

Project on International Order and Strategy

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China's emerging institutional statecraft

The Asian Infrastructure Investment Bank and the prospects for counter-hegemony

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About the Project on International Order and Strategy

The purpose of the Project on International Order and Strategy (IOS) is to understand the changing power dynamics in the international system and the implications for U.S. strategy and international cooperation.

The Foreign Policy program at Brookings created the project in 2007, then called the Project on Managing Global Order, to address the burgeoning debate in the United States on the future of power, the international order, and U.S. strategy. This is being driven by numerous factors including: the rise of new great powers, the diffusion of military and political power, economic difficulties in the Western order, challenges to the regional order in the Middle East, and the re-emergence of territorial disputes in Asia. These challenges to the order, and threats to state and human security, are evolving rapidly, while the United States is grappling with new constraints—as well as new opportunities. IOS examines these developments in their totality and not just as individual issues, and assess the implications for U.S. strategy.

IOS is a unique project, offering sustained research and policy engagement on the questions of international order and strategy, and features many leading thinkers on the subject, including staff members Thomas Wright, Bruce Jones, Robert Kagan, Ted Piccone, and Tanvi Madan; Non-resident Senior Fellows Daniel Drezner (Tufts), Michael Fullilove (Lowy Institute) Rory Medcalf (Australian National University), and Elizabeth Saunders (The George Washington University); and Distinguished Fellow Javier Solana (ESADE). Senior Research Assistant Will Moreland supports the project. The project's key research topics include the future of America's global role, the behavior of the emerging powers, geopolitical competition in an interdependent world, and the revitalization of the West.

IOS promotes sustained dialogue with the emerging powers; convenes the emerging powers and foreign policy officials and experts from the United States and the Western allies, and engages key U.S. decision-makers on the challenge of adapting U.S. leadership and strategy to changing international realities.

Introduction

China is a rising power that is confronting an age-old geopolitical problem: what does it do with its new and growing capabilities? How does it project power and turn power into purpose? How does it gain more control over its geopolitical environment, within Asia and the wider world? Rising great powers inevitably find themselves with growing stakes in how the world is organized, and they seek to help shape that regional and global environment. As their capabilities increase, the instruments of statecraft available to rising powers expand in potency and scope. In this paper, we focus on the building of new international institutions, and specifically ask: how can China use new international institutions to advance its interests? This question is of greatest salience at the level of the international system, and the prospect of China building a network of “counter-hegemonic” institutions that successfully challenge—oppose and undermine—the U.S.-led global and regional institutions and the order they help sustain.

The United States established its international position through the building of a wide array of international institutions—global and regional, economic, political, and security. These institutions have been integral to the rise of the postwar liberal international order. As China’s rise is occurring within this established system of institutions, we begin our inquiry by asking how China is engaging, confronting, and making choices about these institutions and this order. And indeed, China is doing lots of things with

international institutions. First, it is increasing its level of participation and engagement with existing multilateral institutions.¹ Second, it is building new institutions, such as the New Development Bank (NDB, formerly referred to as the BRICS Development Bank), the proposed Regional Comprehensive Economic Partnership trade agreement (RCEP), and most prominently the Asian Infrastructure Investment Bank (AIIB). We focus on China’s creation of new multilateral institutions because it sharpens the questions we want to ask. China is operating within old institutions and in various ways trying to create new ones. So how can we make sense of China’s choices about how to use international institutions as tools and sites for the pursuit of its interests? Or, put differently, what is the logic of China’s emerging “institutional statecraft?”

There is a lively debate on China’s engagement with global and regional multilateral institutions.² In many ways, Robert Zoellick framed this debate in 2005 with his “responsible stakeholder” speech.³ The question Zoellick asked was: would a rising China integrate into, and share responsibility for leading, the world’s governance institutions? American and Western policy has long been premised on this anticipation. But observers disagree on the manner and extent of China’s embrace of the postwar multilateral system. Some see China following the path urged by Zoellick in joining, for example, the World Trade Organization (WTO) and playing constructive roles in a wide array of multilateral institutions.

After all, China is an active member of most of the major multilateral organizations.⁴ Others emphasize China's search above all for pragmatic solutions, a strategic approach that requires active participation and engagement with much of the existing order, but also the use of leverage to extract concessions.⁵ And there are those who argue that China is embarked on a very different path, seeking to undermine and work around the existing system of multilateral institutions.⁶ The AIIB and NDB are seen as harbingers of a growing split between China and the U.S.-led liberal international order.⁷

In seeking to illuminate China's emerging institutional statecraft, we offer four contributions. First, we argue that it is important to place China's recent actions to create new, potential rival institutions within the wider context of its engagement with regional and global institutions, and the broader system of existing multilateral rules and institutions. China is deeply involved in some multilateral organizations and regimes, and it resists others; how should we characterize this pattern? It is also important to distinguish between different possible meanings of "the existing international order." American hegemony, liberal internationalism, and the deeper systemic foundations of sovereignty and state primacy are three layers of this existing system, and China has varied orientations toward each.

Second, we propose a typology of the various choices or strategic stances that China—or other rising states—might take toward old or new international institutions. These choices can range from joining and operating within an existing institution to outright non-involvement and acting outside of established institutional frameworks. Between these extremes, China can choose to operate from within existing institutions, either to enhance its position through seeking the redistribution of decisionmaking authority, or by using its influence to obstruct and contain the progressive evolution of the liberal rules, practices, and norms of an institution in ways that threaten China's interests. Alternatively—and this is the major focus of our paper—China can seek to create a new international institution.

Third, we examine the case of the AIIB—a recently created China-led multilateral development lending institution—to help illuminate the logic of institutional creation as a strategic choice and tool of statecraft, including its opportunities, limitations, and likely impacts. Institutional statecraft may in some ways reinforce China's integration into, and stakeholder role and position in, the international system, while in others it may present various sorts of challenges to the existing system of rules and institutions. We seek to sort out these pathways and identify their implications for the United States, both in the context of development lending and the broader liberal international order.

Fourth, we use the AIIB example to anchor a more specific inquiry into China's creation of new institutions for "counter-hegemonic" purposes. Here we offer some ideas about the logic of counter-hegemonic institutionalism—identifying the ways China could use *new* institutions as part of a strategy (1) to achieve reform of certain rules, practices, and norms of the existing system of institutions and the issue areas they regulate; (2) to increase its influence and authority within the existing system of institutions and liberal international order, and accordingly reduce that of the United States; and/or (3) to propagate rules, principles, and norms that could form the basis of a rival international order. We offer overall conclusions about counter-hegemonic institutional strategies, and the limits on China's ability to pursue them. We argue that multilateralism requires other states to participate, by definition, so China's ability to wield new institutions as "instruments" of its political and economic goals has limits. Moreover, as the existing institutional order has rules and institutions that China can use to pursue and defend its interests (particularly those relating to sovereignty norms), China's struggle to gain advantage and voice may draw it further into the existing system.

In the conclusion, we consider how our analysis may be shaped by Donald Trump's victory in the U.S. presidential election. To what extent will hostility from the Trump administration to multilateral institutions, and liberal internationalism more broadly,

affect the efficacy of China's institutional statecraft? China's approach will not involve a singular decision either to "engage and integrate into" existing regional and global institutions, or "oppose and undermine" these institutions. It will make a range of choices, precisely because institutions can serve a wide variety of purposes for leading and emerging states. However, if the purpose and/or efficacy of existing institutions evolve dramatically under a Trump presidency, China's choices likewise will change. To the extent that the institutions that underpin the liberal international order are well-functioning, enjoy widespread legitimacy and, most importantly, de-

liver China significant benefits, Beijing may see the need to become a more activist defender of the status quo. However, in situations in which China and the Trump administration share antipathy to the liberal character of certain institutional practices, these will face mounting pressure to change, or simply be ignored. Nevertheless, attempts by China to enshrine new rules, practices, or norms will require the cooperation of other states and thus compromise from Beijing. Defenders of the liberal international order can therefore take heart that while compliance rates may fall, an illiberal alternative is unlikely to take its place.

China and international institutions

The rise of China to the status of a global power is one of the seminal developments of the current era. Propelled by almost three decades of double-digit economic growth, China has moved from a weak and peripheral position in the world economy to the center. Although its rate of growth has slowed, in the coming decades—if trends continue—it might pass the United States to become the world’s largest economy. With its growing economic size has come wealth and power. Countries across East Asia and around the world are increasingly tied to China for trade and investment. In the meantime, China is rapidly expanding its military capabilities and projecting power and influence abroad. China is pursuing an expanding diplomatic agenda, building ties and partnerships with countries in all regions of the world.

China is thus following in the footsteps of rising great powers of the past. It is a dynamic that has been captured by theorists and historians, such as Robert Gilpin and Paul Kennedy.⁸ Great powers rise up and contest the terms of international order. As China becomes a world-class economic power, its interests are expanding outward. It increasingly has material interests to protect in the fields of international commerce and finance. It depends increasingly on energy and resources from other parts of the world. More people and places in Asia and around the world matter to China. At the same time, with its growing economy and wealth, China is acquiring greater military and technological capabilities to

project abroad. The older states that rose up in the past to shape the present international order are now faced with China as a challenger. China increasingly has interests and power that lead it to seek to shape the rules and institutions of the regional and global order to suit its purposes.

There are a variety of motivations rising states might have to change or reshape the rules and institutions of international order, and a variety of ways for doing so. In the narrowest sense, rising powers may be motivated by a desire to capture a greater share of global wealth, and to that end may seek greater influence and control over the world economy—their terms of trade, the flows of resources, and the character of the international monetary system. They may similarly seek to alter the terms of property rights and international law. Rising powers may be motivated by the pursuit of greater political influence in bilateral and regional domains, as well as enhanced authority within the broader system of global governance.⁹ Such a rise in influence would inevitably dilute the influence of the most powerful state within this system, and enhance the rising power’s own status and prestige. More radically, a rising power may seek to change the architecture and rules of international governance institutions, and/or fundamentally alter the underlying principles and norms these institutions enshrine to reflect their own national values or ideology.¹⁰

While China is traveling a familiar path, it is also rising up and encountering a distinctive international

order. Two features in particular stand out and interact. First, more so than past ascending great powers, China is rising in an existing order that is highly institutionalized. It is filled with regional and global institutions. The United Nations (U.N.), the Bretton Woods institutions, the WTO, and a sprawling array of other international organizations and regimes comprise the existing global order. As Marc Lanteigne argues: “What separates China from other states, and indeed previous great powers, is that not only is it ‘growing up’ within a milieu of international institutions far more developed than ever before, but more importantly, it is doing so while making active use of these institutions to promote the country’s development of global power status.”¹¹ Second, a far larger number of independent state actors exist within this order and are participating in these institutions. The “cooperation problem” faced by institutions becomes increasingly difficult and complex as the number of actors increases. Accordingly, while institutions are needed more than ever to coordinate the activities of states in an interdependent world, success—in terms of both generating mutual benefits and retaining legitimacy among participants—is even harder to achieve.

Rising powers in the modern era, which across the centuries have included Spain, France, Great Britain, Germany, Russia, and the United States, encountered an “existing order” that was substantially less organized around multilateral institutions and regimes and involved far fewer participating actors. In contrast, today’s global order—dating back to the 1950s—is dense with layers of political, economic, and security treaties, multilateral institutions, and functional organizations. In totality, these institutions have provided significant benefits to and coordinated the activities and expectations of an increasingly large population of states via their contributions to global security, stability, and economic development. Whether China seeks to integrate and rise up within the existing order or not, its pathways and choices are directly and inevitably leading it into encounters with this dense array of international institutions and the diverse interests of close to 200 sovereign states. As we shall argue, this dense array

of institutions will create both opportunities and constraints for China.

Several additional observations follow. First, because the “old order” is more institutionalized than previous international orders, it will be harder to undermine and overturn. The order has a durability that past orders did not. It has more layers and realms of rules and institutions, which are more deeply rooted in the economies and societies of countries around the world. Two other factors reinforce its durability. One has to do with nuclear weapons. Nuclear weapons are today in the hands of most of the leading great powers, making great power war more irrational and less likely. The result is that the classic historical mechanism that has worked to overturn and destroy the “old order”—namely, great power war—has been taken off the table. The other factor is the widespread presence of liberal democracies across the global system, states that are—for the most part—deeply integrated into the existing order. Together, these factors—a high degree of institutionalization, nuclear weapons, and liberal democracy—make the existing international order more entrenched and resistant to efforts by rising states to pursue radical revisionist agendas.¹²

Second, the existing international order is not just “one thing,” in which states must decide: do I “join” or do I “oppose”? Today’s international order is complex and multilayered, both at regional and global levels, and states can be “in” some of it, while staying outside of or opposing other parts of it.¹³ It is composed of many layers of rules, norms, and institutions. There are the deep norms and institutions of the sovereign state system. There are the global multilateral economic rules and institutions, including the Bretton Woods regimes and the WTO. There are a variety of functional organizations relating to health, crime, the environment, and so forth. There are treaties and regimes dealing with human rights and the “Responsibility to Protect” (R2P). There are multilateral security institutions—most notably the United Nations—and various regional alliance partnerships. Some of these rules and institutions offer universal membership and others—such as the

United Nations Security Council—are venues for great power activity. Some of these rules and institutions are global and others are regional, with Beijing having a greater interest in the latter. This situation means that states—such as China—will not pursue a blanket approach to the existing international order, but will find themselves supporting and participating in some areas, while opposing and working around other areas.

Empirically, China does approach the rules and institutions of the international order in this manner, supporting many parts of it and opposing others; and, indeed, so does the United States. China, for example, is deeply committed to the Westphalian sovereign states system but resists some new “norms of intervention” such as R2P and the Proliferation Security Initiative. More generally, China—along with the United States—supports many of the major global institutions and regimes: the United Nations system, the U.N. Security Council, the Nuclear Non-Proliferation Treaty (NPT), the Bretton Woods institutions and the WTO, the G-20, the Asia-Pacific Economic Cooperation (APEC) forum, the Montreal Protocols, and bilateral agreements on greenhouse gas emissions. Yet it resists other institutions and treaties. Together with the United States, China has declined to accept the jurisdiction of the International Court of Justice (specifically, rulings on sovereignty and security issues), nor has it joined the International Criminal Court, the Ottawa landmines treaty, the Comprehensive Nuclear Test Ban Treaty, or the Convention on Cluster Munitions, and Beijing has opposed calls for reform of the U.N. Security Council. The United States has also resisted some of the multilateral rules and institutions that other states have championed. It has not ratified various U.N. treaties such as the Law of the Sea Convention; it withdrew from the Anti-Ballistic Missile Treaty, and opposed U.N.-centered cyber governance. In other words, China has already integrated itself into and supports a wide range of institutions and

regimes, but opposes others. The United States has championed most of the major postwar global rules and institutions, but it too has resisted signing on to some treaties and agreements.

Fourth, it is useful to make several general distinctions about the different aspects of the existing order that China might oppose and resist, or indeed support and seek to preserve. We can distinguish between three aspects of the existing order. One is the United States’ hegemonic position within the international order. American hegemony refers to the rights, authority, privileges, and roles that the United States claims for itself as the leader or patron of the order. For example, the United States has greater voting shares in the Bretton Woods institutions. It has established itself as the leader in these and other international organizations and regimes, and enjoys a disproportionate share of the privileges granted by these institutions. Accordingly, China may seek to challenge the American hegemonic authority and role in some of these institutions and regimes. A second aspect of the order is what might be called its “liberal internationalist” characteristics. These are aspects of the order that enshrine various liberal internationalist rules and principles that include free trade, liberal democracy, human rights, and so forth. The third aspect of the contemporary order refers to the deeper foundations of sovereignty and the primacy of state actors in the international system. These foundational features of international order are not inherently liberal, but have been evolving through the modern era to assume increasingly liberal characteristics, such as the norms and institutions of decolonization and self-determination. More recently, liberal internationalism has nurtured a more comprehensive challenge, via the rise of individual human rights and the push for states to assume a “responsibility to protect.” We discuss this tension between liberal internationalism and the deeper foundations of state sovereignty further below.

The spectrum of institutional choices facing rising states

China is a rising state that increasingly must make choices about how to involve itself in the wide variety of international institutions and regimes. Many of the existing global rules and institutions were established prior to China’s ascent and entry into the global system. While the United States and the other Western states were “present at the creation,” China was largely absent. Of course, China has joined many of the world’s international organizations, and it is a founding member of the United Nations. But as it grows in power, China finds itself confronted with choices about its role in and stance toward global and regional governance institutions. We can identify a spectrum of strategic choices that China faces, ranging from simple status-quo-accepting “stakeholder” membership at one pole to opposition and non-participation at the other. Between these extreme options, there are choices that rising states make to reform and innovate within the existing array of international institutions.

The most straightforward option available to a rising state is to join the international institution as a regular member. In this instance, it chooses to be a “**status-quo stakeholder**” state that accepts existing rules and norms of the institution or regime. A second option is to join the institution but seek to renegotiate the terms of authority and influence within it. The rising state becomes an “**authority-seeking stakeholder**” that seeks to gain greater voice and influence in the formal processes of the institution, defined as “distributive change” via enhanced voting rights and/or greater national representation in the constituent organs based on underlying member characteristics.¹⁴ In this instance, reform of the institution entails the redistribution of decisionmaking authority, facilitating greater influence over operations and potentially a larger share of the gains generated by institutional cooperation. China’s push for greater voting shares in the International Monetary Fund (IMF) falls into this category.¹⁵

Figure 1: The spectrum of China’s institutional choices

STATUS-QUO STAKEHOLDER	AUTHORITY- SEEKING STAKEHOLDER	INSTITUTIONAL OBSTRUCTION	EXTERNAL INNOVATION	OPPOSITION
Join; participate within existing rules and practices.	Join; seek greater voice through redistributing decisionmaking authority.	Join; alter, impede, or contain the pursuit of undesirable rules, practices, and norms.	Build new institution; (1) offer alternative node of cooperation; (2) promote alternative rules/norms within.	Outright opposition to or non-participation in existing institutional arrangements

As a status-quo stakeholder or authority-seeking stakeholder, a rising state is not seeking to reform the substantive rules and norms of an institution. A third choice for a rising state is to operate inside the institution—as a formal member—to alter, impede, or contain the pursuit of undesirable rules, practices, and norms by that institution. In practical terms, in regard to China, this choice might entail attempting to prevent the institution from performing tasks that support and reinforce liberal-oriented characteristics of the prevailing international order. There are several ways this might be done. First, the rising state could play a “spoiler” role by hindering decisionmaking processes and day-to-day operations, either in pursuit of narrower short-term interests, or for the longer-term purpose of undermining the effectiveness and legitimacy of the institution—both its rules, practices, and norms and the order it is designed to promote.¹⁶ Second, the rising power could use its authority within the institution to limit or contain the operational meaning and application of specific rules and norms. For example, China has accepted the existence of the R2P norm, but also quietly worked within the U.N. Security Council to limit its definition and usage.¹⁷

Third, the rising power could block reform that seeks to make an institution *more liberal*. In recent years, the rise of the international human rights regime has created pressure to expand the liberal character of the international order at the expense of the deeper foundations of state sovereignty. Efforts to halt this advance fall into this category. We therefore denote a third strategic choice, which we term “**institutional obstruction**,” in which the rising state also joins existing institutions, and works from within either to play spoiler, or to contain or limit the crystallization or application of emerging rules, practices, and norms. Note that this strategy is not mutually exclusive with the previous stakeholder strategies: a rising state can actively work within an existing institutional framework to achieve both increased operational influence and a greater share of mutually generated gains, while also playing spoiler on occasion or working to alter, impede, or contain the development or operation of undesirable rules, practices, and norms.

A fourth option differs in form from the first three in that it entails the creation of a new international institution or regime. Such “**external innovation**” is what China did with the launch of the AIIB. The new institution may serve multiple purposes, some of which overlap with those strategies conducted from within existing institutions. First, the new institution may simply represent an alternative node of interstate cooperation in the creation of mutual gains. It would not purport to operate under or promote substantively different rules and practices, but rather—to use an economic analogy—be a new entrant within the competitive institutional marketplace.¹⁸ As we will argue in the next section, the launching of such institutions may be motivated by more narrow purposes, such as capturing a larger share of the gains from cooperation to meet pecuniary and developmental goals. Second, founding an institution offers a new instrument of statecraft to build bilateral and multilateral influence within a region or across the wider international system. Influence comes via wielding substantial authority over the operations of the new institution and the status conferred by institutional leadership.¹⁹ A third purpose is to use the new institution to challenge and replace the prevailing substantive rules and norms within the policy domain in which it operates. Repeated over the longer term, new institutions could subvert and ultimately replace existing institutions under the sway of the United States and other established incumbent states. As we explain below, this would be the most direct form of counter-hegemonic institutional statecraft.

A final option is outright **opposition to or non-participation** within an existing institutional framework. This option could be pursued in conjunction with the construction of a rival institution, or it could be done in isolation where the rising state prefers simply to operate outside of—and in violation of—the established system of rules, practices, and norms, but has no interest in leading an alternative order. This latter approach encompasses a wide variety of behavior that does not directly involve institutional activity, and thus ought not to be characterized as “institutional statecraft.” Nevertheless, the disregard

of such behavior for status quo rules, practices, and norms has indirect but potentially significant consequences for international order. As an example, Beijing's increasing assertiveness in the maritime domain, in particular its construction activities in the South China Sea and dismissal of international legal pronouncements on the issue, fall squarely into this category.²⁰

With this repertoire of strategic options, rising states find themselves making choices, bargaining and interacting with other states, facing trade-offs, opportunities, and constraints. We now focus more closely on China's institutional calculations in its creation of the AIIB.

The Asian Infrastructure Investment Bank

The AIIB is a multilateral development bank first proposed by Chinese President Xi Jinping in 2013, with 21 countries signing an initial memorandum of understanding in October 2014.²¹ By the time of the AIIB's official launch and the release of its Articles of Agreement in June 2015, 57 countries had signed on (well over the initial estimate of 35), notably including a number of non-Asian states such as the United Kingdom, Germany, and Brazil. The United States and Japan have, to date, declined to join. Chinese officials maintain that the AIIB is intended to complement rather than compete with or upend the existing multilateral institutions providing development financing in the region—principally the World Bank and Asian Development Bank (ADB).²² These existing institutions offer loans for a broad spectrum of purposes including both infrastructure construction and projects that target health, education, and the environment. In contrast, the AIIB is focusing on building infrastructure that enhances connectivity between economies.²³ Reactions to the emergence of the bank have been varied. For analysts at one extreme, the AIIB represents a “potential vanguard for an alternative economic world order.”²⁴ A more pragmatic view identifies “the opportunity to build from scratch a better development bank,”²⁵ while Jin Liqun, founding president of the AIIB, has recognized “vast room for cooperation” with existing multilateral development banks such as the World Bank.²⁶

On the spectrum of China's choices regarding its institutional statecraft, the AIIB fits squarely into

the category of “external innovation.” As we outline above, external innovation serves three broad purposes: offering a new institutional node of international cooperation within the existing system; creating a new tool of statecraft to enhance bilateral or multilateral influence; and/or challenging and replacing the prevailing substantive rules and norms within the relevant policy domain. To what extent do these logics and pathways of influence align with China's practical objectives in launching the AIIB?

The AIIB does offer a new mechanism to pursue narrower pecuniary and developmental objectives. China's domestic economy is at a critical juncture of its development trajectory, facing a challenging transition from an investment-led to consumption-led model of growth. In turn, Chinese companies must increase their global competitiveness, and China's manufacturing sector must move up the value chain to keep up with increased labor costs and foreign competition.²⁷ The establishment of the AIIB—an international institution that constitutes a new node of interstate cooperation—further these objectives in several ways. First, new overseas infrastructure projects offer outlets to relieve overcapacity in major industrial sectors such as construction, where domestic returns have been declining.²⁸ More broadly, the opportunities generated by new lending can encourage Chinese companies to “go out” by expanding their access to new markets.²⁹ Second, China holds massive foreign exchange reserves, much of which earn relatively low yields in foreign government

bonds (especially U.S. Treasury bills), yet previous attempts to diversify China's foreign investment portfolio have resulted in major losses. Projects have suffered repeated delays or cancellations, while some debtors—foreign governments with poor credit ratings—have been unable to repay Chinese loans.³⁰ The AIIB in particular will utilize the lending experience of creditor states and their specialized knowledge of project finance and due diligence. These multilateral partnerships allow China to reduce the lending risk of its foreign investments while taking the institutional lead on the frequency, location, and operation of new investments. In other words, China can increase its foreign investment returns by participating in sounder investments and sharing risk while retaining influence over where its capital is deployed.³¹ The AIIB may also, over the longer term, promote the internationalization of China's currency, the renminbi.³²

Aside from pecuniary motivations, the AIIB also represents a new tool of statecraft to build and exert influence and authority, and enhance China's leadership status within the international system, consistent with the second broad purpose of external innovation. A successful strategy would see China acquire a more prominent voice within the institutional order while eroding the influence of the United States. The AIIB can potentially increase China's influence and authority via at least two distinct pathways. The first is through leverage obtained from the threat of "exit": offering an alternative to the existing Bretton Woods system of multilateral development lending.³³ There is a perception among developing countries that the lending approaches of existing multilateral development banks are inefficient and bureaucratic and subject to faltering attempts at reform.³⁴ If the AIIB can offer equivalent (or better) functional benefits to states, the prospect of reduced participation by states within the Bretton Woods institutions gives China leverage to seek greater authority or voice within them while diluting the hegemonic authority and privileges of the United States, and further to contain the expansion of liberal internationalism.³⁵

A second pathway of influence arises via the fostering of asymmetric interdependence. The growth in cross-border economic transactions cultivates political constituencies within (smaller) recipient states with interests in maintaining strong bilateral relations with the much larger economy of China (what Albert Hirschman termed a "commercial fifth column").³⁶ These economic interest groups apply pressure on their governments to maintain a positive political foundation to the economic relationship.³⁷ Moreover, in the absence of alternative economic partners, political leaders in these states become unwilling to do anything to jeopardize the material benefits of transacting with China.³⁸ The AIIB allows China to deepen its economic engagement with the rest of the world, fostering the development of such supportive constituencies, and potentially eroding the bilateral political influence of the United States.³⁹ Using institutions to provide foreign investment can also improve bilateral relations by avoiding some of the missteps in previous bilateral financing arrangements, which fomented sizeable anti-China sentiments in several countries in the wake of corruption scandals and neo-colonialist anxieties.⁴⁰

Ultimately, the true motivation for Beijing's actions in creating the AIIB is likely over-determined. It is impossible to say that a single factor (or category) was decisive, and parochial economic incentives by themselves may have been sufficient to instigate the institution-building process, with broader ambitions materializing later.⁴¹ Nevertheless, our analysis lends support to our theoretical argument that the AIIB can advance Chinese interests both as a competitive node of interstate cooperation and as an instrument of influence.⁴² Yet the operation of these mechanisms does not pose a substantial threat to the liberal international order because they essentially feature China working within the system and respecting its rules to enhance its position and authority. What distinguishes the strategy of external innovation is its additional counter-hegemonic potential to challenge and replace the prevailing substantive rules and norms that govern multilateral development financing and, in the longer term perhaps, the liberal character of the international order itself. We consider this pathway in the following section.

China, the AIIB, and counter-hegemonic institutional statecraft

What impact might the AIIB have on the existing liberal international order? To what extent is it counter-hegemonic?⁴³ The AIIB could represent an early step in a longer-term strategy in which China seeks to weaken and delegitimize the order's basic foundations and tenets, while offering a competitive alternative—a new order founded upon principles more accommodating of China's values and interests.⁴⁴ While such an outcome would be far off, China's nascent leadership provides Beijing with a platform to demonstrate that it can build and sustain an order exhibiting “non-Western” characteristics, a crucial step in establishing its long-term legitimacy as an underwriter of the international system.⁴⁵ Moreover, in beginning to bear the costs of providing international public goods, China can foster a reputation as a responsible rising power that is actively building and supporting a stable and prosperous global system.⁴⁶

The creation and leadership of the AIIB kicks off this process by demonstrating Beijing's willingness to negotiate, agree to, and be bound by the constraints of international institutions, albeit under a potentially rival set of rules, practices, and norms. As voluntary membership of China-led institutions expands (especially to include Western industrialized democracies), so does the legitimacy of the system of rules embodied in these new institutions, thereby enhancing China's credibility as system leader.⁴⁷ Signals of restraint may further generate positive security externalities by ameliorating smaller states' concerns of being dominated

by the ascendant power. The more China displays a willingness to engage with institutional mechanisms to solve problems and work collaboratively, the more confidence other states can have that Beijing will not ignore authorized practices and act unilaterally (and with force) to resolve seemingly intractable disputes.⁴⁸

From the perspective of the United States, therefore, China's institutional statecraft poses two issue-specific challenges in the short to medium term: the rules, practices, and norms of multilateral development financing, and the institutional balance of power within this policy domain. It also potentially poses a longer-term challenge to the integrity of the liberal international order and the hegemonic position of the United States. After outlining these three challenges, we consider three opposing factors that may ameliorate these concerns.

The rules, practices, and norms of multilateral development financing: Issue area rules are defined by founding documents and established practices and norms; in the case of multilateral development financing, these have been developed within the Bretton Woods system and practiced by institutions such as the World Bank and ADB. The AIIB may disrupt this established order if, for example, it offers loans with fewer strings attached and pursuant to reduced standards of transparency and accountability.⁴⁹ China's past record of bilateral development lending, in which it has operated largely outside of Organization for Economic Co-operation and Development best

practices, presages this possibility. It has displayed a willingness to allow loan recipients to bypass multilateral mechanisms and controls, in some cases fostering negative outcomes such as corruption.⁵⁰ Further concerns relate to whether the AIIB will apply sufficiently robust environmental, labor, and social standards.⁵¹ Were the AIIB to provide equivalent financing but subject to more permissive standards, it could constitute an alternative for those governments seeking to avoid the strictures of the Bretton Woods framework. Phillip Lipsky argues that the development financing issue area is more prone to competitive institutional pressures compared to the functions performed by the IMF.⁵² Successive defections from the World Bank framework would over time undermine the legitimacy of the rules, practices, and norms it embodies. Beijing's twin high-profile economic diplomacy initiatives—the New Silk Road economic belt and the Maritime Silk Road (collectively known as the “One Belt, One Road” initiative)—could similarly help crystalize a more permissive set of standards in opposition to Bretton Woods.

The institutional balance of power within multilateral development financing: The privileged position of the U.S. within the broader Bretton Woods framework has given it outsized influence over both the geography of development financing and the nature of loan conditionality, consistent with both neoliberal economic principles and, to some extent, U.S. foreign policy interests.⁵³ The AIIB may be hastening an erosion of U.S. power in this policy domain in two ways. First, China now has primary leadership over a major institutional player in this issue area, and will oversee substantial operations in the world's most dynamic economic region.

Second, the AIIB (in conjunction with “One Belt, One Road”) demonstrates that China has “exit” options, and can credibly threaten to withdraw its participation in existing institutions if its demands for greater formal authority are not met. Senior U.S. officials have already recognized this reality, with former Chairman of the U.S. Federal Reserve Ben Bernanke claiming that the failure of the U.S. Congress to approve increased voting rights for China within the IMF pushed Beijing to found the AIIB.⁵⁴ The emergence of the new insti-

tution, in turn, may have finally persuaded the U.S. Congress to agree to the IMF reforms and dilution of Washington's voting power. Moreover, it was reported in May 2016 that the ADB—arguably the most similar existing institution to the AIIB—was open to allowing emerging economies to boost their capital shares, which would thereby increase their formal power within an institution dominated by Japan and the United States.⁵⁵ Greater formal authority sourced in both existing and new institutions will inevitably come at the expense of the power of the United States and its partners to control this policy domain. Over time, it may enable China to push for further adjustment of the Bretton Woods system in its favor.

The hegemonic position of the United States within the liberal international order: The institutional privileges that have been enjoyed by the United States in multilateral development financing are, of course, manifest across multiple policy domains. As a rising power, China seeks equivalent privileges that allow it similarly to exercise influence and pursue its interests multilaterally.⁵⁶ While China's leadership of the AIIB is unlikely in the short term to erode the hegemonic rights, privileges, and roles played by the United States in other issue areas, it does represent a first step towards a future world in which China is a peer competitor to the U.S. across multiple domains within the international system. As Schweller and Pu argue, because balancing under unipolarity is definitionally revisionist, power transitions must be preceded by both the “deconcentration” of hegemonic power and “delegitimation” of the old order.⁵⁷ The AIIB's impact arguably tracks both these processes, both undermining the United States' authority within the Bretton Woods system, and raising doubts regarding whether status quo institutions remain the optimal means to meet states' needs. The more China is able to build and successfully operate alternative international institutions, the further it will tilt the balance of authority away from the United States, and the more legitimate Chinese leadership—and indeed the Chinese “model of political economy,” which in part is reflected in its high-profile institutional statecraft and broader economic diplomacy initiatives—will appear.⁵⁸

However, while these three concerns are real and legitimate, early evidence suggests they may also be overblown, and China actually faces significant constraints in utilizing its leadership of the new institution as an instrument of counter-hegemonic statecraft. Three constraints in particular stand out: (1) multilateralism, especially the participation of other Western governments; (2) global financial markets; and (3) the broader challenge of “competitive order building.”

Multilateralism: The eagerness with which non-Asian governments from Europe and the Middle East participated in the founding of the AIIB was both surprising and a source of great confidence for China.⁵⁹ A broad base of member states is the major source of legitimacy for the AIIB in the face of the continued reluctance of the United States and Japan to join. But even as its widespread membership has quickly elevated the AIIB’s global reputation, the continued participation of these states, especially Western governments like the United Kingdom and Germany, now becomes a critical component of the AIIB’s ongoing viability. Accordingly, the AIIB’s decisionmaking and operations cannot stray too far from Western member state preferences, which are broadly supportive of the existing rules, practices, and norms surrounding multilateral development financing. An official statement by then-U.K. Chancellor of the Exchequer George Osborne addressing the United Kingdom’s forthcoming membership of the AIIB stressed that “the UK will play a key role in ensuring that the AIIB embodies the best standards in accountability, transparency and governance.”⁶⁰

Multilateralism is thus a source of both legitimacy and constraint.⁶¹ At the signing of the initial memorandum of understanding in 2014, China had intended to contribute 50 percent of the bank’s capital, which would have given it simple majority voting power and thus effective unilateral control over the AIIB’s decisionmaking. However, membership applications by the United Kingdom and other Western European countries became the triggers for China to scale back its contribution to approximately 26 percent, sufficient only for veto power over supermajority decisions.⁶² Western officials were also awarded top

management positions, and the bank has instituted a policy of not limiting procurement to member states, a more permissive policy than those of existing institutions.⁶³ The point is that China’s embrace of multilateralism has thus required the sacrifice of formal authority, rendering Beijing unable to exert unilateral control over the institution. While the AIIB is enabling China to translate its growing capabilities into greater political influence, this influence is dependent on it being perceived—to hearken back to Zoellick’s phrase—as a “responsible stakeholder” whose leadership respects the liberal tenants of consent, non-coercion, and a high degree of institutional autonomy.

International financial markets: Like the World Bank, the AIIB is not funding its lending program directly from cash contributions of member states, but from capital raised on international financial markets backed by the collateral of member contributions. The AIIB must therefore earn a greater return from its loans than it initially pays to borrow the funds. No existing multilateral development bank has had a borrower default on its loan, and if an AIIB project were to fail, in addition to making a loss, the institution’s own borrowing costs would rise.⁶⁴ Accordingly, the AIIB is said to be adopting a cautious approach in its early lending, in order to focus on securing a AAA credit rating for its bonds.⁶⁵ Of the first four projects announced in 2016, three were in partnership with another development bank (the ADB, World Bank, and European Bank of Reconstruction and Development). This is a deliberate strategy to allow the AIIB to build up a portfolio of low-risk projects more quickly than if it acted on its own, and accordingly build a positive reputation in financial markets.⁶⁶ The trade-off is that it precludes the bank from assuming the lead role in project implementation and requires it to submit to the lending standards of these established institutions.⁶⁷ Moreover, as Yun Sun points out, infrastructure development is distinguished by long funding cycles, low interest rates, and the potential for waste and corruption. Where loan recipients have volatile domestic economies or unstable governments, loan repayment will be a perennial uncertainty.⁶⁸ If the AIIB subsequently takes up projects that other develop-

ment banks have deemed unsuitable, the risks—and financial costs—will magnify.⁶⁹

International financial markets will therefore discipline the AIIB's lending as much as the political constraints imposed by multilateralism.⁷⁰ To the extent that loan decisions are guided by criteria *other than* the financial soundness of the investment (such as political or foreign policy objectives), the risk of loan default will rise, and the AIIB will be punished in the form of higher borrowing costs, undermining its financial viability and credibility as an institution. The structural feature of relying on international capital markets to fund multilateral development loans inherently constrains the extent to which projects can be directed towards political purposes.

“Competitive order building”: Even if we assumed China could overcome the constraints of multilateralism and international financial markets in the domain of multilateral development financing, there is a larger hurdle obstructing broader efforts to expand a rival order. Were China looking to displace the status quo with an equally comprehensive order, doing so would require the imposition of either (1) an (il-liberal) hegemonic/imperial order that ignored the preferences of its members; or (2) the negotiation of an alternative constitutional order with other (weaker) states.⁷¹ Imposing a hegemonic order would be prohibitively expensive, especially for a developing country with middling per capita income. The success of any constitutional order is a function of the support and legitimacy conferred by participating states, which themselves derive from both (1) the functional benefits states receive from engaging with the order; and (2) the negotiated and constitutional character of the order, i.e. the extent to which the hegemon is able to offer restraint and predictability within an open and rules-based system.⁷² Accordingly, a hypothetical “Beijing consensus”—an international order that accommodated (and even promoted) an alternative model of political and economic organization that deviated from the capitalist liberal democracies of the West—would need to achieve multiple successes simultaneously to “out-compete” liberal internationalism. The less the rival order is open and negotiated, and the less

the rival hegemon is willing to exercise restraint and provide public goods, the greater the (costly) material benefits that need to be offered to balance these shortcomings. And as the constraints placed on the AIIB by global financial markets demonstrate, building a rival order will either require accommodating or wholesale replacing market forces; as several scholars have pointed out, the global economic system is costly to leave and severely constraining on its participants.⁷³

Does China even want change?

In summary, we argue that these three constraints—multilateralism, international financial markets, and the broader challenge of competitive order building—place significant constraints on China's ability to pursue a counter-hegemonic institutional strategy. Yet even if it is less constrained than we argue, it must be asked whether China even wants fundamental change of the international order given it has benefitted so handsomely and risen so successfully within the status quo.⁷⁴ China's economic miracle has relied upon the effective operation of international markets and states' institutionalized cooperation on cross-border movements of goods and capital. The rules, practices, and norms of these economic systems empower and protect Chinese economic interests. While there are some areas where China's integration into these institutional frameworks is far from complete (such as the prevalence of state-owned enterprises, state intervention in foreign exchange markets, and capital controls), the gains enjoyed in areas such as trade are enormous. Accordingly, while China resists complete regulatory harmonization and wishes to retain a strong degree of autonomy and flexibility in its policy settings, it is in the rising state's overall interests to work within the present system—Beijing is a major stakeholder. Moreover, as a developing country, China faces significant domestic economic and political challenges that limit the international leadership ambitions of its leaders.⁷⁵ Indeed, Shawn Breslin argues that reform of international financial institutions is one of China's few “reformist” goals.⁷⁶ Instead, the more China operates within rules, practices, and norms of the liberal international order, the more the order's legitimacy is entrenched.

Concluding thoughts: The impact of the Trump administration on Chinese institutional statecraft

In this paper we argue that more so than past rising great powers, China faces an international order that is highly institutionalized, with layers of global and regional multilateral regimes and institutions, many of which are liberal in character and tied to American leadership. In this context, we motivated this paper with two key questions: first, how can rising states use international institutions, in particular new institutions, to advance their interests? And second, to what extent does the specific creation of new institutions embody a counter-hegemonic logic, potentially challenging the liberal international order and the institutions that sustain it? In sum, what is the logic of China's institutional statecraft? In this final section we consider the policy implications of our argument, before turning to how a shift of U.S. policy under President Donald Trump may affect our findings.

We identified a spectrum of choices or strategies that a rising state might adopt as it faces existing institutions operating within a given policy domain. The purpose of this typology was to outline a distinct set of possibilities to anchor analysis of a rising state's institutional statecraft and the choices, interactions, and bargains it will make, given its opportunities, constraints, and trade-offs. To answer the second question, we examined the AIIB as a specific case of what we term "external innovation," and sought to understand how the AIIB provides both opportunities for and constraints on China's pursuit of its national interests, focusing our attention in particu-

lar on the institution's counter-hegemonic potential. Based on this analysis, we concluded that evidence of the AIIB's operation is trending in favor of the existing order, suggesting that the constraints on counter-hegemonic institutional statecraft are effective. In both its formal design and initial operations, the AIIB looks very similar to the ADB and the World Bank, likely due to pressure from Western members (as discussed above). Moreover, in early operations, the operational need to satisfy financial markets is acknowledged by Chinese officials as imposing a strict discipline. The net impact of the AIIB is therefore more likely to be a strengthening of the rules, practices, and norms within this policy domain, even if the formal authority of the United States is somewhat diluted.

This conclusion yields several policy implications. First, some of China's moves in the institutional arena are to be welcomed because on net they will likely affirm the liberal character of the international order. Trying to block China's efforts—notably Washington's skepticism of the AIIB—will thus be counterproductive and likely fail anyway, particularly when allied states are not on board. The point is that institution-building that embraces multilateral and market mechanisms is a positive thing. The "cost" to the established powers may be a reduction in their overall institutional authority, but the benefits might well include a China that is more deeply embedded into the existing—albeit expanded and reformed—international order. The voice and authority conferred by

institutional leadership will help coopt China, shape its choices, and, as a rising state, afford China ways to signal restraint and status quo intentions.

Second, even as China's institution-building initiatives should be embraced, in each case those actors broadly supportive of the status quo must carefully identify China's objectives and constraints, and work together to address specific concerns with the rules, practices, and norms embodied in new institutions. There will be instances where Chinese interests are at odds with the liberal character of the status quo, and other states and institutional actors must make judgments on whether and how to resist (or accommodate) the emergence of alternative approaches. It will accordingly be useful to establish some markers of when Chinese moves are compatible with international best practices and global standards and when they are not. This information alone will be useful in making the case that departures from the status quo bring real costs for other states, and may need to be opposed.

Our argument that the challenge posed by the AIIB is exaggerated nevertheless risks obscuring the more fundamental threats to the legitimacy and cohesiveness of the existing order posed not by China's institutional statecraft, but by the dramatic shifts in domestic politics within the Western founders of the liberal international order, exemplified by the election of Donald Trump and the United Kingdom's vote to leave the European Union.⁷⁷ How might the foreign policies of the Trump administration in particular affect the efficacy of China's institutional statecraft?

The new president has expressed strong skepticism of multilateralism and international institutions as means to secure U.S. interests. Trump appears to see trade deals as inherently adversarial and zero-sum,⁷⁸ the United Nations system as ineffective and in need of comprehensive reform,⁷⁹ and has even questioned the ongoing relevance of the U.S. alliance network, including NATO.⁸⁰ These sentiments portend a United States that is far less willing to lend its still-significant resources, both material and ideational, in defense of the liberal international order and the in-

stitutions that form part of the order's foundational structure. It is difficult to imagine a more favorable scenario for a rising power wishing to reshape the international system.

Yet as we argue above, it is also true that to a great extent China is already a supportive stakeholder, accepting many of the rules, practices, and norms of liberal internationalism and, for the most part, does not wish to assume the burdens of leadership from the United States. Particularly in the realm of international trade, China has benefitted handsomely from the development of the WTO regime, and would likely suffer major losses from a global return to protectionism or any other policies that harmed global economic growth.⁸¹ Accordingly, it may be in Beijing's interest to play a greater role in underwriting certain aspects of the status quo, whether through enhanced participation, authority, and support of existing institutions, or through external innovation via new institutions that are consistent with liberal principles. Early evidence of this is already emerging in the trade domain, with Chinese President Xi Jinping moving quickly following Trump's election to position China as a free trade champion in speeches at the APEC forum in November 2016 and the World Economic Forum in January 2017.⁸² In particular, Beijing hopes to oversee the successful completion of the China-led RCEP.⁸³

Where it continues to offer benefits, Beijing could ironically become one of the biggest defenders of the status quo. The flipside, however, is that where China views the institutional framework as harmful to its interests, strategies of institutional statecraft at odds with the current order will have greater prospects of success in the absence of any attempt to counter by Washington. This could include obstructing the operation of existing institutions, ignoring them, or opposing them outright. It may also mean the building of rival institutions operating under radically different principles, albeit subject to the constraints outlined in the previous section.

In the context of an American administration unwilling or unable to exercise continued leadership,

the AIIB may therefore presage not China's inexorable rise, but the fragmentation of the complex and multilayered system of institutions, a reduction in overall compliance rates with existing rules, practices, and norms, and a realignment of priorities to incorporate the (shared) concerns of rising powers and rapidly growing segments of the community that are questioning the advance of liberalism. In this sense, such fragmentation could be viewed both as part of a "defensive" strategy to resist political and econom-

ic convergence, but also as a constructive attempt to move on in the absence of effective leadership from the United States or, under President Trump, open hostility from Washington. Doing so would lay the foundations for shifts on central questions of state sovereignty and non-intervention, while also strengthening multilateral mechanisms to enhance China's own authority and reduce that of the United States within the broader institutional landscape over the longer term.⁸⁴

Endnotes

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2. Miles Kahler, "Rising Powers and Global Governance: Negotiating Change in a Resilient Status Quo," *International Affairs* 89, no. 3 (2013): 711-729.
3. Robert Zoellick, "Whither China: From Membership to Responsibility?" (remarks, National Committee on U.S. China Relations, New York, NY, September 21, 2005).
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5. Shaun Breslin, "China and the Global Order: Signaling Threat or Friendship," *International Affairs* 89, no.3 (2013): 615-634.
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8. Robert Gilpin, *War and Change in World Politics* (New York: Cambridge University Press, 1981); and Paul Kennedy, *The Rise and Fall of the Great Powers* (New York: Random House, 1984).
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10. See Gilpin, *War and Change in World Politics*. On China, see: Chin and Thakur, "Will China Change the Rules of Global Order?"
11. Marc Lanteigne, *China and International Institutions: Alternative Paths to Global Power* (New York: Routledge, 2005): 1.
12. See G. John Ikenberry, *Liberal Leviathan: The Origins, Crisis, and Transformation of the American World Order* (Princeton: Princeton University Press, 2011); and G. John Ikenberry, ed., *Power, Order, and Change in World Politics* (Cambridge: Cambridge University Press, 2015).
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15. See: Scott L. Kastner, Margaret M. Pearson, and Chad Rector, "Invest, Hold Up, or Accept? China in Multilateral Governance," *Security Studies* 25, no. 1, (2016): 142-179.
16. David Shorr and Thomas Wright, "Forum: The G-20 and Global Governance: An Exchange," *Survival* 52, no. 2 (2010): 181-198.
17. This could be considered a strategy of "norm containment," conducted from within an existing institution: see: Jochen Prantl and Ryoko Nakano, "Global Norm Diffusion in East Asia How China and Japan Implement the Responsibility to Protect," *International Relations* 25, no. 2 (2011): 204-223.
18. See Lipsky, "Explaining Institutional Change..."
19. See, e.g.: Ngaire Woods, "The United States and the International Financial Institutions: Power and Influence within the World Bank and the IMF" in Rosemary Foot, Neil McFarlane and Michael Mastanduno (Eds.), *U.S. Hegemony and International Organizations*, (Oxford: Oxford University Press, 2003): 92-114; Axel Dreher and Jan-Egbert Sturm, "Do the IMF and the World Bank Influence Voting in the UN General Assembly?," *Public Choice* 151, no. 1-2 (2012): 363-397. Note that influence may extend to leverage in the pursuit of greater formal authority within existing institutions in the relevant policy domain (thus overlapping with the authority-seeking stakeholder strategy).
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 42. Moreover, it can also not be ignored that, as with almost all of China's behavior internationally, Beijing's primary concern is domestic politics and the political imperative of the CCP to maintain domestic legitimacy. Institutional statecraft appears to support this domestic logic not only through its contributions to economic growth outlined above, but also by buttressing the nationalist narrative, promoted in particular by the current President Xi Jinping, of the "China dream" and revival the Chinese nation: "Xi Jinping and the Chinese dream," *The Economist*, May 4, 2013. In a 2014 speech to Chinese business executives, Xi said "with the rise of its overall national strength... China has the capability and the will to provide more public goods to the Asia-Pacific and the whole world"; see: "China Sees Itself at Center of New Asian Order," *Wall Street Journal*, November 9, 2014.
- As successful institutional statecraft is an exhibition of effective Chinese influence and leadership on the world stage, for it inspires pride within the Chinese public at the country's rapid rise to global prominence and leadership status. Establishing and managing international institutions are instruments of statecraft normally only available to great powers like the United States; China's emerging efforts thus allow the CCP to demonstrate that through its leadership China is being restored to its rightful place in the international system.
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