they all made detailed and comprehensive preparations in the policy design stage, carefully implemented the policies, and supervised the effects. In addition, the politicians and scholars also made clarifications publicly to speak with criticisms and justify their unconventional behaviors. When the capital account regulations in these countries have gradually achieved satisfactory results, their pressures are also alleviated. By maintaining capital account restrictions, these emerging markets can safeguard against the volatile global financial market and alleviate the risks brought by economic crises, reflecting the importance of making the policies that are perceived best for the national economy rather than simply following the standard practice.

CHAPTER 6: The accelerated liberalization process in China

The previous chapters mainly focus on emerging markets' resistance to external coercions to liberalizing their capital accounts. I argue that conventional understandings have overestimated the effects of international pressure on emerging markets but have rarely analyzed how recipient countries resist. Unlike the previous chapters, which mainly focus on the period before the subprime crisis, this chapter looks at emerging markets' reactions after the crisis when the effects of the convergent forces highlighted by conventional understandings largely decreased. The crisis was a critical juncture because, after this accident, the US hegemony was severely impacted, neoliberal ideas also lost their supremacy in the theoretical battlefield, and the global financial order confronted a legitimacy crisis (Kirshner, 2014, Stuenkel, 2013).

I focus on China's behavior because it is a critical case in emerging markets. Suppose the most powerful country did not take the opportunity of the crisis to challenge the rules, norms, or prevailing practices of the global financial order. In that case, it would be difficult to imagine other emerging markets launching similar actions. Interestingly, even though China has long maintained a restrained liberalization because of its discontent toward free mobility, it accelerated the pace of liberalization after the crisis. This seems to suggest that the most powerful emerging market decided to show more substantial commitments to orthodox practice when it could have been an opportunity to promote unorthodox behavior at the international level. For analyzing the dynamics

of the policy change, I argue that accelerated liberalization is a signal sent by the Chinese government to please the international community, especially the International Monetary Fund (IMF). Briefly, when the Fund needed support most, sending positive signals obtained more valuable reward feedback. Specifically, by showing a commitment to withdrawing the restrictions on capital account transactions, the Fund permitted renminbi (RMB) to join the Special Drawing Right (SDR), which dramatically helped China pursue its long-term strategic goal.

This chapter consists of five sections. It first reviews China's accelerated capital account liberalization process and shows why current works find it difficult to provide convincing explanations for this puzzle. Then, I explain why capital account liberalization in China is a signal sent to the international community, especially the IMF. In the third section, I analyze the considerations of the IMF and the Chinese government after the subprime crisis, respectively. This analysis shows that both sides had motivations for reaching a reconciliation after the crisis; thereby, China accelerated its liberalization process, and the IMF softened its definition of "free capital account mobility." The fourth section investigates the debates surrounding further liberalization's pros and cons to show how the bureaucrats from the People's Bank of China (PBC) overcame domestic pressures to push the reform agenda. By utilizing the softened IMF criteria, those bureaucrats successfully won the debates about the presumed costs of further liberalization. Finally, I discuss the consequences of accelerated liberalization and shed light on the alternative explanations for China's

accelerated process. Qualitative data collection is analyzed using official documents, consulting secondary resources, and interviewing Chinese scholars who participated in the debates surrounding the liberalization of China's capital account.

6.1 Unexpected acceleration

Capital account liberalization has profound theoretical and empirical importance because it is the most controversial market-oriented economic reform in China (Luo and Jiang, 2005). It is essential to note that the distortion triggered by restrained liberalization has become increasingly inimical to effective credit allocation and to the development of China's financial market. Generally, a country tends to liberalize its capital account within seven years. In contrast, China continues to maintain a certain degree of restriction on capital mobility, even though it liberalized the current account in 1996. This delayed process seems to suggest that China should have accelerated the pace of liberalization. However, dealing with volatile global finance often brings developing countries vulnerability rather than wealth and prosperity (Lubin, 2018). The boom-and-bust cycles that erupt in emerging markets clearly indicate the destructive force of the under-regulated financial market, which is a reminder of the importance of maintaining a stable, manageable pace of liberalization. Hence, how to take advantage of free capital mobility, while controlling potential risks, is the ever controversial issue confronted by China's government.

The last decades have witnessed the difficulties involved in making capital account policy changes. As an integral part of the socialist market economy proposed by the 14th National Congress of the Communist Party of China (CPC), China released an ambitious plan in 1993 to achieve full capital account liberalization by 2000. Unfortunately, this plan was suspended when the 1997 financial crisis broke out. Then, as the fear from that crisis faded away, China cautiously resumed its plan and instead attempted to make changes at the margins. In late 2002, China unveiled the Qualified Foreign Institutional Investors (QFII) program, which grants foreign investors access to a range of domestic financial markets. In 2005, the Fifth Plenary Session of the 16th CPC Central Committee officially announced the goal of gradually realizing RMB capital account convertibility, which was the first time that China included the progress of CAL into its national five-year development blueprint (Committee, 2005). However, these efforts were suspended again because of the outbreak of the 2008 financial crisis.

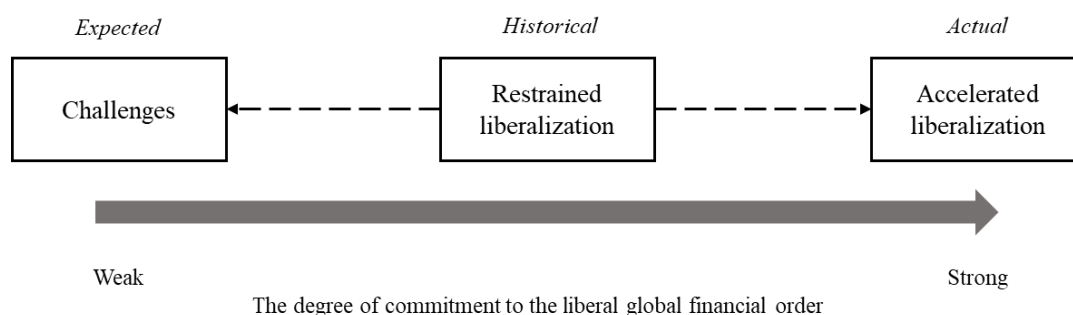
In fear of the volatile global financial market, it has been widely accepted that China will slow down the pace of liberalization. As the last chapter analyzed, China's strong governance has helped maintain a restrained liberalization. This restrained liberalization that has protected China from a volatile external environment and maintained a stable economic development, has been argued by some developmental economists to be an essential component of China's system. Especially after the subprime financial crisis, many scholars argue that China should be more confident in defending its unorthodox practices at the international level (Grabel and Gallagher,

2015, Garrett, 2010). The crisis erupted in the country in the most advanced financial institutions, suggesting that neoclassical economists underestimated the risks of free capital mobility, let alone the difficulties confronted by the countries with comparatively weak economic foundations. Because the global financial order suffered a legitimacy crisis, the countries that have maintained restrained liberalization should take this opportunity to promote their reform agenda in global governance.

However, it is interesting that China accelerated the pace of liberalization during 2014 and 2015. In 2010, the 12th Five-Year Plan (Committee, 2010) still maintained the cautious position that China should "gradually realize RMB capital account convertibility." Whereas in November 2013, the Third Plenary Session of the 18th CPC Central Committee (Committee, 2013) announced that it was necessary to "accelerate the realization of RMB capital account convertibility." This change reflected China's initiative to promote capital account reform, and, as a result, CAL shifted gears. For instance, the quota restrictions of the QFII program were further liberalized, and the famous exchange rate reform on 11 August 2015, made the RMB to US dollar exchange rate mechanism further market-oriented. After 2015, China adjusted its official statement again to re-emphasize the importance of a stable liberalization process. Even up to the present, China's government still maintains a cautious manner toward this issue. Hence, it is not hasty to say that the period between 2014 and 2015 was the only period within China's 40-year market economy reform when the government accelerated the liberalization process (Miao and Deng, 2019).

The accelerated liberalization is puzzling especially considering that the most powerful emerging market decided to underpin, rather than undermine, the global norm of capital mobility when they had a good opportunity to challenge the orthodox practice. Figure 6.1 illustrates the expected and unexpected situations among political scholars in terms of China’s behaviors after the crisis. It is widely accepted that the subprime financial crisis signifies the decline of the US hegemony (Krippner, 2011, Mearsheimer, 2019, Stephen, 2014, Woods, 2010). Because of the long-held discontent with the liberal global financial order, many scholars claim that rising powers, especially China, are doomed to take advantage of this opportunity to launch challenges (G. Chin & Thakur, 2010; Garrett, 2010; Overholt, 2010). Here, “challenge” is a broad term that includes activities initiated by rising powers aiming to revise the norms, arrangements, and structure underpinning the liberal global financial order.

Figure 6.1 How China behaved after the crisis



Source: made by the author

For instance, scholars were concerned that China would launch a norm reform on governing capital mobility, undermine the leadership of the IMF, or promote a state-led

financial mode globally. However, despite many people's expectations, China accelerated its liberalization pace after the crisis, which seemed to indicate a more significant commitment to the liberal global financial order. Given that free capital mobility is the essential component of the global financial order, this shows that the most potent emerging market intended to underpin rather than undermine the status quo order when it suffered a severe shock.

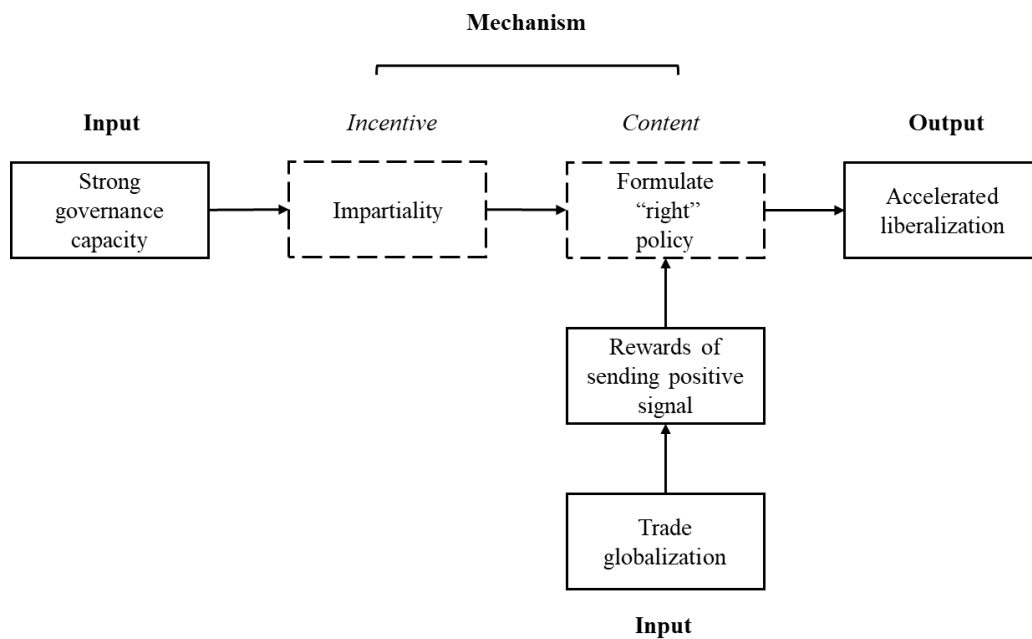
Existing studies on financial openness and China provide a few insights into this unexpected move. According to economic theory, a successful CAL should rely on a series of preconditions, including a free interest rate market, a flexible exchange rate, macroeconomic stability, and a sound supervision system (Gallagher, 2018). However, considering China's economic conditions at that time, even Western economists believed that it was not well-prepared for further liberalization (Lardy and Douglass, 2011). Next, when looking at the coercive forces wielded by the global order, developed countries and international financial institutions have long pressured developing countries to undertake market-oriented reform (Stiglitz, 2002, Chang, 2002). But after the financial crisis, the US was still struggling to recover and should not have made efforts to pressure other countries. In addition, even based on the faction politics of China's financial reform, provincial leaders were often proactive in large liberalization reform, whereas the central bureaucrats were, in general, more cautious (Shih, 2008). But in terms of CAL, provincial leaders rarely expressed their opinions publicly because they were unclear as to the effects. Reviewing the existing theories reminds us

that this phenomenon indeed deserves further explanation.

6.2 The signal effect of capital account liberalization

To understand China’s motivation for accelerating capital account liberalization, we should decipher the benefits of such an unexpected move. I take two steps to unveil the underlying calculation, and this section firstly explains why capital account liberalization is a meaningful signal sent to the international community.

Figure 6.2 Why China accelerated the liberalization pace after the crisis



Source: made by the author

As figure 6.2 illustrates, with the help of a strong governance capacity, China’s bureaucrats can keep impartiality and have a strong commitment to making the policies perceived as the ‘right’ for the country. In the long period since the early 1990s, they

maintained a restrained liberalization even under large international pressure. However, strong governance capacity also gives bureaucrats flexibility to make a timely adjustment to the 'right' policy. With deepening economic interdependence, promoting currency internationalization becomes a strategic goal that is important to China's long-term development. To achieve this goal, sending a clear signal that China supports currency convertibility is a precondition.

When analyzing the gains of capital account liberalization, we often look at the direct economic benefits. As discussed in more detail in chapter 3, these benefits include but are not limited to abundant and cheap credit supply, advanced management and financial skills, and the opportunity to strengthen domestic financial institutions. However, in addition to these economic benefits, making foreign openness policies also shows a strong signal effect. The externally oriented 'lock-in' theory (Pevehouse, 2002, Milewicz and Elsig, 2014) suggests that a country has both domestic and international audiences and purposely makes commitments to obtain distinctive benefits from outside the country. By showing a strong willingness to follow the prevailing international practices, the country can access some distinctive benefits that could only be obtained from outside. For instance, a country can improve its international reputation by gaining international community recognition or receiving more material support from international institutions.

Accelerating capital account liberalization is an external-oriented signal. Capital

account liberalization is a commitment from emerging markets to 'socialize' themselves within the global norm of managing capital mobility. Liberalizing the restrictions is a commitment to the global financial order, as the US, the IMF, neoliberal scholars, and private financial institutions have long encouraged emerging markets to accept capital mobility and tolerate exchange rate fluctuations. In addition, capital account liberalization in China is more meaningful because of two reasons. First, it is the largest emerging market that has long maintained restrictions on currency convertibility. Given its economy has salient state-led characteristics, promoting convertibility is a big move. Second, this signal was costly as China was indeed not well-prepared. A report of the IMF clearly states that there are substantial risks associated with exposure to capital flows in the absence of sufficient institutional development, especially in the financial sector (Prasad et al., 2005). Because of the delayed interest rate and exchange rate reform, China would confront speculative capital inflows from international investors or massive capital outflows from the domestic banking system (Luo and Jiang, 2005, Lardy and Douglass, 2011). In other words, a costly signal further indicates China's commitment to facilitating free capital mobility.

Importantly, the signal effect of capital account liberalization is important because it helps China realize its long-term strategic goal by pleasing the international community, especially the IMF. With deepening integration into the global economy, China gradually found that the degree of its currency usage is inconsistent with its global trade volume. Hence, it has gradually formulated an ambition to promote RMB

internationalization to strategically benefit its economy. First, it would help China decrease its reliance on foreign assets and overcome the exchange rate risk (Aizenman et al., 2013). Enterprises would be able to pay off external debt via RMB, and banks could reserve RMB-dominated assets to meet the capital adequacy ratio requirement made by the Basel Agreement. Next, RMB internationalization will drive cities, such as Hong Kong and Shanghai, to become global financial centers (Wildau and Mitchell, 2016). Because institutional investors can raise funds at home for global investment, internationalization will reduce the cost of operation and increase the supply of capital. In addition, RMB internationalization permits China to gain seigniorage, which is the profit made by the difference between the face value of a currency and its production cost. According to a widely cited estimation, China is expected to receive close to 1 trillion US dollars (USD) within ten years after realizing RMB internationalization (Zhang, 2020).

Nevertheless, the monetary history suggests that the internationalization of a sovereign currency is never a natural economic phenomenon. In the classical gold-standard era, internationalization status for a currency was granted according to a country's economic strength. After the unregulated financial market and uncoordinated national behaviors triggered hyperinflation and competitive devaluation during the 1930s, developed countries established a set of international institutions after the Second World War to facilitate global financial governance. The Bretton Woods principle confirmed that the US dollar should peg with gold at a certain amount and was recognized as the only

international reserve currency to minimize exchange rate fluctuation. Even though this experiment failed because of the problems highlighted by the Triffin dilemma, abandoning the fixed exchange rate regime did not undermine the primacy of the US dollar in global trade (Wincoff, 2014). In the post-Bretton Woods era, the international status of the US dollar was reinforced again by acting as the medium for oil transactions and because of the momentum of financial structural powers. Hence, as Eichengreen (2019) maintains, winning support from international society is a fundamental step to promoting currency internationalization.

As the US largely made the system and receives the most privileges, few countries could obtain parallel economic and military power, let alone circulate their currency as widely as the US dollar. In this situation, an essential, indispensable way to promote a currency's international usage is to join the Special Drawing Right⁹. SDR is a foreign exchange reserve asset created by the IMF in 1969 to supplement its member countries' official reserves. Specifically, the SDR is constructed by combining different sovereign currencies to help risk economies eliminate debt or credit crises. Before 2015, it consisted of USD, euro (EUR), Japanese yen (JPY), and the British pound sterling (GBP) with different proportions according to countries' economic weights. It also acts as a liquidity asset for sovereign states, especially when the US dollar is weak or otherwise unsuitable to be a foreign exchange reserve asset. In the wake of the 2008

⁹ For more information, please consult

<https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/51/Special-Drawing-Right-SDR>

financial crisis, the size of the SDR soared from 21.4 billion to more than 200 billion USD, which reflects its growing influence on managing governmental debt.

Table 6.1 The progress of RMB internationalization in 2013

Function of international currency	Governments	Private sectors
Store of value	International reserves	Currency substitution
	None	1. Hong Kong RMB savings policy banks and commercial banks issue bonds in Hong Kong, China 2. The Ministry of Finance issues RMB treasury bonds in Hong Kong, China 3. The second phase of Asian Bond Fund issuing RMB treasury bonds 4. RMB equity investment under QFII
Medium of exchange	Vehicle currency for foreign exchange intervention	Invoice trade and financial transactions
	1. Bilateral exchanges under the Chiang Mai Initiative (4 items) 2. Bilateral swap agreements between central banks (6 items)	The scope specified in the measures for the administration of RMB settlement pilot projects in cross-border trade
Unit of account	Anchor for pegging local currency	Denominating trade and financial transactions
	None	Bond issuance

Source: made by the author

From China's perspective, joining the SDR will allow distinct achievement that cannot occur otherwise. The three functions of an international currency are storage of value, medium of exchange, and unit of account (Chinn and Ito, 2006). For each function, government authorities and private actors can choose to use a significant international

currency that is not their own. As Table 6.1 illustrates, the usage of RMB was very limited in 2013 because it was treated neither as an official reserve asset nor as an anchor for pegging local currency. In contrast to China's lion's share of the global trade market, the limited usage of RMB in international transactions was a shame. Hence, because the IMF requests its member states to store a proportion of the SDR as an emergency asset, the benefit of joining the SDR is salient: Even though the SDR cannot be used in the private market, it occupies an indispensable share in the public sector's balance sheet. In other words, RMB would naturally become an international official reserve currency if it were included in the SDR basket, which would undoubtedly be a milestone for RMB internationalization.

Therefore, because of the IMF's dominant role in constructing SDR, it is the primary external audience. The IMF monopolizes the authority to govern the SDR and reviews the basket structure every five years. The review process evaluates the key elements of SDR criteria, including the export criterion and the freely usable criterion. First, a currency meets the export criterion if its issuer is an IMF member or a monetary union that includes IMF members, and at the same time, is one of the top five world exporters. Second, for a currency to be determined as "freely usable," it must be widely used to make payments for international transactions and traded in the principal exchange markets. This means that a currency should be easily exchanged when entering or leaving a country's border. Hence, simply speaking, the SDR basket only includes currencies buttressed by strong economies that enjoy a large degree of free usage. As

early as 2010, China had made efforts to propose that RMB join the SDR because of its high international trade amount. However, it is not surprising that the IMF rejected this proposal because it perceived China as still maintaining excessive administrative controls over capital mobility (Beattie, 2011).

6.3 The timing of sending signals

Nevertheless, the timing of sending positive signals is also critical. For China's political elites, they either comply with the IMF's requirements or forego the ambition to promote RMB to join the SDR. But suppose the benefits or costs of liberalizing the capital account are constant. In that case, regulatory agents should make a rational decision as early as possible, rather than maintaining a restrained liberalization and accelerating the pace only after the subprime crisis. By further developing the externally oriented 'lock in' theory, I argue that the signal sender can obtain more benefit when the external audiences need the signal most. Sending positive signals at a logical time makes a commitment to the practice of prevailing internationally at the normal pace, whereas when the status quo or international community confront a troublesome situation, sending positive signals is more valuable in terms of showing support at the right time. In the latter scenario, the external audience makes more compromises in rewarding the coordination of the signal senders, which helps them obtain some benefits that are hard to achieve at the normal pace.

The subprime crisis was the critical juncture for the liberal global financial order. A sustainable order is built on reciprocity rather than coercion. Legitimacy exists when the international order is based on reciprocal consent (Tallberg and Zürn, 2019). It emerges when majority states buy into rules and norms of the political order as a matter of principle, not simply because they are forced into it. If an international arrangement only fits central states' interests at the cost of others, it will confront a legitimacy crisis (Helleiner and Pagliari, 2011). Even though the last decades have witnessed several boom-and-bust cycles among emerging markets, neoliberal scholars often attribute the crises to developing countries' weak implementations or market distortion rather than the problem of the market-oriented reform agenda. However, the financial crisis exposed the inherent weakness of global financial arrangements. The crisis that broke out in the US quickly spread worldwide, and the quantitative easing policies also forced other countries to undertake policy adjustments to maintain their pegged exchange rate. Echoing the famous words of John Connally, the US Treasury's former director: "the US dollar is our currency but your problem." Discontent states call for the reversion of the global financial order, and some of them are even close allies of the US. Frieden criticizes that the structure of international cooperation on economic issues seems seriously deficient, and in most global issues, international cooperation is stalled, flawed, or simply non-existent (Frieden, 2007).

The subprime financial crisis further exposed the inherent weakness of the global financial order. Neoliberal theorists often attribute the financial crises in developing

countries to their weak foundations and poor implementation of liberalization policies (Pang, 2000). However, the crisis that erupted in the center of global capitalism forced scholars and politicians to rethink international arrangements. The contagion indicated that the crisis in the hub would quickly become a global catastrophe in a highly integrated financial market. Because of unrestricted capital mobility, after the US implemented quantitative easing policies, other states had to concurrently deal with hyperinflation and capital flight risks. Even a strong balance of payments position and large international reserves did not protect against adverse spillovers from financial shocks, as seen in Asia after the Lehman collapse. While not denying the liberal global financial order can bring redundant capital supply and contribute to the soaring growth of the global financial market, its volatility is too costly to afford, especially for developing countries (Helleiner and Pagliari, 2011).

The crisis also put the IMF at the center of criticisms. The IMF is responsible for surveilling global financial risks, observing countries' economic conditions, and initiating collective behaviors to resolve economic instability. The unexpected financial crisis at the heart of global capitalism suggested that the IMF is only an activist in promoting liberalization reform in developing countries but neglects speculations and market distortions in its core funders (Gutner, 2015, Wang, 2018). This dereliction of duty undermined its relevance and legitimacy in global financial governance. Many scholars and analysts viewed the crisis response as a failure, implying that the IMF somehow lacked leadership, ideas, and cooperation. Even the IMF's Independent

Evaluation Office slammed the IMF for being "woefully unprepared" for the crisis¹⁰:

The IMF's ability to correctly identify the mounting risks was hindered by a high degree of group-think, intellectual capture, a general mindset that a major financial crisis in large advanced economies was unlikely, and inadequate analytical approaches. Weak internal governance, lack of incentives to work across units and raise contrarian views, and a review process that did not "connect the dots" or ensure follow-up also played an important role, while political constraints may have also had some impact.

Though, the US and the IMF suffered serious impacts, emerging markets' influence on global governance increased significantly. As emerging powerhouses with profound growth potentials, these economies play an increasingly important role in stabilizing the global market, especially when the developed economies were anxious to save themselves. Whether this group takes coordinative actions is critical. Hence, the G7, a traditional informal institution that is responsible for initiating international cooperation in finance, was extended to the G20 by including 13 emerging markets. Even Western leaders appealed for fundamental reform of the international monetary system. They proposed controlling the risks of fluctuant exchange rates and flooding capital flows and started to emphasize the role of emerging markets in underpinning the global financial market (Wade, 2011, Harding, 2011). Hence, it is the first time that emerging markets are participating in the major platform of global governance, signifying their enlarging political voices and responsibilities. From the perspective of the IMF, emerging markets are no longer transition economies that should comply with market-

¹⁰ Independent Evaluation Office of the International Monetary Fund, "IMF Performance in the Run-up to the Financial and Economic Crisis: IMF Surveillance in 2004-07," (Washington, D.C.: International Monetary Fund, 2011), 1.

oriented liberalization reforms to sustain development. Instead, they are important coordinators that can help the Fund to regain legitimacy in governing international financial affairs (Wang, 2018). The Fund is glad to offer more reward feedback in exchange for their support.

Clearly, China is the most important emerging market given its economic size, its number of foreign reserves, and its role as the largest creditor of US bonds. It also has a willingness to reach reconciliation at this good timing. As rational actors, regulatory agents will make benefits-versus-costs evaluations to justify their actions. The benefits include the gains derived from the internationalization of RMB and preventing the opportunity cost of wasted time. Because the SDR basket is reviewed every five years, China will have to wait until 2020 if it misses its chance in 2015. Considering the increasing difficulty in restricting capital mobility with the deepening of trade globalization, gradually implementing liberalization reform is unavoidable. In addition, even though RMB internationalization is a long-term strategic goal, it became even more important after the 2008 financial crisis (Wincoff, 2014). To save the US economy, the FED implemented quantitative easing policies, which led to the sharp decrease of the US dollar exchange rate. As China has bought over 1 trillion USD in treasury securities to store its foreign assets, it became seriously concerned for its foreign investments because the values of treasury securities and USD-dominated assets were depressed.

Evidence that supports this willingness is Chinese political leaders' consistent declarations on the issue. In 2009, when discussing China's responses toward volatile global finance, then-Prime Minister Jiabao Wen maintained that RMB must be one of the future international reserve currencies (Park, 2016). When he attended the World Economic Forum, Prime Minister Keqiang Li advocated that the worldwide usage of RMB would be a milestone for China because it would reflect China's comprehensive national strength. In 2017, President Xi also publicly stated that China would promote RMB internationalization in an orderly fashion. These consistent and coherent public statements suggest that the Chinese government has made a determination to promote RMB internationalization. An indispensable component is the public commitment to the free mobility of RMB. These ambitions have also received support from developed economies. For instance, at the G20 conference, then-President of France Nicolas Sarkozy directly recommended the necessity of improving the international status of RMB (Hollinger, 2010).

6.4 Softened standards and internal debates

When China publicly sent a positive signal after the subprime crisis, the IMF offered rewarding feedback in return. Within one year, then-Managing Director of the IMF Christine Lagarde held intensive meetings with the PBC in November 2011 and March 2012 to discuss China's economic conditions and the reform of the international monetary system. China made a public commitment to liberalizing its capital account

to show its support for the liberal global financial order. In return, the IMF permitted RMB to join the SDR by softening the criteria judging whether a country's capital account can be labeled as "fully liberalized." After the financial crisis, the IMF admitted that developing countries were free to control short-term capital mobility in an emergency (Fritz and Prates, 2014), which suggests that there is no strict requirement to liberalize every item of a capital account. But allowing member states to regulate capital mobility in an emergency does not mean a country's capital account is liberalized, especially considering that China has a long way to go to make all items convertible; softening the hard threshold to define its capital account policies as "almost fully liberalized" is valuable. In other words, even though the IMF does not have the authority to influence countries' capital account policies, it can produce an "operational definition" of capital account liberalization to facilitate the liberalization process.

Even though softening the common criteria inevitably invited criticisms, the IMF believed it a worthy compromise. Edwin Truman, a former US Treasury official and senior researcher at the Peterson Institute for International Economics, criticizes that the IMF stretched its criteria because of the political considerations to maintain a good relationship with China (Donnan and Anderlini, 2015). International investors have also noticed that many measures that China has introduced to make the RMB 'freely usable' have gone untested for other IMF members, such as allowing access to its domestic bond market and giving the market a greater role in setting the daily trading range for the currency. However, the IMF still believes that softening the criteria was necessary

for China's positive commitment. Eswar Prasad, a former head of the IMF's China team, commented that it was clever to bend the rules to accept RMB because the Fund could regain global legitimacy by receiving such well-timed support from China (Wang, 2018). This pragmatic action could accelerate China's progress in capital account liberalization, which becomes increasingly important to the sustainability of the global financial order. In addition, even though the US was dissatisfied, this compromise was still tolerable to most US politicians. After all, allowing RMB to join the SDR does not launch a direct challenge against the dominance of the US dollar in international currency trading.

The IMF's compromise was critical because the bureaucrats at the People's Bank of China also utilized the softening standards to justify their decisions. In other words, even though bureaucrats could remain impartial with the help of strong governance capacity, they still need to show that their policymaking is rational for the maximization of social welfare. Sending positive externally oriented signals should gain the support of domestic audiences, especially since China has long maintained a restrained liberalization. Before the analysis, it is noticeable that the traditional ways of identifying politically influential groups do not apply to analyzing China's capital account policy. Holding that social groups can affect policymaking via lobbying or political patronage, political economy scholars have long looked at economic redistributive effects to specify the potential losers and winners (Frieden, 1991). However, because of China's socialist market economy, market forces have few

political voices, thereby the contests related to economic reform often happen within the government (Steinberg, 2014). A widely accepted framework is the “faction politics of China’s financial reform” (Shih, 2008). To briefly explain, because of different political calculations, local officials (or generalists) are more radical than central officials (or technocrats) in pushing for liberalization reform. This framework, however, also does not apply to the case of liberalization. In traditional economic reforms, such as foreign direct investments, bank lending, and privatization of state-owned enterprises, the benefits are geographically concentrated (Huang, 2018). This leads to local leaders having strong motivations to pursue further liberalization to produce a higher local economic growth than their competitors. In contrast, because capital account liberalization changes the regulations at the national level, local leaders have neither sufficient knowledge about the de facto effects nor the authority to promote the liberalization within their jurisdiction independently. As a result, local leaders rarely expressed their position, and there was no significant central-versus-local conflict on this issue.

Hence, the contest over the pros and cons of accelerated capital account liberalization were mainly discussed within the government. In 2012, the Survey and Statistic Department of the PBC published an official report (People's Bank of China Statistics and Analysis Department, 2012a) entitled “China has almost met the conditions of accelerating capital account openness.” This report argues that China is well-prepared for further liberalization and should accelerate the pace of reform. Even though this

report shows the position of the PBC, it triggered heated criticisms and hectic debates among central officials and scholars about the necessity of further liberalizing the capital account. Three signals indicated that these debates were politically influential. First, the participants included bureaucrats from the PBC, scholars from national think tanks such as the Chinese Academy of Social Sciences and the Development Research Center of the State Council, and senior managers from state-owned investment vehicles such as China Investment Corporation and China International Capital Corporation (Yu et al., 2013). They either worked in the government or had close ties with the government, and the senior managers of state-owned companies were also under the management of the cadre system. Second, most of the debates were organized by the China Finance 40 Forum, a high-level economic forum that discusses national economic issues (Knaack, 2017). The members of its governing committee often hold senior political positions within the government. Third, the State Council also appointed officials to audit the debates, which indicates a way of collecting information.

Given that the debates had strong political influences, there were noticeably different groups publishing their viewpoints and making public statements. Overall, I found that both the for and the against groups were interested in putting forward an “right” policy for the national economy, and their different positions were attributed to different theoretical understandings and working experiences. A group that was for further liberalization included the bureaucrats from the PBC and some senior managers from industry. They argued that maintaining capital control policies is increasingly costly

because it leads to distortion in the capital and current account and impedes China's participation in global financial governance (Sheng, 2013). Considering that China had accumulated a large amount of foreign reserves, it would not only lead to global credit imbalance, but also restrain the demand of domestic firms to optimize their portfolios (Xie, 2013). In addition, they believed that promoting capital account liberalization was an effective way to pressure public sectors to concentrate on coordinated movement. As Zhou (2012) claims, even though setting a timetable does not mean it will be followed strictly, without a timetable, China's officials would not feel a sense of urgency.

In contrast, the group that was against further liberalization believed that China had not met some preconditions, such as a liberalized interest rate market or a flexible exchange rate. The opposing voices came from scholars working at national think tanks, such as the Chinese Academy of Social Science, the Research Institute of the State Council, the National Development Institute of Peking University, and so forth. Their viewpoints also derived from their working experiences and the application of their academic research. For instance, Dr. Justin Yifu Lin, who used to be the vice president of the World Bank, insisted that rushing to further liberalization would lead to even more serious distortions (Lin, 2013). This position is a result of his consulting career advising developing countries in achieving sustainable development. Another influential opponent was Dr. Yongding Yu, who used to be the Director of the Institute of World Economics and Politics and a member of the advisory committee to the PBC, who contended that capital control policy is the last safeguard against volatile capital

mobility (Yu, 2015). Even though Dr. Yu obtained his PhD degree at the University of Oxford, he still criticized the hasty application of the textbook neoclassical economic theory. His position also derived from his working experience in 1997, when he advised the Hong Kong government to surmount the attacks of international speculators. After witnessing how international speculators attacked sovereign currencies in the offshore market, he believed that developing countries should maintain a certain degree of restriction on capital mobility to protect themselves from the volatile global financial market.

Why did PBC bureaucrats finally win the debates? Because the IMF provided them with intellectual resources by softening the criteria of capital account liberalization. A clear signal to show the role was that PBC bureaucrats frequently cited the IMF's reports to emphasize that the definition of "full capital account liberalization" is flexible. At the international level, the SDR institution motivated China to expand the extent of liberalization to promote RMB internationalization. At the domestic level, the vague criteria of liberalization gave PBC bureaucrats an opportunity to develop an operational definition, which in turn helped them earn wide support within the government. As the table in the chapter 1 illustrates, some components of China's capital account still remained non-convertible even according to the reports of the PBC.

The focal point of the debates lay in how to evaluate the cost of further liberalization. Clearly, the similarities between the two groups' arguments were much larger than their

differences. In terms of the benefits of capital account liberalization, both agreed that because it is conducive to RMB internationalization and economic efficiency, it should be a goal that is achieved in the future. However, the cost of further liberalization was considered controversial. PBC bureaucrats argued that the cost was manageable because China had stable macroeconomic conditions, a sound balance sheet of payment, and large foreign reserves (People's Bank of China Statistics and Analysis Department, 2012b). In contrast, the group against further liberalization claimed that the cost was too large. For instance, they claimed that, without a strong capital control policy, massive capital inflows might appreciate RMB value and asset prices, leading to macroeconomic instability (Zhang, 2013a). Considering the unfinished banking sector reform, China would not be able to countervail the attacks of international speculators, and it would be risky if capital account liberalization triggered massive capital outflows or money laundering (Wei, 2013).

Because the controversial issue referred to the potential effects of an economic policy, it was difficult to prepare an easy, standardized answer. In other words, neither group could provide sufficient, unquestionable evidence to persuade the other side based on economic theories alone. Given that the benefits of capital account liberalization were clear, the balance of benefits versus costs depends on how bureaucrats and scholars predicted the magnitude of the cost. If the cost is manageable, accelerating the pace of reform would be rational. However, if the cost is very large, the practical action would be to maintain a cautious position toward capital account liberalization.

It is credible to say that if the IMF did not soften the criteria on defining “free capital mobility,” we could not expect to see the accelerated pace of capital account liberalization in China. On all occasions, PBC bureaucrats repeatedly emphasized that CAL cannot be simply understood as liberalizing all restrictions without any retainment (Xing, 2013, Li, 2012, Sheng, 2013). When criticizing the PBC’s proposal for further liberalization, the group against further liberalization often treated the term “capital account liberalization” as a full liberalization program without any controls left (Gallagher et al., 2011). In this case, withdrawing the restrictions on capital account would be a hasty reform and produce many unmanageable risks. However, according to the operational definition given by the PBC, capital account liberalization is indeed a selective process. On the one hand, it prioritizes the liberalization of capital outflow to satisfy the demands of domestic firms in order to optimize portfolio structure and limit capital inflows to prevent economic overheating. On the other, it has been claimed to welcome long-term stable investment and maintain controls on short-term capital mobility. It seems that PBC bureaucrats had already taken the risks of further liberalization into consideration while at the same time paying attention to the government’s autonomy and flexibility in managing the liberalization process. Consequently, this definition enabled them to make an effective rebuttal against the opposing group: Once capital account liberalization can be seen as a selective liberalization process, the concerns about speculative investment are overestimated and the potential costs should be manageable.

Therefore, even though the IMF did not have the authority to make predictions about the effects of capital account liberalization in China, it had the authority to redefine the criteria. Without the intellectual resources provided by the IMF, it would have been difficult to formulate an operational definition of capital account liberalization. Without this definition, it was impossible to win wide support within the government to enlarge the degree of reform. Since China opened its market in 1978, its government has always adopted a gradual reform philosophy—from the easiest to the hardest and from less risky to riskier (Lin et al., 2003). As PBC bureaucrats also emphasized that they preferred to liberalize the safest items, which were long-term inflow investments and capital outflow, and keep control of short-term volatile capital mobility, this approach fit the long-held pragmatic philosophy. Therefore, based on the IMF's vague criterion about a liberalized capital account, PBC bureaucrats produced an operational definition that perfectly fit the idiosyncratic context of China.

It is undeniable that the potential cost of capital account liberalization was only a part of the debates. Both sides also debated whether there should be a sequence of financial reforms in China and whether a road map and timetable for financial openness should be established. The IMF could not influence every aspect of the debates, and on some occasions, PBC bureaucrats also failed to persuade others (Yu et al., 2013). However, even though overemphasizing the role of the IMF should be avoided, developing an operational definition of CAL has critical implications. A pragmatic, selective approach

is a “best practice” in China that is embedded in its over 40 years’ experience of market economy reform. Consistent with this practical philosophy is a precondition that capital account liberalization can be discussed widely and then considered seriously by the central government. Without using the intellectual resources of the IMF, it would have been difficult for PBC bureaucrats to change people’s established understandings about capital account liberalization, let alone put forward more radical reform proposals.

6.5 Discussion and conclusion

As Yu said (Chen and Qian, 2014), “Once the political decision is made, the debate over whether a specific policy should be implemented is terminated” (p. 3). In November 2013, the Third Plenary Session of the 18th CPC Central Committee approved the “Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform,” which points out that China should “open up the inward and outward capital market, make cross-border capital and financial transactions more convertible in an orderly manner, establish and improve a management system for foreign debt and capital flows under a macro-prudential management framework, and accelerate the realization of RMB capital account convertibility.” This official statement indicates that the group supporting further liberalization finally won the debate.

Finally, after the Central Committee made the political decision, capital account

liberalization shifted gears. Even though the operational definition implies that capital account liberalization is a selective reform, the final official statement only mentions “accelerating the realization of RMB capital account convertibility.” Government officials assumed that the central government had determined to prioritize liberalization profits over liberalization costs, and international investors treated it as China’s changing attitude toward the global financial market.

For direct investment, China replaced many application-for-approval procedures with registration, and further streamlined the procedures. By mid-2015, both foreign and outward foreign direct investment had become “almost fully” convertible (Anderlini, 2015). For portfolio flows, China expanded the existing investment qualification programs and established many new schemes. In late 2014, China unveiled the Shanghai–Hong Kong Stock Connect, allowing both institutional and individual investors to participate in both markets with greater ease. These liberalization efforts were recognized internationally. As a result, during the last review concluded in November 2015, the IMF Board announced that RMB had met the criteria for SDR basket inclusion. Following this decision, RMB successfully joined the SDR basket, following the US dollar, European euro, Japanese yen, and British pound sterling. Since 1 October 2016, the 3-month benchmark yield for China Treasury bonds have been included in the SDR basket.

Overall, this chapter explains why China accelerated the pace of capital account

liberalization during 2014 and 2015. Given that existing works have found it challenging to explain this puzzle, I put forward a novel argument about the timing of sending externally oriented signals. China's willingness on accelerating the liberalization process was a positive signal sent to external audiences, especially the IMF. Because the Fund also needed to regain its legitimacy and relevance in governing international financial affairs, it offered China rewarding feedback by including RMB into its SDR. By softening the criteria for capital account liberalization, the IMF empowered PBC bureaucrats' political voices by providing them with useful intellectual resources. Investigating the debates about the pros and cons of accelerating capital account liberalization provided detailed information about how PBC bureaucrats overcame opposing voices and echoed the conventional understandings about China's pragmatic market economy reform.

Even though this chapter intensively discusses the timing of sending signals, it also consists of the theoretical framework developed in chapter 3. In brief, strong governance capacity helps bureaucrats make the policy perceived as the 'right' to the national economy while changing economic conditions reshape what the 'right' policy refers to. In the case of China, it would not have a strong motivation to pursue RMB internationalization without deepening integration with the global economy. In other words, trade globalization provides a precondition for further liberalizing the restrictions on capital account. Next, without strong governance capacity, it is difficult for China to react quickly by re-evaluating the benefits-versus-costs of capital account

liberalization. As analyzed above, both the proponent and opponent groups have strong motivations to make optimal policies for the national economy. Their competing viewpoints are derived from different working experiences and understandings toward economic theories. The transparent debates particularly reflect how bureaucrats make careful evaluations of the costs of capital account liberalization as the economic conditions change.

There may be three alternative explanations for why China accelerated the liberalization pace. The first resembles traditional factor-based political economy explanations of important-substitution liberalization – China resisted opening the financial sector for foreign investment until domestic banks had caught up and could compete with foreign banks. Their soaring asset size after the crisis seems to suggest that China's banking sector has achieved substantive development. However, while not denying that China intends to protect its 'infant' sectors, this explanation underestimates the costs of opening currency convertibility. An essential problem within China is the distortion between the domestic interest market and the foreign exchange rate market (Luo and Jiang, 2005, Zhang, 2020). Under the situation of high domestic interest rates and relatively undervalued exchange rates, currency convertibility would trigger a series of speculative behaviors. Importantly, the high domestic interest rate to private financing is attributed to a large proportion of savings supporting state-owned enterprises with low-level interest rates. In other words, the distortion of the domestic interest market results from the distinctive political economy of China's market economy rather than

the underdevelopment of the domestic banking sector. Even if the banking sector is not afraid of international competition, it could not eliminate the impacts of further liberalization. Therefore, accelerated capital account convertibility was indeed a costly signal. Without the expected extra benefits obtained after the crisis, China would not take the risk to make a hasty move.

Another alternative explanation is that the direct economic benefits of further liberalization are too attractive to miss. The timing could be explained because Chinese banks and financial sectors perceived an opportunity in the weakness of western banks. Given that China has accumulated many foreign reserves via trade surplus and the asset price in America was at a relatively low level, liberalizing capital outflows would help China obtain many direct economic benefits. However, as we have reviewed the details of the debates, the economic benefits of capital account liberalization are hardly a controversial issue between the pros and cons groups. Both sides have recognized the opportunity, but these economic benefits cannot make people ignore the costs of further liberalization. Especially considering that China's government has intensively emphasized the importance of economic stability after the financial crisis, these economic benefits per se are not sufficient to make a big move. Hence, without an operational definition of the content of liberalization, we would not witness the accelerated liberalization pace in China. In the words of Brooks (2004), the costs following financial liberalization make emerging markets hesitating to advance toward openness, even if they have the most gain from opening.

Finally, there is an alternative explanation for why PBC bureaucrats were able to win the debates. It can be argued that PBC bureaucrats have stronger political influence over scholars from national think tanks, and then-President of the PBC Zhou Xiaochuan also had strong political influence. In other words, it was their political power, rather than their debate strategy, that helped the PBC surmount opposing voices. However, this viewpoint does not fully explain the puzzle. If the PBC had such overwhelming political power, it would not need to take time to engage in the rounds of debate. Instead, the hectic debates clearly suggested that capital account liberalization is indeed such a controversial topic in China that even the central technocrats hold significantly different opinions about this issue. In addition, the final decision was made by the Central Committee, the highest agency in the CPC, which also indicates that the PBC alone was not able to influence the process.

Reviewing the historical process suggests that the accelerated liberalization was indeed a costly signal. During 2014 and 2015, some hasty reforms were implemented that produced unexpected costs, making the accelerated capital account liberalization controversial (Zhang, 2013a). Specifically, alleviating the restrictions on capital mobility triggered a large number of capital outflows; the fluctuation of exchange rates made China's government have little choice but to spend almost 1 trillion US dollar foreign reserves to stabilize the RMB. As a result, China's government had to re-emphasize the importance of maintaining a stable financial market in 2016, which made

2014 and 2015 the only period in the history of the People's Republic of China (PRC) to prioritize the acceleration of capital account liberalization. Miao Yanliang, the research director of the State Administration of Foreign Exchange Investment Center, even points out that liberalizing the capital account without other complementary policies is an "ugly" lesson that China should avoid in future market-oriented reform (Miao and Deng, 2019).

In the end, the accelerated liberalization in China also indicates how the international system influences the behaviors of emerging markets. Unlike small developing countries, China has a large domestic market, abundant domestic savings, and promising growth potential. In this regard, people generally presume that this country has considerable autonomy and could relatively insulate from outside influences. However, this chapter suggests that even though China is flexible in undertaking its market-oriented reform, its road to development also runs through existing international institutions. Even though it could control the pace of capital account liberalization, it also needs to present its commitment to currency convertibility to achieve another strategic goal. As a result, the largest emerging markets also need to send a costly signal to obtain the international community's recognition. Hence, this finding also provides informative insights into how emerging markets deal with the global financial order after confronting a legitimacy crisis.

Chapter 7: Rethinking emerging markets and the global financial order

My thesis aims to explain two puzzles when looking at the capital account liberalization process in emerging markets. First, during the period when the influences of the global financial order culminated, the degree of liberalization among these countries has been fundamentally uneven. Some countries have followed the orthodox common practice of largely withdrawing the restrictions over capital mobility, whereas some have maintained a certain degree of restrictions. This variation is important in that it indicates that some countries can resist international pressures and rather pursue their own policy choices, with countries having restrained liberalization being those that suffered the least impact from external financial crises. Second, China showed unexpected, inconsistent behavior before and after the subprime financial crisis. Given that it has long maintained restrictions, many scholars predicted that it should have utilized the financial order's legitimacy crisis to further justify its "unorthodox" policies or push institutional reform at the international level. However, China accelerated the liberalization pace in 2013, which seemed to signify a larger commitment to a practice that it has long criticized. This is a critical case because if the most powerful emerging market did not show any intention to challenge the financial order, it is impossible to expect other countries to take revisionist actions.

My thesis puts forward and tests two arguments. First, strong governance capacity helps

emerging markets maintain restrained liberalization while deepening economic integration reshapes their preference in dealing with the global financial market. Second, with deepening economic integration, even though China has long maintained restrictions, it sent positive external-oriented signals at good intervals in exchange for rewarding feedback. Overall, I think my findings make three novel contributions to the existing literature. First, they provide a deductively derived explanation that not only deciphers the mechanism of policymaking but also accounts for a variety of policy outcomes. Second, they explain China's inconsistent behaviors via a coherent theoretical framework. The findings suggest that even though emerging powers are discontent with some components of the liberal global financial order, they are increasingly and functionally dependent on the existing institutional frameworks with increasing economic interdependence.

Finally, we can also learn from the restrained and accelerated liberalization to rethink the relationship between emerging markets and the global financial order. I argue that we should not overestimate the tensions and conflicts triggered by rising powers. The last chapter consists of four sections. The first section briefly reviews the ongoing debate among IR scholars about the relationship between emerging markets and the liberal international order. Then, I analyze the values of restrained liberalization by identifying the unilateral resistance in global financial governance. I argue that, when compared with directly pushing institutional reforms, it is a more feasible way for emerging markets to defend their interests. The third section examines different

dimensions of power to suggest that challenging the global financial order is still difficult for emerging markets. Even though a strong governance capacity can help them maintain restrained liberalization (the power of autonomy), it cannot help emerging markets further promote their unorthodox behaviors globally to launch a challenge (the power of influence). Finally, I summarize possible scenarios that explain the behaviors of emerging markets, to contend that we should not overestimate their impacts on the global financial order.

7.1 The ongoing debate

People have become increasingly concerned that the economic centrality has gradually shifted from established to emerging markets, and the liberal global financial order will become fragile as new economic powerhouses challenge the international context to better reflect their interests. Even though “emerging markets” is an economic term in global finance, it reflects capacity redistribution among countries. Economic strength and political importance are closely related as countries can leverage material resources to wield international influence. Political scholars use a neighboring term, “rising powers,” to describe countries that have quickly narrowed down the capacity gap with established or status quo powers. They further explore the underlying tensions and instability triggered by international power shifts (Gray and Murphy, 2013, Hurrell, 2006, Destradi, 2010). Considering their dissatisfaction towards the prevailing practices over capital account policy, they should have intentions to challenge the international

norms and practices proposed by the liberal global financial order.

At first glance, the clash between emerging markets and the global financial order seems to be inevitable. With the deepening of globalization and interdependence, international order involves various domains including trade, finance, security, environment, and human rights (Tang, 2016, Huotari and Hanemann, 2014). The redistribution of material capacity among countries does not necessarily lead to tension and instability because a rising powers' intention is critical; the attitude toward one specific issue area determines whether countries would like to make revisions (Helleiner and Kirshner, 2014, Kahler, 2013). If a rising power is satisfied with existing collective arrangements, it will underpin, rather than undermine, the status quo. For instance, West Germany and Japan acted as guardians of the international order through compliance with international rules. China is now the second-largest funder of the UN and the UN peacekeeping program and actively participates in international cooperation in carbon dioxide emission control, anti-terrorism, and anti-trade protectionism (Hodzi and Yu-Wen, 2018). However, when countries have the ability and motivations to change the status quo, tension is unavoidable. As emerging markets' sentiments towards the global financial order worsen, their growing capacity raises concerns that the international financial system will become unstable.

Among the conventional understandings, the predominant pattern to date has been that emerging markets that are "dissatisfied" will fundamentally challenge the rules and

norms of the international order. This view argues that emerging powers attempt to export an alternative model of political and economic organization that deploys “purposive state intervention to guide market development and national corporate growth, rather than relying on self-regulated market growth” (Kahler, 2013). The other envisages a peaceful integration in which emerging markets are “status quo” powers helping mainly to maintain the liberal institutional arrangements. This view emphasizes that as rising powers have deeply embedded into the global economy, the road to development runs through, not away from, the liberal economic order. Recent studies transcend these binary views by arguing that rising powers tend to launch “within-system challenges”: Rising powers decide to integrate into the international order but will selectively challenge the most liberal components (Tang, 2018).

Therefore, it is valuable to further analyze the profound political implications of these economic phenomena. After all, free capital mobility is politically important; it not only enhances the US’s global primacy but also constitutes an essential component of the financial order. Specifically, in terms of the restrained liberalization, even though controlling capital flow in and out of the domestic market is a unilateral behavior, it is an unorthodox practice from the perspective of neoliberal theorists. It shows some countries could defend their independent policy choices rather than merely following the international prevailing practices. Next, the accelerated liberalization in China seems to suggest that the largest emerging markets tended to make a commitment on free capital mobility to socialization with the global norms. This phenomenon has a

strong symbolic value because China should have an opportunity to further promote its unorthodox domestic policies internationally when neoliberalism has suffered heavy criticisms. It is reasonable to make a “logical generation” from this critical case (Patton, 1990). Given that the most powerful emerging markets tend to underpin, rather than undermine, the global norm of capital mobility, we should not underestimate the possibility that the global financial order can successfully accommodate other countries’ discontent.

7.2 Restrained liberalization and unilateral resistance

Reviewing the existing debates on the relationship between emerging markets and the international liberal order suggests that our conventional understandings are insightful. Nevertheless, no matter the challenge, integration, or within-system challenge, these scenarios only focus on the international or multilateral level. I argue that these scenarios cannot fully account for how emerging markets react to the international order. Drawing from the empirical findings from previous chapters, I suggest that we should also look at emerging market’s behaviors at the domestic level, or in other words the unilateral resistance towards external pressures.

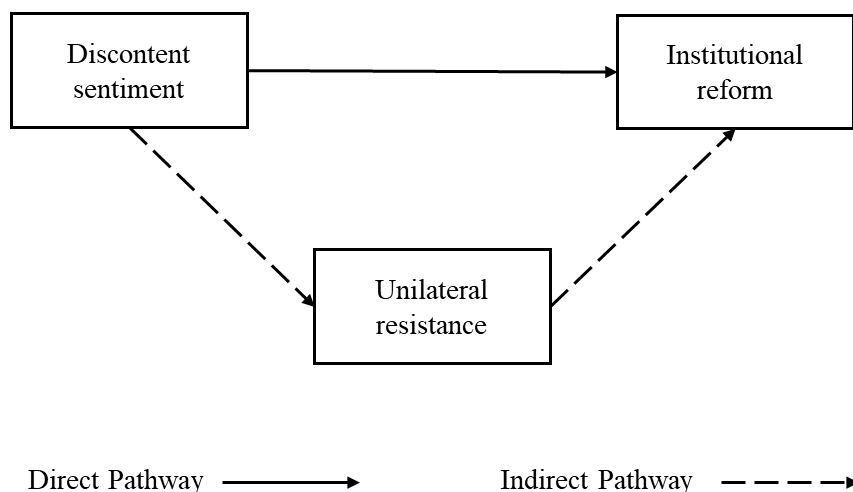
Unilateral resistance is a strategy adopted by rule-takers, rather than rule-makers, of global governance. Over the last few decades, international financial institutions and Western countries recommended they accept the so-called “best practices” proposed by

the Washington Census and other international arrangements (Wade, 2003, Wade, 2011). Many macroeconomic policies have become unavailable because of the proliferation of international rules, obligations, and practices. Interplaying with the global financial market also brings them vulnerability rather than prosperity, and the boom-and-bust cycles made them realize the importance of intervening in the market. Hence, some emerging markets decided to make unorthodox policies at home by restricting free capital mobility. This behavior is unilateral because it is made by individual governments without the permission or collaboration of others. It is also a resistance because doing so must overcome the criticisms and pressures from the US, international financial institutions, neoliberal theorists, and private investors.

This unilateral resistance has profound political implications. IPE scholars have analyzed emerging markets' resistance towards external policy coercion. Akyuz (2007) identifies it as the pursuit of "greater flexibility in the policymaking process," which means countries want to regain the ability to make policies that used to be feasible (Akyüz, 2007). The "countervailing monetary power" means that, at the national level, some countries can countervail political pressures and sophisticated global capital markets to manage financial stability (Gallagher, 2015). Armijo and Katada (2015) call it "defensive financial statecraft." Emerging powers intentionally use credit or monetary levers to protect their economies when facing pressures to implement market-oriented reforms (Armijo and Katada, 2015). The "policy space" literature (Gabel, 2011, Helleiner, 2010, Gabel and Gallagher, 2015) emphasizes that emerging markets'

behaviors should be understood as a strategy to rescale the spaces of monetary, fiscal, and exchange rate policies. Despite using different terms, they all appreciate emerging markets' efforts to make unorthodox policies at home.

Figure 7.1 How rising powers deal with the liberal international order



Source: made by the author

I argue that the importance of unilateral resistance does not merely rely on regaining policy space. Instead, it shows that emerging markets have found a quicker and more feasible way to defend their interests when they are discontent with the international order. To highlight its distinctive advantages, it can be compared to the alternative option. The Figure 7.1 illustrates how discontent states respond to the global order. The straightforward way, as realists often emphasize, is to change the international context to make the rules or prevailing practices fit their preferences. This approach can be further categorized into intra- and inter-institutional reform. The former contests the representation within existing international institutions (Chen, 2016), and the latter refers to countries that combine threats of exit, voice, and the creation of alternative

institutions to pursue policies and practices different from those of existing institutions (Stephen, 2017).

However, institutional reforms are hard to realize. On the one hand, the degree to which emerging markets can influence an international institution in the pursuit of their interests is formalized within the constructs of institutional design, especially voting shares, representation in governing bodies, and how the institution is financed (Koremenos et al., 2001). Even if emerging markets can increase the number of donations with growing economic capacity, they cannot change the fact that the international financial institutions are Western dominated. As the established powers are also veto players within the institution, it is difficult for emerging markets to push any progressive institutional reform (Chen, 2016). In terms of inter-institutional reform, it is more likely to increase regime complexity rather than changing international prevailing rules and practices. After all, the goal of launching an institutional reform is to reach new agreements among states about how to better govern their subsequent interactions (Young, 1996)—reaching agreements among countries requires some preconditions and cannot be realized overnight. Without reaching a consensus with other countries, emerging markets can only undermine the effectiveness of the status quo institutions rather than creating an international environment according to their preferences.

Hence, before emerging markets are better developed, unilateral resistance at home is

a more feasible way to secure their interests. It is undeniable that promoting institutional reform is the optimal situation because it can further legitimate emerging markets' heterodox practices, forming an international context that fits their requirements better. However, because this scenario is hard to achieve in the short term, a pragmatic approach is to take the second-best option. Especially when the liberal international order has not confronted the legitimacy crisis, discontent states are incapable of initiating institutional reforms when they cannot formulate a coalition. Therefore, they make policies based on their own preferences rather than following the guidance of global norms. In terms of the capital account liberalization, because maintaining a restrained liberalization is a unilateral behavior, it is easier to manipulate compared with initiating a norm reform on the management of capital mobility. The only requirement is to overcome the criticisms and pressures once a country deviates from the prevailing international practices, and a strong governance capacity is sufficient to bring countries autonomy.

This strategy protects emerging markets' interests by helping them insulate from the volatile global market. With the help of a strong governance capacity, regulatory agents first keep impartiality to insulate from the influences of strong market forces and then countervail the external pressures to implement policies that are perceived as optimal to the national economy. Importantly, it is necessary to clarify that resistance of liberalization does not simply mean supporting state intervention or isolating from the global economy. The last few decades have witnessed a wave of liberalization reforms,

and it is widely accepted that market mechanism is good at increasing resource reallocation efficiency. Nevertheless, despite following the general trend of market-oriented reform, developing countries should have the autonomy to decide the pace and the terms of reform (Stiglitz, 1993). After the end of the Cold War, when neoliberal proponents were insistent in promoting their ideas (Quoidbach et al., 2013), resisting a hasty liberalization became even more valuable to protect themselves. Historically, the countries that suffered fewer impacts under global economic crises were those that kept maintaining a certain degree of restrictions on capital mobility (Frieden, 2007).

7.3 The gap to influential power

Unilateral resistance has a strong symbolic value because emerging markets are not only discontent with some components of the international order but also have the capacity to countervail the external pressures. It implies that if emerging markets have both the intention and capacity to resist the international arrangements, they may trigger conflict and instability when they are well-prepared. However, I argue that, while not denying the value of unilateral resistance, we should not overestimate the impacts of emerging markets internationally. Power has two dimensions and unilateral resistance shows that emerging markets have obtained autonomy, but these countries still have a long way to go if they want to obtain influential power to revise the international arrangements according to their needs.

Power is generally interpreted as state A getting state B to do something they would otherwise not do (Waltz, 2010). If we only focus on how state A exerts influences over other countries but rarely discuss how state B reacts, it leaves an incomplete image. From the perspective of emerging markets, these would-be great powers are supposed to find a way to expand the room of policymaking (Hurrell, 2010). From this perspective, maintaining a restrained capital account liberalization is not a neutral technical issue that merely refers to how governments regulate capital mobility. It reflects a country's capacity to insulate from outside pressures to follow the common practices and act according to their own requirements. Drawing from Cohen's analyses (Cohen, 2016, Cohen, 2008, Cohen, 2005), influence and autonomy should be identified as two distinct dimensions of power, which can be labeled the external and international dimensions, respectively. He gives an excellent explanation about how to perceive the meaning of autonomy (2008, p. 456):

Autonomy corresponds to the dictionary definition of power as a capacity for action. An actor is also powerful to the extent that it is able to exercise operational independence: to act freely, insulated from outside pressure. In this sense, power does not mean influencing others; rather, it means not allowing others to influence you—others letting you have your way.

Obtaining autonomy is also a precondition of wielding influential power. Logically, exercising leverage abroad is inconceivable without first attaining and sustaining a high degree of policy independence at home. For example, actors must first be free to pursue their goals at the domestic level, which would then be sufficient to exercise influences elsewhere. Drawing from Cohen's words (2008), in any given context it is possible to

think of autonomy without influence, but it is puzzling to think of influence without autonomy. Given that some emerging markets could countervail the structural pressures when neoliberalism's influence culminated, these economies may further promote their unorthodox practices to redefine, mediate, and legitimate the state's interactions internationally (Krippner, 2011, Mearsheimer, 2010). If an emerging market does not have any experiments at home, it is hard to produce diffusion effects to motivate and influence others. Hence, autonomy may not be sufficient to ensure a degree of foreign influence, but it would certainly appear to be the essential foundation of influence. Emerging markets should first use unilateral resistance to secure their interests at home, and then promote institutional reforms to legitimate their practices internationally.

However, upgrading from autonomous to influential power is not easy. Obtaining autonomy is a unilateral behavior, and countries with a strong governance capacity can insulate from external influences. In contrast, wielding influential powers externally is more difficult because, when challenging the status quo, states need to reach new agreements about how to better govern their subsequent interactions. Therefore, influential power requires international leadership to foster cooperation and commonality of social purpose among states (Ikenberry, 1996, Young, 1996). Structural leadership refers to the underlying distribution of material capabilities that gives some states the ability to shape the world's political order (Gilpin, 2016). Intellectual leadership provides visions or generative systems of thought that shape a states' approach to research agreements (Goldstein and Keohane, 1993, Young, 1991). While

structural leadership focuses on translating material resources into influential leverage, intellectual leadership relies on the power of ideas to substantiate how states envisage reciprocity in world politics. Even though countries with a strong governance capacity can implement unilateral resistance, they still need to cultivate other capacities for initiating collective activities internationally.

Therefore, even though a successful unilateral resistance cannot help emerging markets generate intellectual resources directly, countries with a strong governance capacity can make policies that are perceived as beneficial for their national economy. Their economic growth and overall robustness increases their persuasiveness because states are particularly willing to follow an ideal that is appealing and prosperous—leadership by example (Ikenberry, 1996). Nevertheless, these policies only follow pragmatism and cater to one country's specific conditions, which means it is unknown whether these practices can be easily replicated by other countries. After all, rising powers are countervailing the universal best-practice policies to make heterodox choices rather than providing an alternative set of thoughts to build a new orthodoxy. Without scientific theoretical debates and empirical tests, other countries cannot replicate these practices. Without this leadership, it is difficult for emerging markets to influence, motivate, and persuade others to follow their ideas. Distinguishing the different dimensions of power indicates that because autonomous and influential power rely on different elements, being reliant on a strong governance capacity is not sufficient to exercise influences elsewhere.

Deciphering the different dimensions of power suggests that challenging the global financial order is difficult for emerging markets. Given that emerging markets have diverse domestic interests, formulating a standard version is essential to overcome collaboration problems (Laidi, 2012). The legitimacy crisis of the order and the potential to possess structural leadership only fulfills part of the conditions. Analyzing the gap to influential power shows that conventional understandings overestimate the impacts brought by rising powers. It is biased to assume that rising powers could simply utilize the opportunity of the legitimacy crisis to change the international environment basing on their preference. In contrast, to maintain a restrained liberalization at home, these countries need more preparations to achieve their international ambitions. If there are no widely accepted values, visions, or practices shared by countries, rising powers are unable to act as intellectual leaders. Therefore, we should not simply assume that countries that have maintained restrained liberalization could easily take advantage of the crisis.

7.4 Emerging markets' limited impacts?

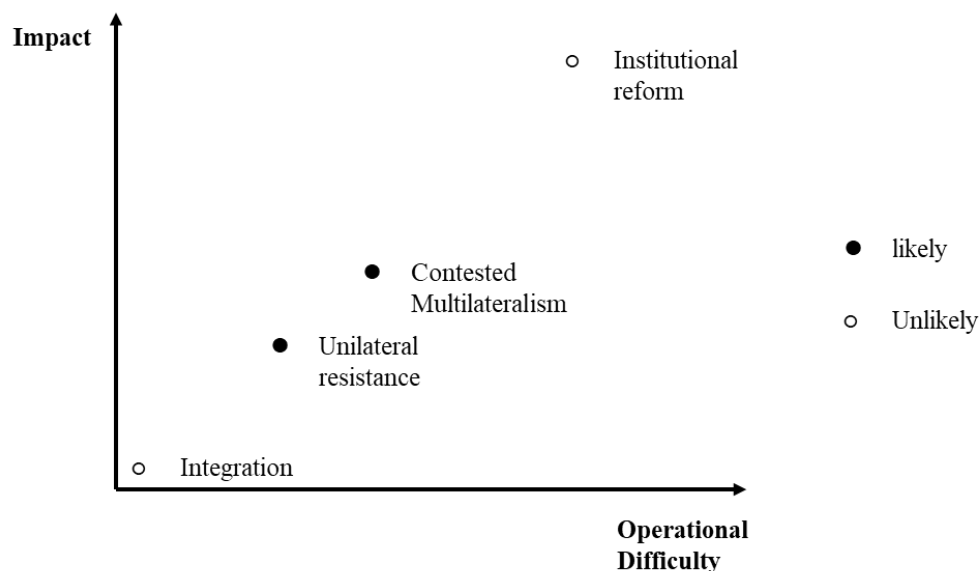
Finally, I combine the analyses above to rethink one of the most critical concerns of our time — what are the impacts triggered by emerging markets on the global financial order? The impacts on the global order refer to whether international rules or orthodox practices are sustainable as time goes by. In the financial domain, they refer to whether

the orthodox policies with liberal characteristics, like promoting free capital mobility, tolerating exchange rate fluctuation, and undertaking liberal structural reforms, will still prevail in the future (Eichengreen, 2019). Different explanations often lead to competing ideas, such as whether emerging economic powerhouses will launch challenges or integrate into the status quo. If these countries have successfully redefined interaction among states, it shows that they have posed significant impacts on the liberal financial order. In contrast, if emerging markets are willing to accept these policies, it is a signal that they act as satisfied status quo powers and pose few impacts.

The Figure 7.2 shows my endeavor to visualize emerging market's impacts based on which situations they most resemble. The purpose is to help us think of the possible impacts brought by emerging markets. The X-axis indicates the operational difficulty, and the Y-axis refers to the degree of impact on the status quo international order. Integration, unilateral resistance, contested multilateralism, and institutional reform follow a quasi-linear line. Integration and institutional reform are two extreme scenarios. Because integration assumes that states will integrate into the global order and support the liberal institutional arrangements, it is the optimal situation to the status quo. At the same time, it is also easy for rule-takers to perform this action as they just need to comply with the prevailing international practices. In contrast, institutional reform means emerging markets have significantly influenced existing institutions or have established widely recognized competing institutions to redefine, mediate, and legitimate the states' behavior internationally. Because it largely undermines the

legitimacy of the orthodox neoliberal behaviors this situation is the most difficult to operate as it requires many preconditions to obtain influential power.

Figure 7.2 The impacts on the international order



Source: made by the author

In contrast to these black-or-white images, the most likely situations are unilateral resistance and contested multilateralism. Their impacts should be located somewhere between integration and institutional reform. The impact of unilateral resistance should be different from that of full integration because, at this stage, states are no longer content with the international rules and have made specific actions to defend their practices. Even though it mainly affects domestic policymaking, it shows that emerging markets have expressed their discontent publicly. Before the 2008 financial crisis, the primary option available to emerging markets was unilateral resistance. The US's claim to world leadership was underpinned by a neoliberal ideology of economic openness, stable growth, and the global economy's joint economic management (Ikenberry, 2009).

After the liberal global financial order has confronted a legitimacy crisis and emerging markets have accumulated sufficient material resources, it is easier to leverage their economic capacity to launch challenges internationally through contested multilateralism. Therefore, emerging markets have either utilized existing institutions, for example, expanding the regional financial safety nets, or built new institutions, for example, the establishment of The Asian Infrastructure Investment Bank to further pursue their interests in the rule-based international order (Chin, 2016). Nevertheless, as scholars intensively analyze the effect of contested multilateralism, it only increases regime complexity and produce uncertainties in global governance rather than pushing a fundamental reform in the international order (Morse and Keohane, 2014, Stephen, 2014, Stuenkel, 2013, Henning, 2017).

Therefore, in the end of the thesis, I try to visualize the possibilities of different scenarios to suggest that the impacts brought by emerging markets should be limited. On the one hand, the road to institutional reform is too difficult to realize for emerging markets, especially in the short term. A legitimacy crisis and the potential to obtain structural leadership only fulfill part of the conditions. Fundamentally, they still lack the intellectual capital to initiate collective activities. On the other, as has been analyzed in previous chapters, the deepening economic globalization brings emerging markets more overlapping interests with the international status quo. In the words of Ikenberry (1996), their road to development runs through, rather than against, the existing

institutions. From the perspective of established powers and international institutions, they also have incentives to accommodate a country's dissatisfaction.

Overall, further investigating the meanings of restrained and accelerated liberalization can also enrich our understanding of the interplay between emerging markets and the global financial order. Considering the difficulty of moving to launch challenges and the possibility of reaching peaceful reconciliation, I argue that emerging markets are more likely to post limited impacts when they either perform unilateral resistance or contested multilateralism. When emerging markets gradually step into the center stage of global governance, to what extent they will bring changes and revisions is an ongoing meaningful topic of our time. Even though this is not the focal point of my thesis, it makes endeavors to provides insights from the empirical findings.

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