Power Transitions and International Institutions: China's Creation of the Asian Infrastructure Investment Bank

Liam Gennari
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Abstract
China’s rise has generated a sense of instability in the international system. Power Transition Theory warns that this period of change at the top of the international hierarchy will be a moment of great danger, as China will likely be dissatisfied with the world order that the United States has created. This view coincides with pessimistic realist projections. Neoliberal institutionalism is more optimistic about the prospects for a peaceful transition, believing that China will not necessarily be a dissatisfied power as the international system and its institutions encourage cooperation and a focus on absolute gains, mitigating the likelihood of conflict. China's creation of the Asian Infrastructure Investment Bank (AIIB) has frequently been cited as evidence for the pessimistic projections, viewed as a signal that China is a revisionist power, intent on disrupting the international system. This paper utilizes an interest-based approach to examine the AIIB in order to discern whether China is deserving of the label of dissatisfied rising power. First, the debate surrounding the AIIB is situated by offering an overview of China's position in global governance and the international political economy. The bank itself is then analyzed, both by examining the intentions that stand behind the creation of the bank, as well as the bank itself. Through this analysis, it is determined that in creating the AIIB, China was not acting as a dissatisfied—or revisionist—power, as, in this area, it finds its interests served by the current international system. This finding adheres to the expectations of the neoliberal institutionalist theory. While continued work must be conducted as part of a larger project to examine how the various dimensions of China’s rise fit together and will interact with one another to affect China's grand strategy going forward, these findings lend support to the optimistic projections for a peaceful power transition.

Keywords
Asian Infrastructure Investment Bank, AIIB, China, Infrastructure, Investment, Power Transitions

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ABSTRACT

China’s rise has generated a sense of instability in the international system. Power Transition Theory warns that this period of change at the top of the international hierarchy will be a moment of great danger, as China will likely be dissatisfied with the world order that the United States has created. This view coincides with pessimistic realist projections. Neoliberal institutionalism is more optimistic about the prospects for a peaceful transition, believing that China will not necessarily be a dissatisfied power as the international system and its institutions encourage cooperation and a focus on absolute gains, mitigating the likelihood of conflict.

China’s creation of the Asian Infrastructure Investment Bank (AIIB) has frequently been cited as evidence for the pessimistic projections, viewed as a signal that China is a revisionist power, intent on disrupting the international system. This paper utilizes an interest-based approach to examine the AIIB in order to discern whether China is deserving of the label of dissatisfied rising power. First, the debate surrounding the AIIB is situated by offering an overview of China’s position in global governance and the international political economy. The bank itself is then analyzed, both by examining the intentions that stand behind the creation of the bank, as well as the bank itself. Through this analysis, it is determined that in creating the AIIB, China was not acting as a dissatisfied—or revisionist—power, as, in this area, it finds its interests served by the current international system. This finding adheres to the expectations of the neoliberal institutionalist theory. While continued work must be conducted as part of a larger project to examine how the various dimensions of China’s rise fit together and will interact with one another to affect China’s grand strategy going forward, these findings lend support to the optimistic projections for a peaceful power transition.
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1. INTRODUCTION

During his first year as General Secretary of the Chinese Communist Party (CCP), Xi Jinping unleashed a series of ambitious economic policies. While many were aimed at reforming China’s domestic economy, others reflected a clear strategy of projecting Chinese power in the global economic arena, such as the One Belt, One Road (OBOR). OBOR, or the New Silk Road, announced in September 2013, has become Xi’s signature foreign policy initiative. It is a four trillion USD infrastructure project to connect the Eurasian continent via a maritime road and a land belt that stretches from China into central Europe. One month following the rollout of OBOR, on October 7 at the Asian-Pacific Economic Cooperation (APEC) meeting in Bali, Xi unveiled one mechanism through which Beijing planned to finance this vision of connectivity: the Asian Infrastructure Investment Bank (AIIB).

The AIIB, like the World Bank, is a multilateral development bank (MDB), which intakes capital contributions from members, and loans these funds to countries for the purpose of economic development. Currently comprised of 57 member states from the Asian region and beyond, the AIIB has a broader purpose than merely financing and facilitating the completion of OBOR. Rather, it is designed to help close Asia’s chronic infrastructure financing gap. Over two years after Xi’s speech at APEC, the AIIB opened its doors on January 16, 2016. In the first year of operations, it has undertaken nine projects, contributing over one billion USD in capital.

While this new source of capital to finance desperately needed infrastructure in the region might appear as a welcome addition to the international financial landscape, geopolitics is always in the background of economic initiatives. The question raged of why China decided to go outside of the current international economic architecture and create a new institution. The AIIB became a lightning rod in U.S.-China relations after the Obama administration not only refused
to join it, but also unsuccessfully lobbied others to do the same. On March 12, 2015, the United Kingdom, the U.S.’s closest ally, announced that it would become a member of the bank. The dominos quickly fell, as U.S. allies rushed to join AIIB before the founding membership deadline closed.

Clearly, the United States suffered a diplomatic loss in their response to the AIIB, but whether the underlying logic behind their opposition was justified is another question. Was this simply an unforced error by the Obama administration or does the AIIB pose a legitimate threat to the international order that the United States has constructed since World War II?

The AIIB became a litmus test for how China’s rise to the level of great power status would proceed. For some, the AIIB was a sign of China’s revisionism. While Beijing might have complied with international rules out of convenience in the past, it always remained skeptical of the global order that the United States had constructed while China was reeling from its Century of Humiliation. It had always been a dissatisfied power. Now, a more powerful and self-confident China was taking its first steps at fracturing, and eventually supplanting, that order. For others, while there were perhaps some troubling aspects of the AIIB, its creation was not an indicator that the long-standing U.S. strategy of integrating China into the global order had failed or was misguided from the start. China might be stepping outside of Bretton Woods, but it was still conforming to international rules and norms in doing so because, fundamentally, its interests were served by the liberal international order the United States and other Western powers had created. China was being more ambitious, but it was acting as a status quo power.

These two views are reflective of divergent visions of how a possible power transition from the United States to China would unfold, which, in turn, are informed by the two dominant schools of international relations. Those favoring the view that the AIIB is a sign of Chinese
revisionism tend to follow a realist logic, believing that the U.S. and China are bound to be long-term enemies. As China continues to grow, confrontation and war between the two states is increasingly likely. They are locked in the “Thucydides Trap,” and the AIIB is further evidence of this unfortunate reality. Those who take the position that China’s creation of the AIIB is largely in line with the status quo that the United States played a disproportionate role in creating have a more sanguine outlook that arises out of a neoliberal institutionalist optimism of the coming power transition. While there are rivalrous elements of the relationship that will likely be exacerbated as the U.S. and China continue to inch towards power parity, common interests that are provided for within the current international system can help mitigate the effects of these dimensions and ensure that cooperation, not conflict, prevails.

**Structure and Methodology**

This project is aimed at adjudicating these two positions to determine which interpretation better fits the available evidence. It does so by utilizing an interest-based approach to analyze China’s actions in order to discern whether China, to use a strict dichotomy, is deserving of the label of *satisfied* or *dissatisfied* rising power. Inferring interests, much like inferring intentions, is a notoriously difficult project. To overcome epistemological barriers, first a larger overview is provided of China’s position in global governance and the international political economy. This background helps situate the in depth analysis of China’s rhetoric, policies, and actions surrounding the AIIB that proceeds in the later sections.

Following the introduction (Section 1), the second section of this paper provides an overview of Power Transition Theory, borrowing heavily from the work of A.F.K. Organski. It describes the two criteria—cross-over and dissatisfaction on the part of the rising power—perceived as necessary for hegemonic wars. Following a clarification of the working definition
of “dissatisfied rising power,” the section concludes by describing how the two major theories in international relations, realism and neoliberal institutionalism, provide different \textit{a priori} expectations of the likelihood that a rising power will be dissatisfied.

Section 3 begins by arguing that the world may soon be entering, or will soon enter, a moment of cross-over if China continues to rise. The section proceeds to give a brief overview of how China has operated within the liberal international order since the establishment of the People’s Republic of China. Then, a literature review of the prospects for China’s continued rise is offered, with a simplifying distinction made between pessimists and optimists that largely maps onto the realist/neoliberal institutionalist dichotomy established in Section 2.

Section 4 begins by motivating the focus of the economic side of the power transition equation. It then proceeds to analyze the changing role of China in the global economy, providing an overview of its economic development model, addressing mercantilist critiques, and arguing that as China has opened itself up to global market pressures, it has adapted not only its economy but also its laws and institutions to operate within this system. This section then highlights a selection of China’s recent economic initiatives, including an expanded role in global economic governance with the G-20, the push to internationalize the Renminbi, the call for IMF voting share reform, and the One Belt, One Road initiative, and concludes by addressing the controversy China has sparked with its more assertive international economic agenda.

Section 5 addresses the establishment of the AIIB, introducing the bank and providing a brief overview of its timeline. It also analyzes early reactions to the AIIB, including the Chinese pitch of the institution, the U.S. response and diplomatic blowback, and the scholarly discourse surrounding its creation, demonstrating why the AIIB is a strong case study for the power transition.
Section 6 attempts to understand China’s motivations in creating the AIIB. In order to address this question, it segments the discussion into three subsections: the economic rationale, the multilateral rationale, and the geopolitical rationale. For the economic rationale, first a general overview of China’s economy is offered. Then, it is shown how the AIIB can help solve many of these economic problems. Importantly, it is noted that these problems and the solutions are all well within the status quo of the international economic system. Subsection 2 examines the multilateral rationale, showing why China would be motivated to use a multilateral institution, and why creating a new MDB is not a radical move given the existing landscape. For the geopolitical rationale, seven possible geopolitical motives are addressed, in ascending order of the challenge they pose to the international system. The section concludes by arguing that while there is ample evidence showing that the less contentious motives factored into Beijing’s calculus, there is little evidence or reason to believe the most troubling purported motives played a role.

Section 7 analyzes the AIIB itself as an institution to determine how it fits within the existing MDB landscape. It is analyzed on the grounds of purpose, governance, and operational policies. While there are differences with the existing MDBs, most notably for operational policies in the use of country-systems and an aversion to conditionality, this section draws attention to the overwhelming similarities that exist between the AIIB, the World Bank, and the Asian Development Bank (ADB). The question of what can be discerned from these similarities is then addressed.

Section 8 concludes by offering a summary of the findings along with policy implications.
**Findings**

This analysis leads to the conclusion that while there are areas of disagreement with and divergence from the international order that underlie the creation of the AIIB, the AIIB is not a revisionist institution and China is not a dissatisfied power in the appropriate sense of the term. China’s long term interests are best served by preserving the fundamentals of the international system, even if China desires some slight alterations to the system or a change of its own status within that system. These findings lend credence to the neoliberal institutionalist optimistic outlook for the prospects of a peaceful transition of power at the top of the global hierarchy. While this work must be combined with the analysis of other dimensions of China’s rise to create a more complete picture, the evidence provided in this analysis of the AIIB suggests that if differences between the United States and China are properly managed with coherent and sensible policies on both sides, the power transition can be marked by continued cooperation rather conflict or hegemonic war.
2. **POWER TRANSITION THEORY**

**Power Transition Theory**

Power Transition Theory warns that periods of change in the international hierarchy can be moments of great tension and danger.¹ The hegemon, by virtue of its power, crafts, or rather plays a disproportionately large role in crafting, the world order. As a result, the existing world order at any time reflects the interests of the power that was predominant at the time of its establishment. Most major, medium, and small states still benefit from this international system, as it is often in the hegemon’s own self-interest to account for the interests of other countries. Thus, most states lack both the means to unilaterally undermine the order and the incentives to band together to do so. Taking a dynamic view of world politics, Power Transition Theory argues that within the world order that was established by the hegemon, changes of power occur as a result of uneven growth rates in economic productivity, populations, and state capacity. Most important among these is the relative economic ascent of less powerful nations—what Robert Gilpin labels the “Law of Uneven Growth”²—as states can industrialize, accumulating wealth, which then filters into the production of military capabilities. As a result of this uneven growth, the hierarchy of the international system is not stable. Eventually, this rising state gains enough power that it is able to challenge the hegemon and the world order it has created.

¹ This formulation of Power Transition Theory reflects that of A.F.K. Organski. *World Politics.* (New York: Alfred A. Knopf, 1968). Similar theories has also been put forward in the work of Paul Kennedy. *The Rise and Fall of Great Powers* (New York: Vintage, 1987); Robert Powell. *In the Shadow of Power: States and Strategies In Politics.* (Princeton: Princeton University Press, 1999), particularly noteworthy for its Status Inconsistency Theory, which holds that the likelihood of war in moments of cross-over is dependent on the extent of the discrepancy between the distribution of power and the distribution of benefits in the world order; Robert Gilpin. *War and Change in World Politics.* (New York: Cambridge University Press, 1981). Gilpin focuses more on the actions of the declining hegemon than those of the rising great power in explaining the breakout of hegemonic wars. Empirical support for Power Transition Theory can be found in A.F.K. Organski and Jacek Kugler. *The War Ledger.* (London: University of Chicago Press, 1980), which finds that moments of cross-over at the top of the international or regional hierarchy were accompanied by major power wars in approximately half of the examined cases. Without such a transition, even among states that did have the capabilities to contend with one another, war did not occur. ² Robert Gilpin, *War and Change in World Politics.* 94.
This is the moment of ‘cross-over,’ commencing when the rising state has accumulated eighty percent of the comprehensive power of the hegemon. The ‘cross-over’ period is a time of heightened danger in the international system. In terms of capabilities, the rising state has enough power that it could pose a serious challenge to the established world leader. This is the first criterion for a major power war. The second criterion is the rising power’s dissatisfaction with the world order established by the existing hegemon. The rising state is likely to find the current system unfair as the rules of the game and the distribution of prestige and benefits were decided before its rise. With its new position, the rising state may find that the existing world order does not confer with its expectations or serve its long-term interests. When these two criteria are fulfilled simultaneously, the rising state will challenge the hegemon, and war is imminent.

While there are certainly issues conceptualizing and measuring the ‘power’ that determines the cross-over conditions, this second criterion is far more problematic. It generates numerous practical questions; how can one know if a rising power is dissatisfied? What are the signs and metrics of dissatisfaction? More fundamentally, this criterion also raises questions as to what dissatisfaction means; is it merely that the rising power is dissatisfied with its level of influence and prestige within the existing system, or does it involve an aim to overturn the basic rules by which international order operates? Clarifying what it means to be satisfied or dissatisfied, or, to use other terminology, status quo or revisionist, is essential for the tractability of the theory.

Hans Morgenthau defined a status quo power as a state that desires the “maintenance of the distribution of power as it exists.”3 Such a definition is overly vague, leading to the possible conclusion that any rising power that desires its relative rise to continue is necessarily revisionist.

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Both A.F.K. Organski and Robert Gilpin provide definitions that are more nuanced and more useful. For Gilpin, a revisionist state is one that not only wants to change the distribution of power or hierarchy of prestige, but also wishes to change the “rights and rules that govern or at least influence the interactions among states.” Organski and Kugler have a similar definition when they write that revisionist powers “desire to redraft the rules by which relations among nations work.” The dissatisfied or revisionist power must seek more than an improved position or increased voice within the existing world order. It must desire fundamental alterations in the principles of that order.

This conceptualization, while superior to that of Morgenthau, is still flawed, as it relies on a simple dichotomy when in reality a continuum is more appropriate. Yet even accepting this strict dichotomy, the practical question remains of how one can know, entering into a moment of crossover, whether the rising state will be dissatisfied and revisionist. Ideally, a state’s actions and rhetoric would signal its status, but a dissatisfied rising state has clear incentives not to reveal these preferences until it accumulates sufficient power. Thus, rather than asking the question with respect to a particular state, the question is often asked more generally as to the probability that a rising state would be dissatisfied. The answer to this question depends on one’s view of international relations. The two dominant schools, realism and neoliberal institutionalism, offer divergent views, as the former breeds pessimism of the prospects that a rising power will be satisfied and the possibility of a peaceful transition of power, while the latter offers a more optimistic projection.

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4 Robert Gilpin. *War and Change in World Politics.* 34
Realist Pessimism

Realist theories rest on a set of assumptions that heighten the importance of security and thus tend to render the first criterion—cross-over—more or less sufficient for predicting hegemonic wars. Long the dominant paradigm in international relations theory, Realism centers on the fundamental belief that states, like individuals, respond to incentives as they operate within the anarchic international system. In this anarchic system, security becomes the top interest, as states must fend for their own survival. It is this search for security that leads states to concern themselves with the relative distribution of power within the system. Conflicts over this relative power can result in war.

Being a realist does not necessitate that one believe in Power Transition Theory. Yet, there is a certain elective affinity between the pessimistic projections of Power Transition Theory and realism. Certainly there will be cross-over moments in the power or capabilities of countries. Power Transition Theory rests on the assumption that the rising state in this crossover will likely be revisionist, dissatisfied with the current rules of the game. For a realist, if security in an anarchic system is the principle concern, this existing order will likely not be satisfactory. Regardless of the stated rules and practiced norms, the state will desire a preponderance of power to provide for its own security. Thus, there is a high probability that the rising power will challenge the current order to establish its relative power advantage over the preexisting hegemon. Great power wars at moments of crossover will be the unfortunate outcome of this struggle. Taken to the extreme, arch-(offensive)realist John Mearsheimer offers a deterministic

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6 Realism itself is a diverse field encompassing many formulations. The most notable divide is between classical realism and structural realism (neorealism), which explains states behavior in reference to the power distribution, or polarity, of the international system. For classical realism, see: Hans Morgenthau. Politics Among Nations; E.H Carr. The Twenty Years’ Crisis, 1919-1939: An Introduction to the Study of International Relations. (London, Macmillan & Co Ltd., 1940). For structural realism, see Kenneth Waltz. Theory of International Politics (Reading, MA: Addison Wesley Pub. Co., 1979).
theory in *The Tragedy of Great Power Politics*, arguing that power transitions necessarily result in conflict.\(^7\)

**Neoliberal Institutionalist Optimism**

Borrowing many of the assumptions of the realist model, neoliberal institutionalism produces a more optimistic set of expectations for world politics and power transitions.\(^8\) For neoliberal institutionalists, security questions alone are not sufficient, as states are involved in a ‘complex interdependence,’ and accordingly have other important interests that must be taken seriously. Even in the anarchic international system, the institutions that comprise the world order can maintain cooperation by making it clear what is to be gained by playing by the established rules. As a result, rational egoists, even within an anarchic system, may find it in their interest, to concern themselves less with relative gains, and more with the absolute gains that can be reaped through cooperation. Institutions can preserve peace and generate prosperity in a manner that is impossible in the standard realist paradigm.\(^9\)

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\(^8\) Neoliberal institutionalism was pioneered by Robert Keohane and Joseph Nye in the last quarter of the twentieth century out of the belief that the dominant realist paradigm could not account for the high levels of cooperation within the international system. For the seminal works in the field, see Robert Keohane. *After Hegemony: Cooperation and Discord in the World Political Economy*. (Princeton: Princeton University Press, 1984); Robert Keohane and Joseph Nye, *Power and Interdependence*, 2nd ed. (Boston: Scott Foresman, 1989); Robert Keohane and Lisa Martin. “Promise of Institutionalist Theory” *International Security* 20 (Summer 1995): 39-51; Robert Axelrod and Robert Keohane, “Achieving Cooperation Anarchy: Strategies and Institutions.” *World Politics* 38 (October 1985): 226-254; Stephen Krasner. *International Regimes*. (Ithaca, N.Y: Cornell University Press, 1983); Stephen Krasner. “Structural Causes and Regime Consequences: Regimes as Intervening Variables.” *International Organization* 36 (Spring 1982): 185-205. While built off of classical Liberalism, it diverges from these past theories by asserting that there is rarely complete harmony of interests between nations, and thus it does not hold the naïve belief that interdependence necessarily produces peace, the thesis of Norman Angell that was proven tragically incorrect with the outbreak of World War I: Norman Angell, *The Great Illusion: A Study of the Relation of Military Power in Nations to their Economic and Social Advantage*. (Toronto, McClelland and Goodchild, 1911). Institutions therefore play a critical role in the preserving cooperation and preventing defection by cementing rules and norms, increasing information, reducing transaction costs, mitigating moral hazard, and ensuring that gains are evenly divided over time.

Similarly to the case of realism, acceptance of the neoliberal institutionalist framework is not necessarily a rejection of Power Transition Theory. One can believe in the importance of interdependence and the role of institutions in maintaining cooperation while acknowledging that rising powers may find their interests not satisfied by the existing rules and norms, and therefore seek to challenge the international order and the existing hegemonic power. Yet, this expansion of the realm of cooperation despite the realities of anarchy tends to make neoliberal institutionalists more sanguine regarding the prospects for a peaceful transfer of power in global politics. While both the rising and dominant state might be concerned with their relative power for security reasons, the promise of increased absolute gains through cooperation facilitated by institutions might ease tensions during the cross-over. So long as the rising state is integrated within a preexisting order that is open and rules-based, the chances that it is dissatisfied might be significantly mitigated.

**Applying Neoliberal Institutionalism**

The crux of neoliberal institutionalist theory is that because of this expansion of the realm of cooperation, a world system can be devised that accounts for the interests of a rising power. Thus power transitions will be less likely to result in hegemonic war. Confluences of interests, interdependence, and the constraints of institutions mean that a rising power need not be a dissatisfied challenger. Whether such a system is in place at any given point in time is always a different question. In testing whether neoliberal institutionalism provides a better account of world politics than structural realism, the key is whether cooperation is maintained during the cross-over period when the rising state possesses the capabilities to challenge the existing hegemon. Yet, if cooperation breaks down and the cross-over period ends in intense competition
or military conflict, the results are still ambiguous; the breakdown could either reflect the shortcomings of neoliberal institutionalist theory, or the deficiencies of current institutions and their ability to accommodate the rising power’s interests. However, if the system in place reasonably reflects neoliberal institutionalist standards, and conflict or war still results, then this would lend credence to the realist view. By contrast, if cooperation is maintained, then this lends support to the usefulness of neoliberal institutionalist theory for understanding manner in which transitions take place at the top of the global hierarchy.
3. ENTERING A POWER TRANSITION: THE RISE OF CHINA

The theoretical debates surrounding power transitions currently carry an enhanced sense of significance, as it now appears that such a moment in world politics may be approaching. By any metric, China is rising rapidly. Sustaining double-digit GDP growth since the reform and opening period commenced in 1978, China now boasts the second largest economy in the world with a global business outreach. This strong economic growth has trickled into other components of comprehensive power; for example, China now has the second largest military budget, behind only the United States. It is a rise emblematic of a larger tectonic shift in the global balance of power from West to East. In light of the trend line and China’s massive population, distinguished economist Arvind Subramanian declared that, “China’s dominance is a sure thing.”\(^\text{10}\) If China continues to rise it appears undeniable that the world will enter a cross-over period, as China will obtain sufficient power to pose challenges the United States’ global hegemony.\(^\text{11}\)

Of course, if is an important modifier. China’s rise might ultimately be curtailed by the mounting domestic problems that the fifth generation of leadership is now facing. These sets of issues can broadly be categorized into three interlinked groups: economic, political, and social. The substantial economic concerns threatening Beijing as it attempts to engineer continued remarkable growth will be discussed in detail in following sections. With respect to political governance, the obvious unique feature of China is the fact that while China has liberalized its economy, the Chinese Communist Party has retained a monopoly of political power.


Maintenance of CCP control is the number one core interest for Beijing, but it is also perceived by external commentators as China’s primary deficiency. There are always questions surrounding how long the authoritarian vanguard party can keep a firm grasp on power, particularly as the deficiencies of this system begin to mount. Relating to the economic concerns, if the economy stagnates and the regime loses a major pillar of its legitimacy, this unraveling could, in the eyes of some, occur sooner rather than later. On the social side, China faces a multi-fronted assault on the dream of a Harmonious Society. As China has become an increasingly unequal and stratified nation—best exemplified by millions of second-class citizens in Chinese cities as a result of the hukou system—there is a danger that social unrest will lead to mass mobilization against the regime. This touches on the larger issue of civil society, that the regime clearly perceives as a legitimate threat to stability, as exhibited by the harsh crackdown against the Falun Gong movement. These domestic challenges inform Susan Shirk’s label of China as a fragile superpower that is “strong abroad but fragile at home.”

These domestic hurdles and burdens suggest that China’s continued rise is not determined, as Subramanian’s statement above suggests. China is not destined to dominate the globe. It is misguided to extrapolate from its past steady ascent that this trajectory will continue into the future. Any one of these challenges could pull down the country, if not dramatically then

simply by a steady drag. There is therefore reason to believe that America’s position at the top of the world hierarchy is more durable than often reported.\textsuperscript{16} Still, China’s rise is real and consequential for the international system.

The Chinese juggernaut has set off ceaseless speculation about China’s future role in the world. As China’s growth gained more attention in the 1990s, in line with Power Transition Theory expectations, China Threat Theory first emerged.\textsuperscript{17} Scholars and politicians debate whether China will be a status quo or a revisionist power. Will China be a ‘rule taker’ of the international order that was crafted by the United States following World War II? Will it be a ‘rule maker,’ more or less accepting the basic fundamentals of the world order, but insisting on slight changes to the rules and norms? Or will it be a ‘rule breaker,’ rejecting the order and directly challenging the United States?\textsuperscript{18} If either of the former is the case, the power transition will likely proceed in accordance with optimistic neoliberal institutionalist expectations. If the latter holds, realist pessimism may be warranted.

**Seeking Truth from Facts**

Ideally one would be able to simply follow a strategy of ‘seeking truth from facts’, discerning from the action and rhetoric of Chinese leadership which category it fits into. The Chinese Communist Party’s policies from Deng Xiaoping’s ‘24 Characters’, Zheng Bijian’s ‘Peaceful Rise/Development’, Hu Jintao’s ‘Harmonious World’, to Xi Jinping’s ‘New Type of


\textsuperscript{17} Charles Krauthammer. “Why We Must Contain China.” *Time* (July 31, 1995).

Great Power Relationship’ show a level of consistency, constantly marketing China to the outside world as a status-quo power that will not challenge the global order. Perhaps there are changes to the system that China desires, making it a ‘rule maker’, but CCP officials have strongly pushed back attempts to label China a ‘rule breaker’ and a revisionist power.

Underneath this stability in the CCP’s rhetorical framing of China’s rise, there have been immense changes over the past four decades in how China interacts with the international order. In *China Goes Global*, David Shambaugh usefully segments this evolving relationship into four distinct categories.19 Prior to 1978, China was a ‘system challenger’, existing outside of global institutions, rejecting their rules and ideals. Beginning with the reform and opening period in 1978, China entered a new ‘system studying’ phase as it began to join international organizations such as the United Nations and the Bretton Woods institutions of the World Bank and International Monetary Fund. While remaining skeptical of many pillars that held up the international system, China began to integrate more within the order. From 1985 to 2000, China was a ‘system exploiter,’ ramping up integration and tapping into the benefits of the World Bank and IMF while seeking accession into the newly established World Trade Organization. Finally, since 2000, Shambaugh maintains that China has become nearly fully integrated within the international system, and is now beginning to voice its own preferences within these institutions, seeking some changes in the global architecture where it believes its interests are not served. While refusing to give China the label of ‘revisionist power’, Shambaugh believes China is no longer acting merely as a passive recipient of world order.

Differing slightly in timelines, other scholars tell a similar story of China’s relationship with the international system. In the early 2000s, many commentators were optimistic about the prospects of a peaceful rise. In a widely cited work, Alastair Iain Johnston set out a clear

19 David Shambaugh. *China Goes Global*. 133-137
standard, based on five criteria, on which to judge whether China was a status quo or a revisionist power. While China did not always completely agree or comply with international rules and norms such as those regarding human rights or the issue of self-determination, such areas were counterbalanced with growing compliance with the global order in the areas of free trade, multilateralism, sovereignty and, military practices. Taking these various dimensions into account, Johnston contended that it was erroneous to label China a revisionist power. On a spectrum from satisfied to dissatisfied, China appeared more the former than the latter. While acknowledging that for the Chinese, multilateralism was primarily tactical rather than an acceptance of the worldview on which these multilateral institutions were founded, the prospects for continued peace and cooperation appeared positive. There was growing hope that China would soon not only accept international rules, but also answer Deputy Secretary of State Robert Zoellick’s call to become a ‘responsible stakeholder’ in the international system. The long-term bet of the United States’ China policy since the Nixon administration appeared to be paying off.

However, present actions are never perfect guides to predicting future behavior; circumstances and incentives transform over time, and intentions can change rapidly. Even at the height of China’s cooperation with the international order, Avery Goldstein as well as Michael Swaine and Ashley Tellis argued that China had been employing a ‘calculative strategy’ since 1996 aimed at participating in global governance and multilateral institutions to improve relations with regional states and major powers, producing favorable external conditions for

China’s rise. This temporary strategy always had an expiration date, and the question became what would replace it. Following 2008, it appeared that an answer might be emerging. This answer conferred with pessimistic realist expectations. Perhaps catalyzed by an enhanced self-confidence following the Global Financial Crisis that emanated from and crippled the West, China set course on a more assertive foreign policy, marked most notably by its actions in the South and East China Seas. The actions from this period provide much of the rationale for the ‘system challenging’ label given by Shambaugh. The ‘calculative strategy’ period had run its course, and in its place appeared a more assertive strategy. Many perceived China as a ‘rule breaker’, ready to air its grievances and disrupt the international system. The perception of this change in China’s grand strategy caused some to doubt the effectiveness and rationale of the U.S. policy towards China. While the preexisting China policy was not thrown out, this period did serve as the impetus of a new American regional policy, as, in response to requests by U.S. allies, the Obama administration launched its pivot, or rebalance, to Asia in 2011.

Theories of China’s Rise

The above analysis shows that while the actions of a state are important to study as possible signals for future intentions, such a process will always be messy and inherently limited. Just as China’s norm-conforming behavior during the ‘calculative strategy’ did not prove

neoliberal institutionalist optimistic expectations were correct, China’s aggressive foreign policy from 2008 to 2010 is not necessarily, as many realist pessimists interpret it, a tip of the hand of what is to come. Disagreement still rages as to how the power transition between the United States and China will unfold. While a dramatic oversimplification, these views can be segmented into ideal types of pessimists and optimists, which closely mirror the realist-neoliberal institutionalist dichotomy in the previous section. The pessimists tend to align with structural realist theories, the optimists with those of neoliberal institutionalists, with moderates occupying a middle ground.

Pessimists

The archetypal offensive-realist John Mearsheimer represents the most pessimistic strand of theory regarding China’s rise. Informed by his deterministic realist paradigm, Mearsheimer argues that China will be locked into the Iron Law of great power politics. In order to provide for its security needs, China will seek hegemony within its region, ensuring that it is necessarily a dissatisfied power. It is thus on a collision course with the United States, with conflict during the time of cross-over being unavoidable. There is no hope of escaping the Thucydides Trap. This view is also expressed by Aaron Friedberg. While endowed with a certain degree of classical Liberalist ideology, believing a state’s government type matters, Friedberg similarly follows a realist logic, arguing that China will want to be the preponderant power in East Asia, attempting to expel the United States from the region. Economic interdependence, common interests, and enmeshment in institutions cannot prevent this certainty in Friedberg’s point of view. Robert Blackwill and Ashley Tellis take this logic into the policy sphere, suggesting that as

a power transition with China will undoubtedly lead to conflict as China seeks regional dominance, the United States should reverse its policies, leaning more toward the side of competition rather than cooperation, before the relative power gap completely closes.\textsuperscript{29} This perspective has been given a hawkish voice within the Trump White House with the appointment of Peter Navarro as the director of the National Trade Council.\textsuperscript{30} Within China, which has a long tradition of realism, similar theories can be found, such as the ‘cultural realism’ of Yan Xuetong, which envisions China implementing a grand strategy of ‘striving for achievement’ that ultimately aims to overthrow the existing American global order.\textsuperscript{31}

Once again, such views do not encapsulate all realist theories. Scholars such as Michael Swaine or even the most famous American practitioner of realpolitik Henry Kissinger take a more moderate view, believing that differences can be overcome with a grand bargain, allowing for spheres of influence.\textsuperscript{32} Michael Swaine contends that the Manichean view of many realist scholars obfuscates possible solutions to power transition conflicts. However, this pessimistic realist view remains a strong voice guiding public policy and popular opinion.

**Optimists**

At the opposite end of the spectrum from realist pessimists are optimists who tend to follow the neoliberal institutionalist tradition, believing in the power of interdependence and the importance of institutions in guiding China and the U.S. through a peaceful power transition.

John Ikenberry states that the world order is undergoing a transformation, but it is a transformation of leadership in what he labels the open and rules-based liberal international order; it is not a transformation of the liberal international order itself. The United States’ unipolar moment is ending. As China closes the power gap, it will demand that the United States cede some authority and prestige, as China will desire a larger say in international governance. However, in line with the definition provided above, China will be a satisfied or status quo power in the sense that it will not desire to dissolve the world order. Ikenberry’s thesis rests on his view that the liberal international system is “hard to overturn and easy to join.” Integrated within this order, China has tied its future prosperity to it, diminishing any revisionist instincts. Even if China continued to use multilateralism as a tactic, rather than fully embracing this worldview, China would find the costs of exiting the system it had integrated into unacceptably high. From this perspective, “interdependence is a predicament countries must deal with, not a worldview or a foreign policy strategy.” Additionally, even if China did desire replacement of liberal international order, it would find little appetite for such alterations to the system from other nations. Taking stock of these views while citing a confluence of other factors, a group of scholars led by Robert Ross and Zhu Feng have laid out a vision of a peaceful power transition in global leadership, with China’s rise to great power status marked not by war, but by maintained cooperation.

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34 John Ikenberry. *Liberal Leviathan.*
Within China’s academic community, a similar optimistic outlook can be found. While hardliners like Yan Xuetong are commonly cited by hawkish realist pessimists, China is deeply conflicted on foreign policy, with a diverse set of views. Representing the more optimistic end of the spectrum, Wang Jisi, Dean of the School of International Studies at Peking University, situates China clearly within the category of ‘rule maker’. In a 2011 article entitled “China’s Search for a Grand Strategy,” Wang Jisi asserted that while “no major power’s interests can conform exactly with the international community…China will serve its interests better if it can provide more common goods to the international community and share more values with other states.” While China may want slight changes to the global architecture, and while strategic distrust between China and the U.S. is rising, China’s interests will ultimately be served by playing a larger role within the liberal international order.

Going Forward

Consensus does not exist as to how the power transition from the United States to China will unfold. These differing predictions of the future matter because they inform policy today; should the United States increase engagement with China? Should it contain China? Or should it try to strike a grand bargain? The importance of getting expectations for the power transition right and crafting coherent policy informed by these expectations cannot be overstated.

37 Michael Pillsbury. The Hundred-Year Marathon: China’s Secret Strategy to Replace America as the Global Superpower. (New York: St. Martin’s Griffin, 2015).
38 David Shambaugh. China Goes Global. Ch. 2
4. THE ECONOMIC DIMENSION OF POWER TRANSITIONS

For discerning whether China will be revisionist or whether neoliberal institutionalist projections hold and optimism is warranted in this power transition, the economic dimension is a critical area to study.41 First and foremost, its importance derives from the simple fact that this is where China has experienced its most substantial rise to global prominence. In terms of global stature, the Chinese economy far outweighs the Chinese military, which lags significantly behind the United States and is not yet ready to truly go global. In economics, however, China is already the second largest economy in the world, the number one trading nation, and rapidly becoming a leading source of global investment. If China were going to challenge the United States and the international system, it would likely desire to play to its strengths and do so on economic grounds, not military battlegrounds. China’s actions within the international political economy may therefore serve as an early indicator of China’s rise in other dimensions.

Secondly, in crafting foreign policy, interests must be ranked in order of importance. Clearly in the case of China, economics ranks near the top of the list. As mentioned previously, economic performance has become a major pillar of regime legitimacy. In the post-Mao era, the CCP has defined itself not as the vanguard party delivering continuous revolution, but as the vanguard party delivering continuous growth and prosperity. Economics matter in any country, but in China GDP growth figures carry special significance. Therefore, economics is an important area to watch for revisionist tendencies to discern whether China will be dissatisfied with the world order, as this domestic interest has long played a substantial role in shaping

41 A Chatham House project involving many pioneers in Power Transition Theory such as A.F.K Organski, Ronald Tammen, and Jacek Kugler argues explicitly that economic factors ought not be viewed as secondary to security concerns, insisting that “power transition recognizes no distinction between security and economics. The status quo is defined by the dominant nation’s assertion of its preferences regarding security and economics for the world.” Ronald Tammen. Power Transitions: Strategies for the 21st Century. (London: Chatham House Publishers, 2000): 107.
China’s foreign policy. The economic element is central in the U.S.-China relationship. After the fall of the USSR, the Sino-U.S. relationship lost its initial *raison d’être* of a common enemy. Over the past decades, economic relations have filled this void, serving as the lynchpin of the relationship. How China acts within this space of global economics is therefore highly consequential for the overall power transition.

Lastly, because of the thickness of institutional arrangement in the international political economy, and this segment of the international system’s close connections with other dimensions of the current world order, *a priori* if China were a revisionist power, this is a portion of the story of China’s rise where revisionist tendencies would be expected to appear. The current international economic system is a microcosm of John Ikenberry’s conception of the larger liberal order: open and rules-based. It is open in the sense that all can join so long as they support the free exchange of goods and capital across boarders. It is rules-based as these principles and norms have been institutionalized in the system that emerged after World War II. Known as the Bretton Woods institutions, it includes the International Monetary Fund, tasked with managing the global monetary system and financial stability, the World Bank, a multilateral development bank (MDB) providing loans to promote economic and social growth, and the World Trade Organization, which grew out of the General Agreement on Tariffs and Trade (GATT), regulating international trade. The vision of 1944 was of a world economic order with a deeply entrenched set of institutions, disproportionately shaped and managed by the United States, that would promote shared prosperity contingent on a state’s cooperation with the overall global system.\(^\text{42}\) If China were dissatisfied with the current international system, one would expect to find evidence of it in this arena.

Not finding revisionist tendencies in China’s actions within the international political economy does not rule out the possibility that China is revisionist in another area. In particular, a realist would suggest that the security dimension is the top concern. What is most important is how all of these pieces fit together to form a more comprehensive picture of China’s rise. Yet, for these reasons, not finding revisionism in this segment of China’s interactions with the international community is a positive sign supporting neoliberal institutionalist optimism for the prospects for a peaceful transition of power.

**China in Global Economic Governance**

The paramount questions in the area of the international political economy relate to what economic order China will desire as it continues to rise and accumulate sufficient power to potentially challenge the system that the United States has created. Will it wish to continue to propagate the current system, or will it shape a new order that better serves its interests? Answering this question demands analysis of China’s economy and its growth model to produce a better understanding of China’s interests.

The story of China’s economy over the past four decades has been one of extraordinary growth. This growth has been facilitated by concerted steps China has taken to integrate itself within the international economy, and in so doing has joined international economic institutions and conformed to established rules and norms. Most notably, this involves openness to foreign capital and trade. Since the beginning of the reform and opening period, for three decades China was the top recipient of foreign direct investment (FDI). One can rightfully argue that China’s sustained high levels of FDI are the result of market distortions and a failure to fully liberalize.

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43 David Shambaugh. *China Goes Global*. 174
the economy, but there can be no doubt that China’s prosperity has been dependent on establishing and preserving relationships with international partners. This remains true even as China’s economic conditions change, and it is no longer only a recipient of FDI, but is now pursuing an aggressive strategy of outward direct investment (ODI) as it seeks new sources of growth. Similarly, in line with the East Asian Growth Model, China’s economy has relied on high levels of trade with the outside world. In 2008, its trade to GDP ratio reached 57 percent, far exceeding that of any previous rising power. China can truly be called a trading state, highly dependent on the outside world for its economic needs. Robert Gilpin argued that the structure of the international system defines the norms and markets that constrain the choices of a country. China appears to have responded to those constraints by embracing the openness of the liberal economic order.

There are of course those who argue that this image does not really capture China’s economic model, or its role within the international economy. China does not have an open economy. Rather, some suggest it is a prototypical mercantilist nation that has strong state intervention, manipulates its currency, controls its capital account, infringes on intellectual property rights, and does not reciprocate economic openness. This alternative narrative of China’s economy is promoted by a diverse crowd, from left-leaning economists like Paul

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46 Arvind Subramanian. *Eclipse.* 122
Krugman\textsuperscript{48} to hawkish conservatives such as Peter Navarro.\textsuperscript{49} At the bedrock is the belief that China does not play by the rules of the liberal order. Accordingly, as China rises to power, it will challenge the existing global economy as it continues the heterodox practices that first boosted it to power.

There is certainly a degree of validity in these mercantilist claims, but the conclusion can be doubted for three reasons. First, China’s development story is actually not overly abnormal. It is following a developmentalist model that more or less conforms to the historic tradition that gave rise to other Asian economies, notably Japan, as well as the United States itself.\textsuperscript{50} Secondly, while elements of mercantilist policy exist, there are ample reasons to reject labeling China a mercantilist state, as this does not capture the reality of immense economic reforms that have taken place over the past decades.\textsuperscript{51} In joining multilateral organizations such as the WTO, China has shown a willingness to accelerate reforms and alter its laws to comply with the rules-based system.\textsuperscript{52} China’s abnormality might actually come from a high level of international compliance by developing nation standards. Within the economic global governance systems like the WTO, China has taken no extreme actions to change international practices to favor China.\textsuperscript{53} Lastly,

even if China were a prototypical mercantilist state, there would be reasons to doubt that it would wish to cement these practices into a new economic world order. China has used mercantilist practices as a strategy within the liberal economic system. It is not a vision for a new system, as it would be a simple fallacy of composition to suggest that since China grew rapidly with such a model it would wish all to join in a new international economic order predicated on these practices.

What does this mean going forward?

Arvind Subramanian, who openly acknowledges China’s mercantilist history, believes that China’s current economic model will serve as a force for cooperation in the power transition that he perceives to be inevitable. As China has become highly integrated into the international economy and its mercantilist tendencies have been curtailed, it has found its interests served by the Bretton Woods institutions that act as legitimate multilateral venues for cooperation and mediation. Subramanian argues that: 54

Self-interest will largely rule. But the pursuit of self-interest need not augur badly for the open rules-based system that the world enjoys. China’s unique features—especially the fact that it is on of history’s most open superpowers—will invest it with a stake in broadly maintaining the current trade and financial system. And China’s stake in the market openness will be of primary importance because delivering development—the basis for the regime’s legitimacy—is crucially predicated on markets remaining open.

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54 Arvind Subramanian. *Eclipse*. 186
In *Playing Our Game*, Edward Steinfeld goes even further, insisting that the argument above only begins to encapsulate the fundamental transformation that China is undergoing.\(^{55}\) China is the factory of the world not in the sense that it independently manufactures products that are consumed in many other countries. Rather, China is the factory of the world because it is the assembly point of a fragmented production network that extends across national borders. This type of trade accounted for 56 percent of China’s export growth from 1995 to 2005.\(^{56}\) In order to join this hierarchical global market China had to transform its domestic economic institutions to conform with those of the supply-chain leader. China opened itself to external powers to a degree that it never intended, outsourcing institutions to international organizations like the WTO. As a result, China now finds itself thoroughly immersed within the liberal economic order that will continue to pull it ever closer towards Western norms and standards.

There is compelling evidence supporting these optimistic points of views. If they prove to hold, following a neoliberal institutionalist logic, the desire to cooperate on economic areas can help ensure that a rising China will be a satisfied power, and the power transition can proceed peacefully.

**China’s Recent Economic Initiatives**

This image of China’s role within the international economy offers support to the optimistic view of the coming power transition. However, recent economic initiatives launched by Beijing have led many to doubt this assessment. While China has retreated from certain

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elements of its more aggressive foreign policy implemented in 2008, China’s push to launch itself into the global economic governance structure has intensified under Xi Jinping. Such aggressive actions in this sphere have once again given rise to questions surrounding Beijing’s intentions: Does China simply want a larger seat at the table, or is it looking to alter the global landscape and the international rules? This section will provide a general overview of China’s role in the G-20, its push to internationalize the Renminbi, voting share reform at the IMF, and the One Belt, One Road, which all serve as data points to help answer this crucial question.

G-20 & Global Macro-economic Governance

China’s intensified push for a larger role in global economic governance began with the financial crisis in 2008. Following the economic downturn, there was a general recognition that recovery required coordinated policy from more than just the G-7 countries. Thus, the G-20, which includes China, was formed. At the first summit, the group agreed to $1.1 trillion in new funds for international financial institutions, with China contributing $43 million along with a substantial domestic stimulus package that would serve as a boost to global demand.\(^{57}\) China’s participation in the G-20 is not particularly remarkable. What is noteworthy is Beijing’s eagerness to undertake this enhanced role in international macro-economic policy making. In the 12th Five Year Plan there appeared a new section entitled “Actively Participate in Global Economic Governance and Regional Relations” which stated that China should “participate actively in the G-20’s global economic management cooperation in order to build a balanced multilateral trade system.”\(^{58}\) Wary commentators perceived China’s foray into ‘economic


diplomacy’ as the beginning stages of China’s attempts to reform the international system.\textsuperscript{59} Beyond advocating for a more ‘just’ allocation of prestige and resources—code for Beijing having more authority—China has presented no comprehensive or coherent strategy for such reform. These fears remain largely speculative, rather than grounded in empirical facts.

**Internationalization of the Renminbi**

Coupled with this enhanced participation in economic governance, Beijing has set course on a mission to play a larger role within the international monetary system. In particular, China has been actively promoting the internationalization of its currency, the Renminbi (RMB). In October 2016, the fruits of this push began to materialize, as the IMF officially added the RMB to the basket of currencies that make up its Special Drawing Rights (SDR). SDR are reserve assets in which the IMF denominates loans to governments. RMB will now be included along with the U.S. Dollar, the Euro, and the Yen.

While inclusion into the SDR has been a longstanding goal of the CCP, most economists question the practical significance of this change.\textsuperscript{60} There is no market for SDR. Rather, it is an accounting tool of the IMF. Inclusion into this basket of currencies does not mean that any country will be willing to hold RMB in reserves or denominate trade in RMB, both of which are essential for the internationalization of a currency. Countries would only use the RMB for these purposes if China were willing to undergo substantial reforms such as liberalizing its capital account, letting the RMB float freely on a global market, and initiating significant domestic reforms, including the institutionalization of economic policy processes in order to create

\textsuperscript{59} IBID. 169

confidence in the currency. Many are skeptical of China’s willingness to pay this price for currency internationalization.61

China may eventually possess a currency that can dethrone the dollar from its privileged position and create a multi-currency world. However, the degree to which it is successful in doing so is positively correlated with the extent to which it is willing to reform its policies to more completely align with the rules and norms of the existing system. Internationalization of the RMB, and acting as a revisionist power disrupting the system, would be goals running in opposite directions. RMB inclusion in the SDR is, however, important for China’s status within the international order, which Beijing clearly perceives as intrinsically valuable.62

**IMF Voting Share Reform**

China has also sought greater status in the international political economy by pushing for voting share reform in the IMF. China’s call for vote reform in Bretton Woods reflects an underlying tension regarding China’s place within the international system. China is the largest beneficiary of the current global economic architecture, but also endowed with a sense of skepticism due to the fact that this system was created when China was still weak, and the CCP was not in charge. This skepticism has only been exacerbated by the fact that China’s voting shares in the Bretton Woods institutions are now out of sync with its economic weight. Positive action was taken to quell this discontent with the announcement in 2009 that China’s voting share within the IMF and World Bank would rise by five and three percent respectively.63 This

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change was part of a larger ‘voice reform’ introduced by the Bretton Woods institutions that increased the representation of developing countries, shifting the scales of voting power from the global North to South. Jin Liqun, the vice-president of the Asian Development Bank who would later become the president of AIIB, praised the reform, stating that the transformation in the economic landscape ought to be reflected in the distribution of authority within the system.64

Despite the fact that the change in voting rights was part of a much needed $755 billion injection of capital into the International Monetary Fund, and the fact that the rise in China’s voting shares would come at the expense of European powers and not the United States (preserving the United States’ de facto veto power), the reform was blocked by the U.S. Congress until the end of 2015. This delay was widely regarded as one of the impetuses for China’s creation of the New Development Bank, as well as the AIIB.65 The rejection of voting share reform is clearly reflective of fear of China’s rise diminishing the United States’ relative power advantage. Yet, as Ikenberry points out, one must distinguish between a crisis of leadership in the system, and a crisis of the system itself. China’s push for voting share reform clearly signals a desire for a greater leadership role within the system, closing the authority gap with the United States. However, it does not necessarily signal that China wishes to fundamentally change the rules of the game. China can desire a larger voting share without being a revisionist state.

One Belt, One Road

These debates regarding how China’s recent economic initiatives fit within the existing global order have been most intense with respect to One Belt, One Road, also known as the New Silk Road. This four trillion USD infrastructure vision has become the signature foreign policy initiative of Xi Jinping.66 Announced in 2013, One Belt, One Road (OBOR) is comprised of two parts. The first is a Eurasian land belt that will connect China to Europe. The second is a maritime Road, linking East Asia, South Asia, East Africa, the Middle East, and Europe.67

Figure 1: The One Belt, One Road Vision

As tariffs have steadily fallen, the lack of regional infrastructure leading to high transportation costs is now the primary impediment to intra-regional trade. To address this issue, the stated purpose of OBOR is to increase connectivity. In doing so, the initiative aims to create a stronger economic ecosystem and a ‘community of common destiny.’ The creation of this community

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66 Tai Wei Lim, Katherine Hui Tseng and Wen Xin Lim. China’s One Belt One Road Initiative. (London: Imperial College Press, 2016).
would be funded by the preexisting Chinese Development Bank, as well as new financial institutions such as the $40 billion dollar ‘Silk Road Fund’ and the AIIB.

Many of the projects now falling under the OBOR banner were in place prior to Xi Jinping, showing that OBOR is in some ways an intensification of a project that has long been a priority of the CCP. Some interpret this as a continuation and combination Jiang Zemin’s ‘Going Out’ and ‘Grand Western Development’ policies. More directly, OBOR’s origins have been traced to the ‘March West’ strategy, articulated in 2012 by Wang Jisi. ‘March West’ maintains that China should respond to the U.S. pivot and heightened tensions in the South and East China Seas by shifting its attention to its western periphery. Such a rebalance of strategic purpose would allow China to focus on its historically important Central Asian relationships, while avoiding conflict with the United States and its allies in East Asia. Wang Jisi also maintained that such a policy would serve Xi Jinping’s ‘China Dream’, promoting China’s project of national rejuvenation (the New Silk Road nomenclature directly reflects this ambition).

The motivations behind this landmark piece of foreign policy are highly contested. It is a clear example of a transition from ‘keeping a low profile’ to ‘striving for achievement.’ Yet, Wang Jisi writes, it “is not the cry from a global proletariat revolution, but it leaves room for selective opposition to the status quo.” China appears willing to leverage its capabilities on the world stage to further its interests, both geopolitical and economic. Debates as to China’s intentions with OBOR mirror those surrounding AIIB, and therefore will be addressed in following sections.

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70 Wang Jisi. “Marching Westwards.”
Shaken Confidence

As China asserts itself onto the world stage with a series of economic initiatives, confidence in the belief that China will be a status quo power in the area of economics has been shaken. China is clearly aiming to take on a larger role in global economic governance. This larger role will provide China with the prestige, recognition, and authority that it believes a great power of China’s stature deserves. China has also demonstrated an appetite to make slight alterations to the international architecture to better serve its interests. Whether its ambitions end there, or whether it is a dissatisfied power that will seek greater transformations in the future, is not a settled question.
5. The Asian Infrastructure Investment Bank

Within this field of the international political economy, the Asian Infrastructure Investment Bank is a strong case study to test the validity of neoliberal institutionalist projections. The AIIB has been used frequently as a sign of China’s dissatisfaction with the status quo of the international system. The creation of this new institution has been interpreted by many as China stepping outside of Bretton Woods, creating its own institutional architecture to lay the groundwork for its long-term plan to unseat the United States at the top of the global hierarchy. If these claims are true, the promise of neoliberal institutionalism, or at least the promise of the institutions currently in place, would indeed be, as Mearsheimer refers to it, a false promise.

Founding of the Bank

Xi Jinping’s first year as General Secretary of the CCP in 2013 was marked by a string of actions designed to push forward China’s ambitious economic initiatives. In March, leaders of the BRICS countries formally decided to create the New Development Bank. In September, Xi first introduced the One Belt, One Road at a speech at Nazarbayev University during a state visit to Kazakhstan. One month later, on October 7, at an Asian-Pacific Economic Cooperation (APEC) meeting in Bali, Xi announced his vision of an Asian Infrastructure Investment Bank.

The idea of the AIIB first appeared in Chinese policy papers at the Bo’ao Forum in April 2009. It was proposed by the newly created China Center for International Economic Exchanges

(CCIEE) as one part of a three-pronged approach to support the flagging economy. Following Xi’s announcement in Indonesia, Beijing moved swiftly to make this bank a reality. By early 2014, Chinese finance minister Lou Jiwei revealed that the Chinese Finance Ministry was willing to contribute as much as $50 billion for the bank. On January 24 of that year, the first multilateral working group convened in Beijing. Ten months later, on October 24, China and twenty other countries from the region signed a memorandum of understanding. By the deadline for becoming a founding member of AIIB on March 31, 2015, 57 countries had joined. Of the 57 countries, there were 37 regional and 20 non-regional members. Following five rounds of negotiations, finance ministers from member countries descended upon Beijing to sign the Articles of Agreement on June 29 of that year. The AIIB opened its doors in January 16, 2016, concluding the fifteen-month participatory process. That June, the AIIB announced its first loan packages.

**Bank Basics**

The Asian Infrastructure Investment Bank is a multilateral development bank (MDB) like the World Bank. The mission of an MDB is to provide capital and expertise to countries and sub-national agencies for developmental purposes. A group of countries contribute to this international financial institution, and the bank provides loans to states that can not typically find alternative sources of capital in the private sector at reasonable interest rates due to long term periods, inability to monetize projects, or heightened risk and uncertainty. Additionally, MDBs can help facilitate cooperation between countries for larger projects that extend across national

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borders.\textsuperscript{75} MDBs typically share the general goals of increasing development, as broadly understood, and reducing poverty.\textsuperscript{76} The AIIB holds these common goals, but it is aimed primarily at improving infrastructure in the Asian region to increase connectivity and produce a prosperous regional economic ecosystem. These goals are presented in Article 1 of the Articles of Agreement, which stipulates that the AIIB’s purpose is to “foster sustainable economic development, create wealth, and improve regional connectivity in Asia by investing in infrastructure and other productive sectors.”\textsuperscript{77} In particular, the AIIB has six key focus areas: rural infrastructure and agricultural development, energy and power, environmental protection, transportation and telecommunications, water supply and sanitation, and urban development and logistics.

In his inaugural address on January 16, 2016, Xi Jinping reiterated this purpose, stating that:\textsuperscript{78}

The founding and opening of the AIIB will effectively boost investment to support infrastructure development in Asia. It will serve to channel more resources, particularly private investment, into infrastructure projects to promote regional connectivity and economic integration. It will bring along a better investment environment and more job opportunities and trigger greater medium-to-long-term development protection on the part of developing members in Asia. This, in turn, will give impetus to economic growth in Asia and the wider world.

\textsuperscript{77} “Asian Infrastructure Investment Bank: Articles of Agreement.” (Beijing: Asian Infrastructure Investment Bank, 2015).
\textsuperscript{78} Xi Jinping. “Remarks by the Chinese President Xi at the Inauguration of the Asian Infrastructure Investment Bank.” \textit{Meetings of the Board of Directors in Beijing} (January 16, 2016).
Xi’s focus on regional integration demonstrates that the AIIB is designed to supply the hardware for Asian connectivity to go along with the software that is offered by ASEAN and free trade agreements.\textsuperscript{79} With the continued decline of tariffs and non-tariff barriers along with the increasing harmonization of regulations, poor infrastructure is now perceived as the major hurdle. The AIIB will help alleviate this issue by providing much needed financing.

From this perspective, there is an obvious link between the AIIB and the One Belt, One Road initiative. There is a reason the two were announced within a month of each other, which Xi acknowledged at the inaugural speech for the AIIB when stating, “China continues to welcome AIIB and other international financial institutions to take part in the building of the Silk Road Economic Belt and 21\textsuperscript{st} Century Maritime Road.”\textsuperscript{80} It must be noted that the AIIB is not the Silk Road Fund, as it differs on two important areas. First, the AIIB is a multilateral institution, not solely funded and operated by Beijing. Secondly, the AIIB is not exclusively intended for OBOR projects. While many of the larger infrastructure investments will certainly tie into the OBOR vision, the AIIB will finance (and already has financed) other projects not related to OBOR, as exhibited in its focus on the areas of energy production and telecommunications. President of the bank Jin Liqun insisted upon this point in an interview with CCTV, stating, “AIIB is not a policy tool for Chinese government in its OBOR initiative. AIIB is an MDB that must serve the interests of all of its members…The bank will pay equal attention to other non-OBOR Asian nations’ projects.”\textsuperscript{81}

\textsuperscript{80} Xi Jinping. “Remarks by the Chinese President Xi at the Inauguration of the Asian Infrastructure Investment Bank.”
is both clear and significant. The AIIB will serve as a multilateral bank to further the OBOR mission. The benefits of this multilateral platform will be discussed in following sections.

As stated above, in 2014 China announced a willingness to contribute as much as $50 billion the AIIB. The overall goal was to reach a capital level of $100 billion. This would make the AIIB a midlevel MDB, comparable to other major regional development banks.\(^8^2\)

**Graph 1: Multilateral Banks’ Subscribed Capital in USD Million (2015 Annual Reports)**

![Graph 1](image)

**Early Reactions to AIIB**

The AIIB has sparked an immense amount of commentary and controversy. This controversy is part of what makes the AIIB a strong case study for the neoliberal institutionalist vision of the power transition, as it is an area in which it has been speculated that China is signaling its revisionist tendencies. Therefore it is useful to study the rollout of the bank from the

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perspective of the Chinese presentation of the institution, the U.S. response and its failure in lobbying other countries against joining, and the scholarly discourse surrounding the new MDB.

The Chinese Pitch

Beijing’s rollout of the AIIB can be described as a ‘charm offensive’, as CCP officials and those affiliated with the bank have taken every opportunity to stress its win-win nature and its positive role in the creation of a region and world of ‘common destiny.’ Chinese officials have vehemently rejected any suggestion that this is a geopolitical ploy designed to undermine U.S. leadership or the Bretton Woods institutions. In an interview with the Financial Times, Premier Li Keqiang emphatically stated, “I wish to emphasize that the AIIB and ADB can work in parallel in promoting Asian development. And the initiative of AIIB is not to reinvent the wheel. Rather it is intended to be a supplement to the current international financial system. And if there is a need for reforming the current system, we are also ready to work with other countries to help make the system more just, reasonable, and balanced.”

AIIB President Jin Liqun, has continuously proliferated this message in numerous public appearances. In December 2015, in a CCTV interview primarily targeted at an American audience, Jin insisted that “AIIB is not a challenger to global financial order, it is to complement the existing MDBs and will concentrate on infrastructure investment…The World Bank and the Asian Development Bank support AIIB and they are working for areas of cooperation.”

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84 “Jin Liqun: President of AIIB”
message was reiterated during Jin’s trip to the United States in 2016 at press conferences at the Brookings Institution and the Asia Society Policy Institute.⁸⁵

This is not to suggest that there was no reference to the geopolitical implications of the bank from China. An article in People’s Daily from March 2015, as the deadline to become a founding member of the bank was approaching, extolled the fact that the “Asian Infrastructure Investment Bank shows China’s growing global influence.” China has played both to its domestic audience, harking on a vision of national rejuvenation, while quelling fears of the international community. However, by and large, the external-oriented voice has driven the narrative from China.

The U.S. Response & Blowback

This charm offensive was in part necessitated by the U.S. reaction to the creation of the AIIB. The new bank was met by the U.S. not with open arms, but rather with a cold shoulder. Members of the Obama administration saw the AIIB as an arrow pointing at Washington D.C. and Bretton Woods, as it was interpreted as a strategic ploy to disrupt global American leadership and undercut or supplant the principles and rules the U.S. had worked for decades to propagate and enshrine in the liberal international order. Chief among the concerns cited by the U.S. were the AIIB’s policies on environmental protection, social safeguards, aid to corrupt and anti-democratic regimes, along with the overall Chinese domination of the bank. A senior Treasury department official was quoted in the New York Times as questioning, “how would the

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new institution add value? How would the Asian Infrastructure Bank be structured so that it
doesn’t undercut the standards with a race to the bottom?"86

The administration’s answer to these questions was revealed by its actions. The United
States decided that it would not join the bank, despite the invitation extended by Beijing. An
unconfirmed leak from a White House meeting of Jin Liqun and president for Asian Affairs at
the White House’s National Security Council Evan Medeiros reported that Mr. Medeiros had
rejected Mr. Jin’s offer to join the AIIB, stating, “I am not going to buy the cake you have
cooked,” to which Mr. Jin replied, “you are always welcome into the kitchen to help with the
baking.”87 The U.S., however, signaled no intention of entering this kitchen, as another senior
U.S. official was quoted as saying, “large economies can have more influence staying outside
and trying to shape the standards it adopts then by getting on the inside at a time when they can
have no confidence that China will not retain veto power.”88

The Obama administration was not merely content sitting outside the institution. It
embarked on an active campaign to dissuade allies from joining the AIIB. This effort was an
unquestionable failure. The dominoes began to fall on March 12, 2015, when Chancellor of the
Exchequer George Osborne announced that the United Kingdom, the United States’ closest ally,
would join the AIIB.89 The UK reportedly had not informed the Obama administration of their
decision prior to the announcement. The U.S. government responded by doubling down on its
previous position. A White House official told the Financial Times, “we are wary about a trend

https://www.nytimes.com/2014/10/10/world/asia/chinas-plan-for-regional-development-bank-runs-into-us-
opposition.html/_r=0.
87 IBID. Mr. Medeiros has rejected that such an exchange took place.
88 Jonathan Pollack. “Joining The Club: How will the United States Respond to AIIB’s Expanding Membership.”
Brookings Institution (March 17, 2015). https://www.brookings.edu/blog/order-from-chaos/2015/03/17/joining-the-
club-how-will-the-united-states-respond-to-aiibs-expanding-membership/.
89 George Osborne. “UK announces plans to join Asian Infrastructure Investment Bank.” Gov.UK (March 12, 2015).
toward constant accommodation of China, which is not the best way to engage a rising power.”

Following the UK’s break with the U.S. position, other key U.S allies made the same decision, including France, Germany, and Italy. Regional allies like South Korea and Australia soon followed. By the deadline to become a founding member, the only major ally still on the outside with the United States was Japan.

The U.S. plan to limit AIIB membership was a political fumble. Regardless of Beijing’s intentions, it made the United States appear as a loser in a zero-sum geopolitical match against a rising China. In the fallout of this blunder, the Obama administration tried to walk back, or at least soften, its position. At a joint press conference with Japanese Prime Minister Shinzo Abe on April 28, 2015, President Obama attempted to “dispel this notion that we (the U.S.) were opposed or are opposed to other countries participating in the Asia Infrastructure Investment Bank...if, in fact, the Asian Infrastructure Investment Bank that is being set up ends up having...safeguards, is run in a way that ultimately is actually going to lead to good infrastructure and benefit the borrowing countries, then we’re all for it.”

In an article in Foreign Affairs, Jack Lew made a similar revisionist stand. The narrative, however, was set and the damage already done. The U.S. was left isolated on the outside, hurting from a largely self-inflicted wound.

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Scholarly Discourse

Partially due to the botched U.S. response, the formation of the AIIB has become a hot topic of geopolitical debate both in the media⁹⁴ and in the academic sphere. The question at the forefront of the conversation is whether the AIIB is a threat to U.S. leadership, a threat to the liberal international order, or a status quo institution that has been horribly misconstrued.

In June, 2015, *Foreign Affairs* asked 33 scholars to respond to the statement, “the AIIB represents the start of a fundamental challenge to the current order.”⁹⁵ The results show a high level of disagreement.⁹⁶

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⁹⁶ By scholar, the results were as follows. Strongly Agree: Yun-Han Chu, and Parag Khanna; Agree: Ian Bremmer, Warren Cohen, Alexander Cooney, Aaron Friedberg, Francis Fukuyama, Jean-Marie Guehenno, Yukon Huang, and David Shambaugh; Neutral: Xiao Qiang and Yang Yao; Disagree: Jessica Einhorn, Fravel Taylor, Matthew Goodman, Sebastian Heilman, Yanzhong Huang, John Pomfret, Minxin Pei, Lynette Ong, Damien Ma, Sebastian Mallaby, Baozhen Luo, Winston Lord, James Lindsay, Kenneth Lieberthal, and Eric X. Li; Strongly Disagree: Daniel Drezner, Richard Katz, David Lampton, James Steinberg, and Andrew Nathan.
Graph 2: Foreign Affairs Brain Trust Survey

The AIIB represents the start of a fundamental challenge to the current global multilateral order.

Results:

- Strongly Agree: 2
- Agree: 9
- Neutral: 2
- Disagree: 15
- Strongly Disagree: 5

Those who agreed with the proposition tended to fall into one of two categories. The first, represented by Aaron Friedberg, holds that the creation of the AIIB was inherently threatening to the U.S. and the world order it had established. In line with realist pessimism, China is seen as a revisionist power whose ultimate goal is to undermine and supplant this order, wishing to construct a new regional system with Beijing and CCP ideology at the center. In this picture, the AIIB is a clear step in that direction. This view is presented more moderately by David Shambaugh, who believes that the AIIB is complementary to the existing international institutions, neither revisionist nor redundant. However, in the broader context of China’s recent economic initiatives, it appears an entire parallel set of institutions is emerging that might begin to take on an anti-Western and illiberal cast. Another camp, represented by former World Bank Director for China Yukon Huang, believes there is nothing intrinsically threatening about the AIIB. However, the U.S. response has made the AIIB a threat to the existing order, as AIIB success will now inevitably be scored as a loss to the U.S. and Bretton Woods.

Those who disagree with the claim can also be divided into two groups. The first group, which includes all the members who strongly disagree, reflects neoliberal institutionalist optimism, as it sees the AIIB as complementary to the existing order, with any reforms China
wishes to make to the MDB model well within the area of acceptability. Andrew Nathan represents this position, arguing, “from all indications so far, the new bank will use lending standards that are similar to those used by the World Bank. Although this is a new player in the international system, it reaffirms rather than overturns the rules by which an international system operates.” This is also the position of David Dollar, who was not surveyed for this piece, but is former World Bank Director for China and current consultant to the AIIB.\textsuperscript{97} The other group, including Mathew Goodman, takes a softer position, insisting that regardless of China’s intentions, the multilateral nature of the AIIB will constrain China from making any serious reform to the international economic system or the world order in general.

Many of these arguments will be directly addressed in following sections. What is important is that this sample shows the great heterogeneity of views that exist. Given the economic dimension’s importance in Sino-U.S. relations, getting the interpretation right is critical, as the AIIB has become a lightning rod, with one’s view of the AIIB often indicative how one believes the overall power transition will proceed. The AIIB is thus a hard case study for whether complex interdependence and a confluence of interests provided for within the international system can preserve peace during the transition. To arrive at a correct interpretation, it is important to disentangle two related but distinct questions: Why did China create this new MDB called the Asian Infrastructure Investment Bank? And how does this bank conform to or deviate from the existing status quo of the MDB landscape? The following two sections are aimed respectively at answering these two questions.

6. WHY DID CHINA CREATE THE AIIB?

Why China created the Asian Infrastructure Investment Bank is the critical question. The answer will reveal whether U.S. objections to the bank were warranted, and provide a key piece of data, which will help in projecting how the power transition will likely unfold. Unfortunately, a clear answer is elusive for two reasons. First, it is always difficult to know for certain the intentions behind a country’s actions. This is perhaps even truer in the case of China, as CCP policy making has commonly been described as a black box. The best way to overcome this hurdle is to identify and describe how the creation of the AIIB would advance China’s known interests and objectives. Second, there is a confluence of interests that go into a major initiative like the creation of the AIIB. For analytic purposes, it is useful to delineate between the economic interests and the geopolitical interests that are served by the AIIB, identifying the most relevant factors in each of these categories.

The following section will adhere to this strategy. First, it will lay out China’s economic rationale behind creating the AIIB. It will provide a brief overview of the current state of China’s economy, and then demonstrate how the AIIB can help solve or alleviate many of the economic challenges China is now facing. Next, the decision to create a new international financial institution to serve these purposes will be addressed. This analysis will lead into the last section, a discussion of the geopolitical interests behind the bank. In evaluating China’s motives in each of these areas, it must be remembered that what is relevant are the variables that were input into Beijing’s calculus in creating the bank. The outputs, or the success of the bank in achieving these goals, are not addressed. This is in part because the outputs are not yet known, but also because this is outside of the purview of this project, which focuses on what the creation of the bank signals about China’s overall rise.
The Economic Rationale

There is a tendency for outside commentators and policymakers to view the major economic initiatives of other countries solely through a geopolitical lens. Analysis of China’s actions have often fallen victim to this propensity, as expressed in Same Bed, Different Dreams, where David Lampton writes that, “Americans viscerally view what they do internationally in terms of domestic constraints, but they rarely appreciate that Chinese behavior also cannot be understood apart from domestic considerations.”98 This fundamental attribution error of foreign policy can lead to faulty or one-sided conclusions on intentions. For an economic initiative like the AIIB, the economic side of the equation needs to be comprehensively addressed. In order to do so, it is essential to understand the current state of the Chinese economy.

The State of the Chinese Economy

The grand narrative of the Chinese economy since 1978 is that of a juggernaut that has sustained double-digit growth for three decades, pulling hundreds of millions of people out of poverty as it rose to become the second largest economy in the world. This story is the reason Sino-U.S. power transition considerations now matter. However, the Chinese economic model is also fragile, with underlying problems now surfacing and putting pressure on the CCP.

Even if the Chinese economy continued its impressive growth rate into the future, it would need to concern itself with the growing inequality in the country. In particular, Beijing must address the dramatic East/West economic chasm. Much of the reform era initiatives, such

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as the special economic zones, attracted foreign capital and investment into the eastern part of the country. Western regions like Xinjiang and Tibet, where relationships with Beijing have been contentious to say the least, have not equally shared in the growth. While China has attempted to address these concerns through initiatives such as the “Great Western Development,” launched by Jiang Zemin in 1999, the gap appears to be widening. This expanding inequality threatens the social and political stability of these western regions.

China’s economic woes do not end there. It would be erroneous to assume that because the Chinese economy has shown incredible dynamism in the past, it will continue to grow in the future. In fact, economic history suggests this will not be the case. There is a ‘middle-income trap’ that most developing countries fail to escape. Economic historian Barry Eichengreen writes that while there is no iron law, most middle-income countries experience a dramatic slowdown in growth to about 3.5 percent per annum. The CCP has demonstrated an unwillingness to accept a decline in growth to such a low level in the near future. China may not be aiming at double-digit growth, but it still sets targets that are nearly double those found to be the norm by Eichengreen. The CCP has signaled that it believes high levels of growth are imperative to the party’s rule, the paramount core interest, and thus it is willing to take extreme action to avoid this trap. Yet, while it is not predetermined that China will fall to a much lower growth rate, there are ample reasons to believe that China will not be able to defy historical patterns, as the problems facing the Chinese economy are mounting.

The growth model that China shares with many other Asian countries relies on a high level of investment and high level of exports to raise GDP. It is a model that has had enormous success in the past half century, not only in Japan, but also in other Asian countries. However, as many of these other countries have found, it is a growth model with an expiration date. This developmentalist approach makes sense so long as wages and the overall level of capital within a country are low. If these conditions hold, a country can be the workshop of the world, utilizing its comparative advantage to sell low-end products on world markets. However, these conditions no longer perfectly hold in China. China’s labor markets are tightening as it hits its Lewis Turning Point.\textsuperscript{103} China’s army of surplus labor from the countryside is drying up, causing upward pressure on wages that is threatening China’s comparative advantage in low-end manufacturing.\textsuperscript{104} While such a turning point is expected to occur in any developing country, the problem in China is exacerbated by a severe demographic shift, in part due to the One Child Policy.\textsuperscript{105} For decades, China has been able to cash in on a demographic dividend. As this now becomes a demographic headwind, upward pressure on wages will be atypically sharp. To sustain growth, China must now decrease its reliance on investment and exports, and increase its focus on domestic demand. At the same time, as wages rise, it must try to make the difficult move up the supply chain and away from low-end manufacturing.

This difficult transition was inevitable. However, acknowledging there is never a good time for a worldwide recession, the Global Financial Crisis of 2008 was particularly inopportune for China. Economic downturns always expose the imbalances in an economy, but for the Chinese in 2008 it exacerbated them. China had long-relied on trade as an engine for economic

\textsuperscript{103} Arthur Lewis. “Economic Development with Unlimited Supplies of Labor.” \textit{Manchester School of Economic and Social Studies} 22 (1954): 139-191.
\textsuperscript{105} IBID. 119
growth, with annual trade growth since 1978 at a remarkable 17 percent.\textsuperscript{106} China had to eventually wean itself off of its over-reliance on foreign sources of demand. Ideally, this can be done gradually. With the Western countries continuing to feel the effects of the financial crisis, Beijing’s hand has been forced and its opportunities limited. One cannot export an ever-increasing number of goods to stagnant Western economies. This has resulted in downward pressure on China’s current account surplus, and thus GDP, that is likely to continue into the future.\textsuperscript{107}

To make matters worse, actions that the CCP took in response to the crisis only further aggravated these long-term problems. In 2008 the Chinese State Council began to rollout a $586 billion (RMB4 trillion) stimulus package to ramp up domestic demand.\textsuperscript{108} This Keynesian boost was enormously successful as it helped China sustain relatively robust growth throughout the crisis, serving as the locomotive for the global economy. The success of the economy during this period played a role in producing China’s self-confident, aggressive post-2008 foreign policy. However, this success came at a substantial cost. Namely, it intensified many of the problems already present in the economy, not just delaying necessary reforms and transitions, but also moving the economy in the opposite direction. In 2009, the investment-to-GDP ratio in China soared to a globally unprecedented 47 percent.\textsuperscript{109} More importantly, these investments went into the sectors of the economy that China was supposed to be moving away from—infrastructure and low-end manufacturing—making the already needed transition more painful and risky.


As a result, China now faces a severe problem of overcapacity. China has far more capital in heavy-industry and state-run sectors than the economy can hope to absorb in the near future. Fitting with the fact that investment was funneled into shovel-ready infrastructure projects, the two sectors that are most burdened by this excess capacity in the near future are steel and coal. The CCP is taking this problem seriously. In the case of steel, the government created the ‘Industrial Structure Adjustment Fund,’ which will provide RMB20 billion in subsidies to close down forty to fifty metric tons of capacity per year for the next three years.”

Thus, despite China’s sustained economic success, there are serious underlying challenges. One thing that can be agreed upon is that, as Nicholas Lardy argues in *Sustaining Economic Growth After the Crisis*, “the policy mix that brought China so well through the biggest global financial and economic crisis in several decades is going to be less successful going forward.” China does have assets it can deploy to address these challenges, such as three trillion dollars of international reserves. Success will hinge on Beijing’s ability to leverage its assets to solve these problems in a sufficient and timely fashion. From this perspective, the Asian Infrastructure Investment Bank has a clear role to play in this process.

**AIIB’s Economic Benefits**

The Asian Infrastructure Investment Bank is not simply a geopolitical ploy. It is designed with these challenges in mind and has a clear economic logic behind it. This is true from both a short-term perspective, with regard to the construction projects that will be unlocked for Chinese companies as a direct result of the bank’s loans, and in the long-term, as a result of improved

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111 Nicholas Lardy. *Sustaining China’s Economic Growth After the Global Financial Crisis*. 11
infrastructure and increased regional connectivity. For both of these reasons, it makes economic sense for Beijing to deploy a small fraction its abundant foreign reserves to support this initiative.

In the short-term, the construction projects financed by AIIB will, in theory, help China cope with its severe overcapacity problem. China has excess capacity in sectors related to infrastructure such as steel, cement, heavy equipment and construction. China could deal with this overcapacity by curbing domestic production, which, as stated above, is being done. However, this approach is costly, as it both wastes physical capital and leaves workers unemployed. Such unemployment could be avoided by allowing unprofitable firms to continue operating. These ‘zombie firms’ do exist in China, but this too is far from ideal as it exacerbates China’s burgeoning debt problem. Some of this capacity has been used for the construction of projects with little clear marginal return or purpose, as was the case during the stimulus, but the continued creation of white elephants is typically the sign of a coming crisis, not a robust recovery. The first-best option would be to find external sources of demand for the excessive domestic supply.\(^\text{112}\) The problem is that because the financial crisis was global, fewer governments are spending substantial sums on infrastructure, and dumping goods like steel on the world market, which China has done, leads to tariffs and WTO penalties.

China appears to be attempting to make this first-best ideal a reality through the AIIB. This multilateral institution is catalyzing infrastructure spending, which creates outlets to employ idle Chinese domestic supply. The AIIB will invest in projects such as building roads, telecommunications, and energy plants. These are the exact areas that China has poured its

\(^{112}\) As an influential Chinese commentator put it, “this infrastructure problem cannot be solved merely by increasing domestic demand; rather, China must look to the overseas markets to channel this overcapacity (Hu 2013).” Domenico Lombardi and Hongying Wang. Enter The Dragon: China in the International Financial System. (Ontario: Centre for International Governance Innovation, 2016).
stimulus money into since 2008 and built up overcapacity. There is reason to be skeptical about the ability of the AIIB and OBOR to soak up China’s excess capacity. David Dollar writes that if the bank is very successful, it might lend $20 billion per year.\textsuperscript{113} China would need $60 billion per year in new demand to absorb just the excess capacity in steel alone. Furthermore, unlike bilateral projects, including many connected with OBOR, Chinese companies are not guaranteed the contracts for AIIB funded projects, although with advanced capital, cost-advantages, expertise, and a strong regional presence, Chinese companies will undoubtedly be able to attract a high percentage of these deals.\textsuperscript{114} Still, Dollar acknowledges that, “there is no coincidence that this period of excess capacity at home is the moment at which China launched expensive new initiatives, such as the Asian Infrastructure Investment Bank, the BRICS Bank and the ‘One Belt, One Road’ initiative in order to strengthen infrastructure both on the westward land route from China through Central Asia and on the southerly maritime routes from China through Southeast Asia.”\textsuperscript{115} This may be a case in which domestic demands for action drives government policy. With the dissatisfaction of interest groups in these sectors, it is important that the CCP be seen acting on the issue, attempting to find outlets for this supply. Regardless, it is clear that the absorption of Chinese capacity, whether real or merely perceived, entered into Beijing’s calculations.

To understand the longer-term economic benefits that China will accrue as a result of the AIIB, it is necessary to examine the public good that the bank is delivering. Unlike in China, where infrastructure spending lately has been channeled into the construction of white elephants, there is an abundance of worthwhile, shovel-ready projects in the continent that will deliver


much higher returns on investment. In 2009, the Asian Development Bank published a now-famous white paper entitled *Infrastructure for a Seamless Asia*, which declared that the Asian region would require $8 trillion dollars in additional infrastructure spending during the current decade (2011-2020). With an ADB capital base of $160 billion, a World Bank capital base of $223 billion, a general tightening of fiscal policies, and little hope of substantial private investment, there is an immense funding gap that the AIIB will help fill. How will contributing to a much needed improvement in regional infrastructure serve China’s current economic needs?

First, while the above analysis has shown that China cannot rely on Western countries as ever-increasing sources of demand of Chinese goods, one should not infer that these markets are no longer important to the Chinese economy. China’s single largest trading partner is still the European Union, which accounts for approximately one fifth of all Chinese exports. The Eurasian land belt portion of OBOR, which includes an impressive new high-speed freight train, is directly aimed at reducing time and costs of exporting to Europe. To the extent that AIIB serves a similar role in improving connectivity, it will help Chinese companies gain or retain market share in Europe, while controlling transportation costs and boosting profitability.

Secondly, as a trading partner, China stands to benefit from an improved regional economy. This infrastructure creation matters for development. Poor infrastructure can stymie growth. Profitable investment, as China’s model has shown, can unlock the potential of a country or region. Despite globalization, a country’s regional ecosystem matters. Gravity models of international economics suggest that neighboring countries are disproportionately important as trade partners and links in trans-national supply chains. This is increasingly true in China, as in

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the ten years from 2001 to 2011, the trade volume between China and South and West Asian countries increased thirty fold.\textsuperscript{119} The Asian region has only become more important for China’s future economic strategy since the Global Financial Crisis, as China now sees these countries as new sources of demand for Chinese exports as Western countries continue to stagnate.\textsuperscript{120} While AIIB loans are designed in the short term to induce demand for infrastructure that Chinese construction companies can supply, in the long run, they will induce demand for goods that Chinese manufacturers can export.

Thirdly, China can also profit from this improvement in regional infrastructure through its outward direct investment (ODI) in the region. China’s ODI can be traced back to the “Going Out” strategy initiated in the 1990s under Jiang Zemin. However, recently, there has been a marked increase in this outward investment. As the Chinese labor market tightens, Chinese companies are facing the reality that they will likely no longer be able to sell labor-intensive products on the world market, as China will be supplanted by other less developed countries with a comparative advantage in low-end manufacturing. Part of the Chinese response is to organize a comprehensive push to move up the supply chain entitled “Made in China 2025.”\textsuperscript{121} The other prong of the strategy is to do precisely what other countries did in China for decades: put excess savings to use by investing in countries in the region with lower labor costs to profit off of their comparative advantage.\textsuperscript{122} This outward direct investment has increased exponentially over the past several years.\textsuperscript{123}

\textsuperscript{119} Nicholas Lardy. “Comment on China’s Outward Foreign Direct Investment.” In Robert Feenstra and Shang-Jin Wei. \textit{China’s Growing Role in World Trade}: 578.
\textsuperscript{123} David Dollar. \textit{China as a Global Investor}. 3.
Graph 3: China’s Outward Direct Investment

China is now a significant source of capital for the region, making up a sizeable proportion of the foreign direct investment to countries on its periphery.124 Some of these investments are to secure resources for Chinese companies, which has been particularly true in Central Asian countries such as Kazakhstan and Pakistan, as well as in Southeast Asian countries like Myanmar.125 Increasingly, however, outward direct investment in the region is aimed at manufacturing, both for low-end final goods and the low-end portions of Chinese supply chains.126 The State Council clearly views such actions favorably as, until a recent scare of capital flight, it decreased restrictions on overseas investment and offered financial support for many projects. In 2009 the Ministry of Commerce established the “Measures for the Administration of Overseas Investment” to ease the approval process. Improved connectivity in the region will allow goods produced by Chinese firms in these countries to plug into the supply chain and reach export markets with reduced costs and time.

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126 Albert Ng. “Going Out—The Global Dream of Manufacturing.”
Lastly, interlinking economics with general domestic stability concerns, Beijing hopes that AIIB along with OBOR will help facilitate development in the western region of the country and ease the increasing East-West income gap. With the “Develop the West” plan, China attempted to better integrate the western regions into the growing Chinese economy, in part by improving infrastructure and connecting the west to the more prosperous eastern coastal region. Now, China aims to connect landlocked provinces like Yunnan and Guangxi in the south and the problematic western autonomous regions of Xinjiang and Tibet with the countries on their periphery. China has long supported development in Central Asian countries, pushing for their inclusion into the WTO, as it believes that a strong regional economic environment can help ensure a prosperous and peaceful Xinjiang. The AIIB is an extension of this strategy, exemplified in Wang Jisi’s ‘Marching Westward’ article, which served as the intellectual origin of both OBOR and the AIIB. One of the three major objectives of OBOR laid out by the Chinese Ministry of Foreign Affairs was to accelerate growth in the West by turning it into the “frontier in opening up to the world.” A more developed, growing Central Asia, with robust infrastructure connecting it with an increasingly important Chinese partner would place these Western regions in a strategic position from which they could profit. The failures of “Develop the West” make one skeptical of whether the AIIB will ultimately have a great effect on the economic conditions of the western provinces, but there can be no doubt that Beijing designed these major economic initiatives with this end in mind.

129 Lin Wen Xin. “China’s One Belt One Road Initiative: A Literature Review” in Tai Wei Lim, Katherine Hui Tseng and Wen Xin Lim. China’s One Belt One Road Initiative. 114.
The Status-Quo Nature of the Economic Rationale

To conclude this analysis of the economic rationale of AIIB, one must return to the overarching question of whether China is acting as a status-quo power. While attention is often paid to the geopolitical side of the ledger, which is commonly depicted as zero-sum, the economic rationale behind the AIIB is strong. One must therefore be skeptical of any argument that frames the creation of the AIIB as purely a geopolitical battle, squaring off the United States against China.

Additionally, there are two important factors in this analysis of the economics behind AIIB. First, China appears to be creating the AIIB because it perceives it to be in its own economic and domestic interest. Second, from this economic perspective, there is nothing to suggest China is not maintaining the basic world order. In fact, as China seeks to further its development goals, it appears to be relying more on the international economic system that is in place. It is continuing and intensifying its commitment to high levels of trade and, with some restrictions, capital flows with other countries. Fitting these two together, the picture that emerges is of a China that is satisfying its core domestic interests by acting within the framework of the current international system. The filtration of domestic policy into foreign policy is pushing China towards the status quo of the global order. Through acting as an active participant in this order, supplying public goods to the international community, China derives special benefits such as reducing overcapacity and enhanced domestic stability. This is not necessarily bad or abnormal. Rather, it is the hope of the neoliberal institutionalist promise.
Multilateralism Motive

There is a strong economic rationale that informs China’s desire to finance infrastructure in Asia and improve regional connectivity. However, the AIIB attracted so much attention not due to what it was going to construct, but rather because China was stepping ‘outside Breton Woods,’ creating a new international financial institution to perform this task. This image of China as an institution creator, not merely a responsible stakeholder in Western-led intuitions, was perceived by many as a signal that China was a dissatisfied power. There are two alternative paths China could have pursued:

(a) China could have pursued new infrastructure investment projects on a purely bilateral, state-to-state basis. This is how China’s major foreign infrastructure financing has been conducted in the past, and how China is financing many of the projects that fall under the banner of One Belt, One Road.

(b) China could have used an existing multilateral development bank, such as the World Bank or the Asian Development Bank, which is primarily owned and operated by the United States, Japan, and the European Union.

Since China had these available alternatives and decided to create a new development bank that operates out of Beijing, many have favored the geopolitical arguments offered below over the preceding economic rationale. Before exploring these geopolitical considerations in detail, it is useful to first examine both the benefits of multilateralism, in order to understand why China would choose not to proceed with alternative (a), as well as the multilateral development bank landscape, to understand why China decided to create a new MDB rather than pursuing alternative (b).
Bilateral development loans and infrastructure projects, coordinated on a state-to-state basis, still play a significant role in China’s overseas investments. Yet, by creating the AIIB, Beijing is attempting to capture many of the advantages a multilateral development bank provides to an international investor. In an essay entitled “Why Is There Multilateral Lending?” Dani Rodrik offers a clear explanation of the two primary advantages of MDBs.\(^{130}\) The first advantage that Rodrik explores pertains to informational problems. MDBs can serve as providers of economic and regional expertise, while also improving the monitoring of projects. This can lead to a more effective and efficient use of a creditor’s money. The second advantage arises from the fact that MDBs possess a degree of autonomy from the governments that own them. This allows the banks to establish policies and pursue projects that could not be implemented or performed on a bilateral basis.

There can be little doubt that China is incentivized to capture these two advantages. In many of its bilateral development projects, China has felt the pain of economic and political turmoil leading to loan defaults.\(^{131}\) Beijing will therefore look to use multilateralism to improve its analysis and monitoring processes, while decreasing risk and exposure in any one country or project. As the AIIB catalyzes new infrastructure funding from other countries, China’s financial liabilities and risk will be further diminished.

The second advantage, related to the relative autonomy of a MDB, is of particular interest to China. As China has increased its global investment footprint, it has stepped on the toes of many other countries in the Asian region. China has endured a serious public opinion hit as


increasing overseas investment has sparked waves of Sinophobic backlash. In Central Asia, a
critical area to the AIIB and OBOR initiatives, 2016 gave rise to massive anti-Chinese protests in
both Kazakhstan and Kyrgyzstan.\textsuperscript{132} Marlene Laruelle writes that:\textsuperscript{133}

Four major aspects of the ‘Chinese question’ are likely to remain in play in Central Asia:
first, the transparency of transaction in the energy and mineral sector, which form some
of the largest contributions to all state budgets; second, the establishment of non-energy
sector companies, which raise issues of competition for work and due respect for labor
regulations; third, the issues of land ownership, which has long been a particularly
sensitive topic for Central Asians; and last, the control of commodity flows from China.

These public sentiment concerns are not limited to Central Asia, but also have manifested in
recent events in Sri Lanka and, perhaps most notably, in the extraordinary case of Myanmar,
China’s long-time friendly neighbor on its southern border.\textsuperscript{134} These souring relations with the
populations and governments of these countries constrain China going forward. Beijing cares
about its soft power, and therefore does not wish to further diminish its reputation in the region
with too many bilateral projects. Wang Jisi’s strategy of ‘Marching West’ was predicated on
moving away from the tumultuous interactions with neighbors in the South China Sea and
improving relations on its western flank. The fact that the AIIB is a multilateral bank with broad
membership will allow China to pursue its ambitious regional economic vision with less fear of
backlash.

Deciding to use a multilateral institution is no free lunch. There are practical reasons why
China has favored bilateral lending in the past. One cost of using an MDB of particular interest is

\textsuperscript{132} Alexander Cooley. “The Emerging Political Economy of One Belt One Road” in Tai Wei Lim, Katherine Hui
Tseng and Wen Xin Lim. \textit{China’s One Belt One Road Initiative}.
\textsuperscript{133} Marlene Laruelle. \textit{The ‘Chinese Question’ in Central Asia}. 91
\textsuperscript{134} Thomas Miller. \textit{China’s Asian Dream}. 
the other side of the coin of the second benefit that Rodrik explores: the relative autonomy of the bank. China can make significant investments in the AIIB, using the bank to finance an increasing share of the projects China would have previously pursued bilaterally. However, doing so would constrain the options available to China. If China wants to be a revisionist state, using the AIIB to form a new global architecture that undermines rules and norms of the existing international system, it will need the consensus of other member states.\textsuperscript{135} South-South cooperation is real, but such an anti-Bretton Woods consensus does not exist.

Why not (b)?

Beyond China’s desire to capture on the benefits of a multilateral bank, the question still lingers as to why China decided to step outside the existing institutions and create a new MDB. Many of the specific geopolitical factors that influenced this decision will be addressed in the following sub-section. Before exploring these specific reasons, it is first useful to analyze the existing aid architecture, as this will reveal how atypical, or anti-status quo, it is to create a new MDB rather than pursue alternative (b).\textsuperscript{136}

Importantly, the foreign aid and development bank international structure is not highly consolidated. At the lowest level there are many private foundations and firms that contribute to and administer foreign aid programs. Beyond that are individual states that provide loans to countries on a bilateral basis. The 29 members of the Organization of Economic Cooperation and Development (OECD) coordinate their loans through the Development Cooperation Directorate


Even at the multilateral level, MDBs are not concentrated. There are 28 international development institutions. Most important among these are the World Bank and regional development banks, like the Inter-American Development Bank and the Asian Development Bank (ADB). The ADB, with a $150 billion in capital, is approximately half the size of the World Bank. This loosely coordinated structure renders multilateral development lending far more diffuse than the world balance of payments system, where power is highly concentrated in the International Monetary Fund.\textsuperscript{137}

\textbf{Table 1: Proxies for Policy Competition and Outside Options, 1978-2005}

<table>
<thead>
<tr>
<th>Number of Institutions</th>
<th>Disbursement Share of Leading Institution (IMF or WB)</th>
<th>Herfindahl–Hirschman Index of Distributions</th>
<th>Proportion of IMF or WB Disbursements to U.S. Bilateral Disbursements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance of Payments Lending (IMF)</td>
<td>6</td>
<td>94.3%</td>
<td>87.9%</td>
</tr>
<tr>
<td>Development Aid (World Bank)</td>
<td>28</td>
<td>31.1%</td>
<td>22.2%</td>
</tr>
</tbody>
</table>

This difference implies that, \textit{ceteris paribus}, it is less revisionist for the Chinese to establish a multilateral development bank than it was for the Japanese to call for an Asian Monetary Fund. Comparatively, multilateral development banks have fewer network effects and lower barriers to entry.

\textsuperscript{137} Phillip Lipscy. “Explaining Institutional Change.” 353
This is not to suggest that because the MDB landscape has these characteristics one should presume that China’s intentions are benign. However, it does appear that when the Chinese argue that there is room for another bank that can work in conjunction with the existing development banks to further a shared mission, there are reasons to take such claims seriously. Furthermore, the fractured nature of the system creates a high level of competition between banks, which, according to Phillip Lipscy and in line with the argument offered above, implies that “to remain relevant, aid organizations must be accountable to their stakeholders. If the AIIB is seen as overly dominated by China, other members will turn elsewhere…there is no plausible scenario under which the AIIB could supplant the World Bank and ADB unless the organization suitably reflects the concerns and interests of the broader international community.”138 All of this operates against the narrative that the AIIB is a wolf in sheep’s clothing, designed to rupture the existing order. However, to discern if this optimistic conclusion is accurate, the broader geostrategic rationale behind Beijing’s creation of the AIIB must be addressed.

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138 Phillip Lipscy. “Who’s Afraid of the AIIB.”
Geopolitical Rationale

CCP officials, including Xi Jinping and those affiliated with the Asian Infrastructure Investment Bank, have mounted a public relations campaign surrounding the bank that centers on the language of Xi’s call for a “new type of great power relationship” with the United States. Chinese officials commonly refer to AIIB by using terms such as ‘win-win’, ‘positive sum’, and ‘mutual respect’, arguing that the bank will work cooperatively with the Bretton Woods institutions to provide public goods for the region. China is taking a more active role in global governance in a manner compatible with the existing rules. This is not the way the bank’s creation has been perceived by many outside commentators, who more commonly have referred to the language of the ‘the China Dream’, ‘national rejuvenation’, and ‘period of strategic opportunity’, citing the geopolitical motives behind the AIIB and One Belt, One Road. The AIIB is emblematic of China’s push to enhance its soft power capabilities, causing many to question whether China is hoping to leverage these capabilities to disrupt the current world order, possibly fracturing it and establishing its own exclusive sphere of influence.139 Some of these fears are based on largely unsubstantiated conjecture, such as the argument, compatible with the ‘string of pearls’ theory, that the AIIB and OBOR will help build the hard infrastructure that will facilitate the increase of China’s military presence in the region.140 However, real geopolitical motives behind the bank’s creation do exist, and they have serious implications for the coming power transition, as they provide essential data for determining what type of rising power China is likely to be.

139 For an in depth overview of these commentaries, see Michael Swaine. “Chinese Views and Commentary on the ‘One Belt, One Road’ Initiative.” Chinese Leadership Monitor 47 (Summer 2015): 1-24.
This section specifies seven possible geopolitical motives behind the creation of AIIB, assessing the logic and theory that supports each. The motives are addressed in ascending order, from the least challenging to the international system, which are motives largely compatible with the general status quo, to the most challenging, in which China appears as revisionist power. In this order, the seven motives that have been identified are:

1. A Good-Neighbor Policy—Improving China’s Regional Relationships
2. Improving China’s Energy Security
3. Prestige—Gaining Recognition on the World Stage
4. Signaling Discontent with ‘Bretton Woods’
5. Fostering a ‘Community of Common Destiny’—Complex Interdependence to Increase China’s Influence in the Region
6. The Hedging Strategy—Nesting Institutions
7. Institution Breaker—Fracturing or Overthrowing ‘Bretton Woods’

While there is some degree of overlap in these motives, segmenting them allows for more fruitful discourse that can better inform policy. China could, and in fact does, possess many of these motives. Yet, it is dangerous to presume that because China holds any number of these motives it likely possesses all seven. Attaching motive 7—the Institution Breaker—to the AIIB indicates that China is a revisionist power, dissatisfied with the rules of the game and likely headed towards conflict with the United States. The gravity of this implication necessitates careful examination of each of these motives to determine which can, with a degree of certainty, be ascribed to the creation of the Asian Infrastructure Investment Bank.
1. A Good-Neighbor Policy—Improving China’s Regional Relationships

Few would be envious of China’s geographic position. It shares borders with more countries than any other state in the world, and every single one of these borders has been disputed. In other words, even in the best of times, China is in a difficult spot. Unfortunately for the Chinese, these are not the best of times. With China’s assertive foreign policy stance after 2008, its commitment to multilateralism and cooperation waned as it attempted to pursue its self-interest and the expense of others in the region. Beijing is now learning that actions have consequences, and while you might be able to flex your muscle in the short term, scaring many of the countries on your periphery is likely not the best idea in the long run. The U.S. pivot to Asia was the result of Secretary of State Hillary Clinton’s visit to the APEC conference in Singapore in 2011, in which American allies requested an increased U.S. presence in the region to counter China. If China’s assertiveness was meant to demonstrate that Asia was its terrain, it had the opposite effect; it scared other Asian states, strengthened their hub-and-spoke relationship with U.S., and provided the impetus for the U.S. to increase its military and diplomatic presence in the region.

Beijing soon recognized these adverse effects and began to change its strategy. In 2011, Beijing took steps to reassure countries in the region and beyond that it remained committed to multilateralism and was a constructive partner hoping to further common interests. This began with State Councilor Dai Bingguo’s speech that signaled China would continue to adhere to its path of peaceful development, which jumpstarted the aforementioned ‘charm offensive’ in Asia. This charm offensive has continued under Xi Jinping, who has made regional

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142 Chun Han Wong and Carol E. Lee. “China Extends Diplomatic Blitz to Southeast Asia.” Wall Street Journal
relationships and China’s soft power in Asia a priority. In 2014, Xi declared that “we should increase China’s soft power, give a good Chinese narrative, and better communicate China’s messages to the world.” The AIIB can be interpreted as growing out of this soft power push as China seeks to implement a ‘good neighbor policy.’

This is not the first time that China has pursued such a strategy. In many ways, it parallels the calculative strategy Beijing followed in 1996, when it increased its multilateral presence in the region by joining existing institutions, such as ASEAN, and creating new multilaterals, like the Shanghai Five, which would later become the Shanghai Cooperation Organization. As was the case in the 1990s, this good neighbor policy is the result of a calculation by Beijing to create an external strategic environment that is conducive to its rise. It is a calculation that China is better served by improving relationships in the region and providing public goods than by going rogue and being overly assertive. This should be applauded rather than feared, as it shows that the international system that is hard to overturn and easy to join is working; China is finding its interests are served by adapting its policy to better fit the interests of others.

2. Improving China’s Energy Security

The AIIB can also be seen as part of Beijing’s continued strategy to improve its energy security. Energy, as one of the six key focus areas of the AIIB, is an important topic deserving of nuanced analysis. In China’s bilateral deals, including many affiliated with OBOR, China attempts to gain direct ownership over the natural resources in other countries. The Chinese

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144 Avery Goldstein. Rising to the Challenge; Michael Swaine and Ashley Tellis. Interpreting China’s Grand Strategy.
Development Bank has long extended energy-backed loans, which provide China with long-term supply contracts in resource-rich countries.\textsuperscript{145} These loans have attracted the most attention in China’s loan packages with Africa, but have also been used within Asia, in countries such as Pakistan, Kazakhstan, and Myanmar.\textsuperscript{146} The energy logic behind AIIB is slightly different; it is less about gaining ownership over resources—to which the multilateral setting is not conducive, as any energy that is produced as a result of AIIB investment will have to be purchased on the market at world prices—and more about China increasing its energy security through diversification.

China will not be energy independent in the foreseeable future, and thus has embarked on an attempt to diversify its sources of energy. One does not need to believe the hype surrounding the Malacca dilemma in order to understand the rationale behind this strategy. The vast majority of China’s oil comes from the Middle East, as well as Australia. This oil is transported to China by sea, arriving in China’s eastern ports. If China were ever to find itself in an international confrontation, the worry would be that these sea-lanes could possibly be blocked, and China’s energy supply choked off. Therefore, China has a large interest in increasing the energy production in the Asia region, particularly in Central Asia, and constructing pipelines that can deliver this energy to China by land.\textsuperscript{147} China currently imports only a small proportion of its oil through land routes from Central Asia, primarily due to production and infrastructure deficiencies. It has attempted to enhance the infrastructure on a bilateral basis, with the Chinese Development Bank investing substantial sums in the Kazakhstan-China oil pipeline and the


\textsuperscript{146} Thomas Miller. \textit{China’s Asian Dream}. Ch. 3.

Trans-Asia Gas Pipeline.\textsuperscript{148} The multilateral nature of the AIIB, for the aforementioned reasons, will facilitate further work on similar projects. There is little hope of China constructing enough pipelines to not be overly reliant on maritime transportation routes, but it is making a concerted effort to diversify.

One would obviously hope that such an event would never occur where China is involved in an international confrontation and the sea-lanes through which most of its oil travels are blocked off. However, the possibility always exits, and therefore countries must prepare for these contingencies. All countries, including the U.S., take steps to increase their energy security by diversifying energy sources, supporting domestic production, or holding energy reserves. Therefore, this motive behind the establishment of the AIIB should be seen as in line with global norms, not a sign that China plans on sparking confrontations with other countries.

3. Prestige—Gaining Recognition on the World Stage

The upshot of the prior summary of China’s various international economic initiatives is that China is seeking prestige on the world stage. In Xi Jinping’s view, China is now a great power, and ought to be recognized as such by the international community. One can question the degree to which China’s unique history—in particular the notion of the ‘Century of Humiliation mentality’\textsuperscript{149}—affects its major foreign policy decisions. Yet, it is apparent that Beijing is concerned with \textit{face} in international relations.\textsuperscript{150} Prestige, status, and respect all matter. When Xi discusses the idea of ‘national rejuvenation’, he is alluding to an idea that China must regain its

rightful place in the world. Many of his economic initiatives operate in accordance with this belief. This is most apparent in the push to include the RMB in the IMF’s Special Drawing Rights, which appears to have few practical implications beyond prestige considerations. While they have a more sound economic logic, this is also reflected in how the AIIB and OBOR are framed by CCP officials.\textsuperscript{151} At the inauguration of the AIIB, Xi stated that as a great power, China must, “undertake more international obligations, promote improvement of the current international economic system, and provide more public goods.”\textsuperscript{152} This line has been parroted by Foreign Minister Wang Yi\textsuperscript{153} and AIIB President Jin Liqun.\textsuperscript{154} If prestige is important, as it clearly is, it matters that this is an institution with its origins in China, with Chinese majority ownership, and with a Chinese president. This level of prestige could not be found in Bretton Woods. Just as the Beijing Olympics in 2008 was China’s chance to take center stage in front of a worldwide audience and say “look what we have built,” the founding of the AIIB serves a similar purpose.

Should the international community be worried that China is actively looking to gain prestige on the world stage? In some cases the answer is yes. If China is attempting to increase its status through more assertive policies or military displays, this could cause friction, particularly between the U.S. and China. Perhaps the search for recognition of great power status leads China to flex its muscle and take more aggressive actions, as it did in 2008. The more pertinent question is thus how will China seek to acquire this prestige? To the extent that it

\textsuperscript{151} Michael Swaine. “Chinese Views and Commentary on the ‘One Belt, One Road.’”  
\textsuperscript{152} Xi Jinping. “Remarks by the Chinese President Xi at the Inauguration of the Asian Infrastructure Investment Bank.”  
\textsuperscript{154} Jin Liqun. “Building Asia’s New Bank.”
decides to take action to provide public goods or increase its role *within* global governance, it can be a positive, rather than threatening, development.

4. Signaling Discontent with ‘Bretton Woods’

China is pursing prestige with the creation of a *new* institution in part due to its continued discontent with the existing international financial institutions. China has attempted to increase its prestige within Bretton Woods by advocating for voting share reform. Reform appears warranted, as the voting shares within the World Bank and the International Monetary Fund have become disconnected from the economic landscape. In fact, it is not only a problem in Bretton Woods. In the ADB, China’s voting shares are only one third that of Japan’s, despite the fact that China has a larger economy. Across all of the core existing MDBs, China’s voting shares are significantly underweighted relative to its 13 percent share of global GDP.\(^\text{155}\)

The continuing problem is that voting shares in institutions is a zero-sum game. For China to gain power, another country must lose it. The United States has been reluctant to allow this to occur, as the U.S. Congress vetoed a capital injection into the IMF that would have doubled China’s voting shares, holding the reforms up for five years until Congress finally passed the bill in late 2015. Interestingly, Congress blocked the increase in China’s voting shares not because it would come at the expense of the United States, which retains 17 percent voting rights and therefore de facto veto power, but rather because it would dilute the power of America’s European allies.

Unsurprisingly, Beijing was upset by the U.S. impeding reform. Jin Liqun has been particularly vocal in his discontent with this glacial pace of reform, arguing that Bretton Woods
risks losing its reason for existence. In an IMF-directed project, *Bretton Woods: The Next 70 Years*, Jin writes that:

The worst scenario is that some mistakenly believe that they would behave in a way as if they touched the finite boundary of the zero sum game. Prior to any drastic social changes, an enlightened conservative has no alternative but to accept the reality. To some people who prefer the status quo, they should perhaps savor the thought-provoking quote from the movie *The Leopard*—the words of an aristocrat when social change is looming large—“if we want things to stay as they are, things will have to change.

China’s creation of the Asian Infrastructure Investment Bank is certainly proving this to be the case.

This motive behind the creation of AIIB shows a threat to the existing international order, but it is not the one that is often cited, or predicted by Power Transition Theory. It is not that China is intrinsically a revisionist power dissatisfied with the rules of the world order. Rather, the problem lies on the other side of the power transition ledger, with the United States. Some factions in the U.S. now appear unwilling to fully integrate China into international institutions, despite the fact that this has been a longstanding American mission since Nixon. China is now responding to this reluctance. While arguing that the world order is at an impasse, as the American-led liberal hegemonic order can no longer hold, John Ikenberry asserts that there are three possible paths for the international system to follow: a post-hegemonic order in which America cedes more authority in institutions to emerging powers like China, a renegotiated America-led system in which America retains its first among equal status in the security domain while giving ground on economic authority in IFIs, or a breakdown in order leading to

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competitive spheres of influence.\textsuperscript{157} If the U.S. refuses to cede any ground, it could force breakdown. This is a question of America’s actions, not simply China’s intentions. As the U.S. Congress finally made positive movement on IMF reform in 2015, the creation of AIIB may have served as a wakeup call.

5. Fostering a ‘Community of Common Destiny’—Complex Interdependence to Increase China’s Influence in the Region

The fifth possible geopolitical motive behind the creation of the AIIB relates to Beijing’s long-term strategy. It rests on the idea that with the AIIB and OBOR, China is building a Sinocentric economic order in which all roads lead to Beijing.\textsuperscript{158} Enhanced economic ties in Asia will provide China with increased leverage with regional countries due to China’s disproportionate weight in these relationships. Smaller regional trading partners will be more dependent on China than China will be on them. Robert Keohane and Joseph Nye label this an asymmetry in complex interdependence.\textsuperscript{159} This asymmetry in dependence creates a new source of power that can be wielded by the larger trading state. The more integrated a small economy becomes with a large economy, the more it stands to lose if this relationship is severed, and the more compelled it might feel to make its political actions align with the interests of the larger state. Robert Blackwill and Jennifer Harris argue in War By Other Means that China is the top practitioner in geoeconomics, the use of economic tools for political purposes.\textsuperscript{160} In relationships

\textsuperscript{157} John Ikenberry. Liberal Leviathan. 216.
\textsuperscript{159} Robert Keohane and Joseph Nye. Power and Interdependence. 19.
\textsuperscript{160} Robert Blackwill and Jennifer Harris. War by Other Means: Geoeconomics and Statecraft. (Cambridge, MA: Harvard University Press, 2016).
with regional countries with economies dependent on China, it already routinely uses economic carrots and sticks to extract political favors.

Many notable China scholars are skeptical about the ability of a country to translate economic relationships into political favors. Thomas Christenson writes that economics is not a zero-sum game and, citing the United States’ economic relations with Latin America, there is little historical evidence to support the claim that trade, aid or investment can lead to political cooperation or alliance building. Evan Fiegenbaum, who has written extensively on Asian connectivity, argues that “merely being (economically) weighty does not mean that you can always and in every situation translate that weight into leverage and influence…because weight runs into strategic, institutional, and domestic contexts.” The use of geoeconomics can also backfire, as displayed in China’s punishment of South Korean businesses in 2017 following the deployment of the THAAD anti-missile system, which not only failed to induce a reversal of South Korean policy, but actually sent it further into the arms of the United States. Even in areas where China has not resorted to coercion, but instead used the carrot of increased investment and trade, China has recently endured waves of anti-China backlash.

A longer-term perspective, however, is necessary. In *National Power and the Structure of Foreign Trade*, Albert Hirschman argues that there is an influence effect to international trade beyond the supply effect. This influence effect again arises out of an asymmetry in dependence that results from the trade relationships, but it is not limited to the forces of coercion and short-

term compellence. The more powerful element of the influence effect relates to how international economic relations affect the domestic politics of the smaller trading partner, shaping national interests to align with those of the larger partner, in this case China. This occurs both by strengthening the position of those within the country who already benefit from the relationship, and by creating new domestic interest groups that will support improved political relations with the larger partner. Together, these combine to create a powerful political coalition that will support policies favorable to the larger power. Rawi Abdelal and Jonathan Kirshner provide three case studies of the Hirschmanian influence effect with the United States gaining control over the Hawaiian Kingdom following a free trade agreement in 1875 that increased Hawaiian sugar imports, Austria rejecting reunification with Germany during the interwar period due to Czechoslovakian financial support that favored supporters of the Christian Social Party, and Russia leveraging energy connections to keep Ukraine within its political sphere after the collapse of the Soviet Union. In each of these cases, there is strong evidence of the mechanism of improving the political position of friendly parties and creating new political interest groups producing geopolitical outcomes favorable to the larger economic partner.

If one adds to this reasoning the fact that it is no longer primarily finished products that cross national borders, but rather entire economies are engineered to plug into cross-national supply chains, this logic becomes even more convincing. The more China becomes a hub of an integrated regional economy, the more influence it will wield in Asia. This is not a new idea for Beijing. It is arguably the policy China has followed with Taiwan for almost three decades. Furthermore, institutionalizing this influence within the AIIB can provide a level of stability and legitimacy to China’s power in the region. This argument mirrors that of John Ikenberry in his
Institutionalization of power creates durability in compliance to a particular political order.

There are reasons to believe this logic informed Beijing’s calculus behind the AIIB and OBOR. Beginning in the Hu Jintao era and continuing under Xi Jinping, CCP officials commonly refer to China’s ‘comprehensive national power’ or ‘soft power,’ in which economics plays a significant role. In the context of AIIB, Xi has routinely spoken of creating a ‘community of common destiny’ in Asia. What this community of common destiny means is that the future of any one country in Asia is inextricably linked with the future of the Asian continent as a whole. Due to China’s immense size and regional weight, this also means the future of any one country is tied to China, and to the maintenance of a stable relationship with Beijing. While China speaks of ‘Asian connectivity’, China is really interested in connecting the rest of Asia to China, binding them in complex interdependence. The asymmetry in the relationship will provide China with the benefits of foreign trade’s influence effect, which has been institutionalized and made to appear more legitimate with the AIIB.

While the AIIB is an economic initiative, these power dimensions are always in the background. It would be naïve to believe that Beijing is not hoping to increase its soft power and influence in the region with the bank. However, while this soft power push might lead to conflict or tension as the power distribution in the region shifts, this does not imply that China is a dissatisfied power, as defined above. China’s ambition to rise in influence does not pre-determine conflict. What matters is the type of system into which China plans to rise.

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6. The Hedging Strategy—Nesting Institutions

There is another possible motive for China stepping outside of Bretton Woods to create the AIIB—other than China’s considerations of prestige or discontent with the pace of voice reform—that is more threatening to the status quo. It relates to the fact that no country gets a second chance to make a first impression. In 1996, China was able to use its calculative strategy because China was just beginning to emerge on the world stage. It had not yet integrated into global governance. Post-2008, after unleashing a more aggressive foreign policy that struck fear in many countries in the region, it is questionable whether China will be able to fully walk itself back by deploying the past strategy of multilateralism and pushing the image of China as a responsible stakeholder. It is possible that China simply broke the Obama Doctrine of ‘don’t do stupid stuff’, but another possibility is that China tipped its hand from 2008 to 2010. It was a taste of China’s true intentions for the future—how China will act when it is stronger. China may have done irreparable damage to its global image, and countries will be less willing to play ball with China going forward. Coming off of a tumultuous period in foreign policy, this appeared to be a real possibility.

When Xi took charge in 2012, China was facing a deteriorating strategic environment. Asian countries were balancing against it by improving relations with the United States. From Beijing’s perspective, there was a legitimate fear that the United States and these nations would attempt to constrain China’s rise going forward. The institutions that the U.S. created and dominates would certainly play a large role in this containment. Therefore, the new ‘calculative strategy’ for 2012 was two-pronged: attempt to repair China’s image in the international

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community by increasing China’s role in multilateral institutions, but also hedge, creating nested institutions in case relations cannot be repaired, and this coalition to counter China emerges.

This interpretation of Beijing’s new grand strategy has recently gained traction. Injoo Sohn of Hong Kong University sees the AIIB as a clear case of China not wanting to put too many eggs in one basket, avoiding overdependence on the existing G-7 global institutions. Establishing new institutions provides China with a viable exit strategy. Evan Feigenbaum has labeled the creation of the AIIB a prime example of ‘portfolio diversification,’ signaling China’s ability to carry on outside of the world order that Washington has created. Aaron Friedberg agrees, believing that China is attempting to establish a complete nested order that is separate from the existing system.

There are a few points worth examining in this nested institutions argument. First, China has not been nesting institutions across the board, as Friedberg suggests. With the New Development Bank and the AIIB, China is creating a particular type of international institution: multilateral development banks. As discussed previously, this is an area where network effects are not strong and the existing structure is already highly fragmented. This line of reasoning should not overreach. Secondly, the AIIB is not simply a parallel institution, offering a public service that is already being provided by the existing MDBs. As will be discussed in the following section, when Jin Liqun says that the AIIB is a ‘new type of development bank’ he means that it will employ new strategies to meet existing demand that is not currently being satisfied. These tactics deserve further analysis to see how they fit with the status quo, but there is a legitimate point of differentiation beyond any nesting or hedging element.

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170 Foreign Affairs’ Brain Trust, “Should Washington Fear the AIIB?”
Employing a hedging strategy, or portfolio diversification, does not necessarily suggest that China is a revisionist power. It does, as was the case for the energy diversification motive, suggest that China is preparing for certain contingencies. This is more worrying than China’s energy strategy, because while many countries diversify energy sources, few form nested institutions. Yet, on the positive side, Beijing appears to have taken this approach in fear that it might be blocked from stepping back from its 2008 strategy and retaking prior positions. If China is not blocked and allowed to further integrate, finding its interests in the liberal international order, any hedge made need not be of great importance.

7. Institution Breaker—Fracturing or Overthrowing ‘Bretton Woods’

The most alarming motive that some have assumed to be behind the creation of AIIB is a Chinese desire to undermine, fracture, and eventually dislodge the existing international order. This would be the apotheosis of China as a revisionist power—a system breaker. From this perspective, China is creating a parallel institution not to hedge, but to delegitimize the Bretton Woods system. The new IFI will introduce and authorize new ideas and practices that are not compatible with Bretton Woods, offering a different vision of how the world economy and world politics should function. If one believes that even while China has integrated further into it, its hostility towards and resentment of the international system and the process of globalization have not subsided—believing as Elizabeth Economy does that “Beijing has launched a ‘go out’ strategy designed to remake global norms and institutions” then this theory might be compelling. AIIB is an extension and intensification of this long existing strategy.

The process through which China would go about achieving these purported goals was explained by Randall Schweller and Xiaoyu Pu in “After Unipolarity: China’s Visions of International Order in an Era of U.S. Decline.” As China is emerging from a period of being a ‘shirker’ in international responsibility, Schweller and Pu argued that China will transition to become not a ‘supporter’ or co-manager of the system, but rather a ‘spoiler.’ In the road towards confrontation with the hegemonic United States, China would first delegitimize the hegemon’s global authority. In this delegitimization phase, China would practice “rightful resistance,” laying the groundwork for creating a revisionist and anti-hegemonic coalition that demands a new world order. With the AIIB, China is following this trajectory by beginning to form this coalition centered on Chinese principles and serving China’s interests. It is a narrative that fits well with Yan Xuetong’s moral realist paradigm.

There are numerous issues with this line of reasoning. The argument rests on linearly projecting from one break with the status quo that China will continue down this path until it overthrows the entire system. Schweller and Pu recognize that utilizing rightful resistance does not necessarily mean that a state will play the role of spoiler. Both a ‘limited-aims’ revisionist, content with merely slight changes to the system, and a ‘system spoiler’ revisionist would enact a strategy of rightful resistance. While assuming the worst and hoping for the best might be a useful adage in certain situations, in the case of responding to a rising China, it can be a dangerous mode of operating, misinforming critical policy decisions. Instead, one ought to seriously consider whether such an extreme assumption is justified based on the evidence available. In the case of China and the AIIB, the evidence indicates this extreme pessimism is unwarranted. First, in line with the Ikenberry “hard to overturn, easy to join” logic, China has

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173 Yan Xuetong. “From Keeping a Low Profile to Striving for Achievement.”
consistently integrated into the current system, wedding its future to this open world order. The idea that China would now seek to play spoiler runs contrary to too many of its fundamental interests. Secondly, it is highly questionable whether the creation of the AIIB is even an act of rightful resistance. CCP and AIIB officials may use the rhetoric of making global system more fair and just, but they are also quick to note that China has benefited enormously from the Bretton Woods institutions, and that the AIIB seeks to work cooperatively with the World Bank to further a shared mission. In some cases talk is cheap, but in the case of rightful resistance, the resistance would be predicated on talk and how the bank is framed. Lastly, it is important to consider how the AIIB differs from existing MDB practices. As will be addressed in greater detail in the next section, the fact that the AIIB largely resembles the existing template casts further doubt on this idea that China is playing ‘spoiler’ to the system.

**Making Sense of the Motives**

To recap, this section has explored Beijing’s motives behind the creation of the AIIB. It first demonstrated that there is a clear economic rationale behind the bank, as it will serve many of China’s short-term and long-term economic interests. These economic issues are those of a country transitioning within the international economic order, not those of a heterodox outsider. The solutions reflect this reality, as they are compatible with the standard practices of the global political economy. With respect to why China was motivated to create a new multilateral development bank to fulfill these economic purposes, the benefits of multilateralism in development lending, as well as the fractured nature of the MDB landscape were discussed to show that the creation of this institution does not necessarily represent a radical departure from the status quo or signal the intentions of a revisionist power. Lastly, the geopolitical motives
were addressed in order of the threat they pose to the international system. Beijing possesses many of the less troubling motives, such as improving regional relations or enhancing global prestige. Other motives that appeared to enter China’s calculus, such as expressing discontent with Bretton Woods, do symbolize a danger for the global system, but this has more to do with U.S. unwillingness to fully accommodate or integrate China than some intrinsic fact about China’s intentions. There is some degree of evidence that China could be executing a hedging strategy by nesting institutions, yet the extent of this strategy and its implications are often overstated. Furthermore, there is little evidence to substantiate the claim that China desired to fracture and overturn the existing global economic order with the creation of AIIB.

Taken as a whole, this suggests that much of the initial fear incited by the AIIB’s creation was unsubstantiated. Beijing had ample economic and geopolitical reasons to create the bank that are not threatening to, but rather compatible with, world order. Therefore, one does not have to reach for worst-case scenario motives, like geopolitical motive 7, for which there is little evidence and appears to run contrary to China’s interests, to explain the AIIB’s creation. China serves its interests by cooperating with the world order, and, in line with neoliberal institutionalist theory, by ensuring that this system is upheld. Of course, to feel confident in this more optimistic conclusion, the AIIB itself must be analyzed as an institution, to see whether it conforms to global rules and norms. This is the goal of the following section.
7. The AIIB: A Revisionist Institution?

In determining whether the impetus for the Asian Infrastructure Investment Bank was the dissatisfaction of a revisionist power, the actual bank itself has received too little attention. It is frequently assumed that China created the AIIB out of both frustration with its voice within the existing international system and also, most importantly, dissatisfaction with the rules by which the system operates. Rarely do commentators identify precisely which rules China is dissatisfied with or how the AIIB deviates from this status quo to better serve Beijing’s interests. To substantiate the claim that China is a revisionist power attempting to create a Sinocentric international system that operates in accordance with a different notion of an ideal world order, one must be able to identify the differences between the AIIB and the Bretton Woods or regional institutions, such as the Asian Development Bank. This section is aimed at specifying the areas where China conforms to or deviates from the existing MDB landscape. Where the AIIB does diverge, the radicalness of this difference will be analyzed. This analysis will be performed across three major areas: the AIIB’s stated purpose, its governance, and its operational policies.

Purpose

The purpose of the AIIB is presented in Article 1 of the Articles of Agreements, signed in June of 2015 after fifteen months of consultation. It states:174

The purpose of the Bank shall be to: (i) foster sustainable economic development, create wealth and improve infrastructure connectivity in Asia by investing in infrastructure and other productive sectors; and (ii) promote regional cooperation and partnership in

174 “Asian Infrastructure Investment Bank: Articles of Agreement.”
addressing development challenges by working in close collaboration with other multilateral and bilateral development institutions.

Subsequently, the top functions of the bank are listed as: promoting public investment, utilizing resources to finance development, and encouraging private investment. For comparison, the Articles of Agreement of the Asian Development bank state that:175

The purpose of the Bank shall be to foster economic growth and co-operation in the region of Asia and the Far East and to contribute to the acceleration of the process of economic development of the developing member countries in the region, collectively and individually.

Among its functions are the promotion of private and public investment in the region, the utilization of resources to finance development, and the provision of technical assistance where needed.

From fostering ‘regional sustainable development’ to promoting ‘regional cooperation’, there is an obvious high degree of similarity in the purposes of these institutions. This is not coincidental. During the commencement of the drafting process in 2014, Chinese Finance Minister Lou Jiwei insisted that the AIIB would adopt the model provided by existing multilateral development banks.176 Accordingly, officials from these MDBs were actively recruited to help draft the AIIB’s Articles of Agreement. The cooperative element is enshrined in the second component of the AIIB’s purpose: “by working in close collaboration with other multilateral and bilateral development institutions.” This collaborative approach that focuses on shared purposes is an early positive indication that the AIIB is not a radical institution.

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176 Mike Callaghan and Paul Hubbard. “The Asian Infrastructure Investment Bank.”
Despite these overwhelming similarities, there is a key point of differentiation for the AIIB. As the name indicates, the AIIB’s primary goal is to improve infrastructure. From its six areas of focus, to the constant reiteration of the language of ‘connectivity’ and ‘regional integration’, substantial infrastructure projects are first and foremost on the AIIB’s agenda. It is an approach to development that is largely predicated on China’s own experience in the past four decades, as Jin Liqun expressed in a speech at the Brookings Institution in which he said “the only solution, in my view, is connectivity. The ensuing economic opportunities will bridge the gap between the livelihood of the people and the outside world. It is as simple as that. China’s idea comes from China’s own experience.”

This purpose reflects the approach to development followed by the World Bank and the Asian Development Bank in their early stages. For the first decade of its operations the acronym ADB was synonymous with “Asian Dams and Bridges,” as development was understood as heavy investment in infrastructure and physical capital. Over the past four decades, the MDBs have evolved in focus. While their purpose is still economic growth and development, this development is now much more broadly construed. The ADB has included into its definition of development poverty reduction and social development, putting in place a set of comprehensive policies and practices in pursuit of these goals. Attention has shifted away from heavy infrastructure towards improving social policies and enhancing the inclusivity of certain services, resources, and opportunities. A similar phenomenon occurred at the World Bank beginning with the presidency of Robert McNamara in 1968, as McNamara began to transition the World Bank away from neoclassical economic visions of development that focused on capital

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177 Jin Liqun. “Building Asia’s New Bank.”
178 Mike Callaghan and Paul Hubbard. “The Asian Infrastructure Investment Bank.”
accumulation and towards a definition of development that incorporates poverty reduction, social services, and heightened attention to basic human needs.\textsuperscript{180} What this looks like from a numerical point of view is a shift from 70 percent of World Bank loans in the 1950s and 1960s directed towards the core business of infrastructure, to the mirror image with only 30 percent of loans financing infrastructure projects in the 2000s.\textsuperscript{181}

The AIIB’s reversion to a more traditional development model with a focus on infrastructure is a differentiating feature, but it is more of a positive raison d’etre rather than a worrying revision. The importance of infrastructure for development remains undeniable. As Asia continues to experience a substantial funding gap, there is a need for new sources of capital. With this more narrow focus on an important factor of development that is currently underserved, the AIIB will be more than simply a parallel institution. To the degree that it can fulfill its purpose, as Jin Liqun has described it, the AIIB will be more than just a clone, but rather will be a gene of the MDB with a positive mutation.\textsuperscript{182}

**Governance**

In analyzing the governance of the AIIB, the first question is who can become a member of the bank. The AIIB is open to all states, but like the Asian Development Bank, it distinguishes between regional and non-regional members. This distinction is relevant to the allocation of ownership and voting rights. As regional development banks, both the ADB and the AIIB limit the size of the non-regional voting share to preserve the Asian voice in the institution. For the ADB, the articles of agreement stipulate that at least 60 percent of shares must be allocated


\textsuperscript{181} David Dollar. *China as a Global Investor*. 11.

\textsuperscript{182} “A Conversation With AIIB President Jin Liqun.”
amongst regional members. For the AIIB, that number is 75 percent (this is the same figure as the African Development Bank’s).\textsuperscript{183} Currently, regional states control 77 percent of AIIB’s shares.

\textbf{Graph 5: AIIB’s Voting Shares By Region}

![Graph showing the distribution of voting shares between regional and non-regional members.]

In this dimension, the AIIB is following a model provided by the existing MDB landscape, as it is open to all but maintains a clear Asian focus.

On a member state level, the AIIB also allocates shares similarly to the ADB. For the ADB, 20 percent of shares are distributed evenly amongst all member states, with the remaining 80 percent allocated proportionally to capital contributions. For the AIIB, 12 percent of shares are distributed evenly, a fixed number of shares (600) given to each of the founding members, with the remaining shares allocated proportionally to capital contributions.\textsuperscript{184} The existing allocations of shares between member states in the two institutions are currently:

\textsuperscript{183} “Asian Infrastructure Investment Bank: Articles of Agreement.” Article 5.

\textsuperscript{184} “Asian Infrastructure Investment Bank: Articles of Agreement.”
Graph 6: Voting Shares By Country—The ADB & The AIIB

While there appears to be a move in ownership with the AIIB from the global North to South and East to West that often attracts attention, the AIIB’s mimicry of the ADB on voting shares allocation shows that this is not the result of a change in policy or restriction of membership. Rather, it is largely driven by the unusual privileged position that the United States holds in the ADB and the fact that the United States and Japan have refused to join the AIIB. With their inclusion, a large degree of this difference would dissipate.

What is noteworthy is the fact that China controls 27.84 percent of the bank’s shares. This number is significant in light of Article 28: “A Super Majority vote of the Board of Governors shall require an affirmative vote of two-thirds of the total number of Governors, representing not less than three-fourths of the total voting power of the members.” In other words, the fact that China controls more than 25 percent of the shares gives it de facto veto power over certain important decisions that require super majorities. This power has fueled speculation that the AIIB is really a tool the CCP will control and direct to fulfill its narrow self-interest. However, two facts suggest this fear is misguided. First, it is unclear whether China’s veto is written in stone, or whether it will lose this power in the future. In the negotiation stage,
Beijing reportedly offered to forgo its veto power if Japan and the United States joined.\textsuperscript{185} With their refusal, China’s level of capital contribution provided it with greater than 25 percent of the shares. As membership is expanded in 2017, it is possible that China will forfeit this privilege.\textsuperscript{186} Even if this does not occur, this would not be particularly revisionist. The United States has continuously acted to retain its veto power in Bretton Woods, increasing the threshold for a supermajority as its shares were diluted. By clinging to this power, China could be accused of lacking trust in multilateralism, but it would be fitting a pattern that the United States has previously set.

Beyond membership and control, for the actual governance structure of the institution, the AIIB borrows heavily from existing MDBs. The ADB has a three-level system of leadership comprised of a Board of Governors, a Board of Directors with seven regional and three non-regional representatives, and a president and vice presidents, with the president hailing from Japan per tradition.\textsuperscript{187} The AIIB’s management is comprised of Board of Governors, a Board of Directors with nine regional and three non-regional representatives, a president and vice presidents, with the first president, Jin Liqun, being from China. Once again, these similarities are the product of a conscious effort to replicate the existing framework. The one major difference for the AIIB is that it will not have a resident board. This innovation is part of the AIIB’s push to be ‘lean, clean, and green’ as it estimates it can save as much as fifteen to twenty percent in operating expenses by not having a full-time board.\textsuperscript{188} Again, this difference has been used as evidence that China is loosening the ownership’s control of the bank to enhance the

\textsuperscript{185} Ming Wan. \textit{The Asian Infrastructure Investment Bank}. 19.
\textsuperscript{187} “Agreement Establishing the Asian Development Bank.” Ch. VI.
\textsuperscript{188} “A Conversation With AIIB President Jin Liqun.”
power of the management Beijing puts in place. This position was expressed by former senior Treasury official Edward Truman, who stated, “I understand why the U.S. and other advanced countries prefer the resident board…We do not trust the likely management.”

Despite fundamentally misunderstanding the process by which management will be selected, this line of reasoning is undermined by the fact that Bretton Woods institutions have long been embroiled in a debate regarding whether resident boards are a necessary expense. It can be traced back to the debates between John Maynard Keynes and Harry Dexter White in New Hampshire during 1944, but has been renewed recently due to the proposal by the High-Level Commission on Modernization of World Bank Group Governance, led by former Mexican President Ernesto Zedillo, which recommended eliminating the resident board, which currently costs $70 million per year. Henry Paulson, the former U.S. Secretary of the Treasury, endorsed this proposal for the World Bank and regional MDBs in 2008. China’s governance innovation must be seen as emerging from this internal debate in Bretton Woods.

the fear of enhanced autonomy for the management of the AIIB is also discredited by the fact that the AIIB is filling its pay roll with former World Bank and ADB officials. This begins at the top with President Jin Liqun, who was appointed executive director of World Bank Groups in 1988 and served as vice president for the ADB from 2003 to 2008. Jin has brought over a team of ADB and World Bank employees as consultants, such as David Dollar, and high-ranking officers on staff. This employment is a signal of China’s priorities and vision of the AIIB; it is

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192 Mike Callaghan and Paul Hubbard. “The Asian Infrastructure Investment Bank.”
concerned with the AIIB becoming a world-class institution, not a revisionist one. Being a world-class institution entails meeting the standards and norms of the current world order.

**Operational Policies**

The Asian Infrastructure Investment Bank’s operational policies will have the most significant impact on the existing IFI landscape. Accordingly, it is the most contentious and intensely debated area. For the most part, there is a high degree of harmony between the AIIB’s policies and those of the World Bank and Asian Development Bank. As suggested in part (ii) of the AIIB’s Purpose Statement, there was a conscious effort made during the consultation process to conform to the existing rules that govern MDB operations. At an event at the Asian Society Policy Institute in Washington D.C. in 2016, President Jin Liqun touted that the AIIB has “harmonized policies” with Bretton Woods. From the content of the policy papers to the use of English as the official language and the U.S. dollar as the official currency, the Sinocentrism fades into the background, as the AIIB appears as a truly international institution.

This cooperative element, however, is often overshadowed by the differences from the existing system. Despite the constant rhetoric of cooperation, what captures headlines is the language of difference, such as Chinese finance minister Lou Jiwei declaring in a press conference with ADB governor Takehiko Nakoa in 2015 that since the AIIB is “mainly led by developing countries…we must consider their appeals—some rules proposed by Western countries may not be best, in my view.” The question that has been raised is whether China will use this notion of South-South cooperation to produce a new type of multilateral

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194 “A Conversation With AIIB President Jin Liqun.”
development bank where developing countries’ interests take precedent, leading to new operational policies. Evidence supporting this fear has primarily arisen from three areas: environmental policies, standards and safeguards, and conditionality.

Environmental Policies

The AIIB’s environmental policies have been attacked on two fronts: the perceived lack of stringency of the environmental safeguards, and the bank’s willingness to undertake projects that have been restricted or entirely discontinued by other MDBs. The former is addressed in the following sub-section in conjunction with the AIIB’s social safeguards. With respect to the latter, coal-powered energy plants have become the grand symbol of the debate.

Other banks such as the World Bank and the European Bank for Reconstruction and Development have limited lending to coal-related projects to ‘rare and exceptional circumstances’ due to their environmental impact, following pressure from interest groups in developed nations. In 2013, the United States made a similar decision for its bilateral lending practices. The AIIB has taken a different view. When the Environmental and Social Framework was released in February 2016, it notably did not include coal-powered projects in its ‘Exclusion List.’ This divergence in policy has garnered significant attention because it is paradigmatic of developing countries’ interests dictating policy irrespective of established international rules. Developing countries in Asia are in need of new energy sources, with the AIIB forecasting that the region will require $8.74 trillion in energy investment between 2016 and 2025. Many Asian countries are also well endowed with coal and resentful of paternalistic developed countries that have used coal-powered energy in the past dictating the use of their natural endowments.

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AIIB has, to a degree, played into this notion, with the AIIB’s Energy Sector Strategy draft published in January 2017 stating, “the specific issues countries in Asia confront in their energy sectors are similar to those facing most non-OECD countries—they need for affordable, sustainable and reliable energy systems to support regional and global economic growth.”198

In this discussion of coal-powered energy, it is important to keep in perspective the degree of divergence from the norm. By most standards, the AIIB is living up to the final part of its slogan to be ‘lean, clean and green.’ It has subscribed to the principles underpinning Sustainable Energy for All (SE4ALL), the 2030 Agenda for Sustainable Development, and the Paris Agreement.199 So, while there exist some differences, the AIIB is taking genuine steps to harmonize with other MDBs. In fact, the area of coal-powered energy has been contentious even within the existing regional MDBs, as the Asian Development Bank continues to fund the construction of some coal-fired power plants. It may be a sign of developing nation solidarity but extrapolating to say that the AIIB aims at an entirely new set of international standards is not justified, as this is a slight divergence in an area where China has a vested interest in encouraging investment due to the fact it has substantial overcapacity and expertise in this field.200

Standards and Safeguards

The other side of the attacks on the AIIB’s environmental policies is part of a larger debate surrounding the bank’s environmental and social safeguards. Substantial infrastructure projects frequently produce negative externalities. The chief concerns relate to the topics of environmental impact, involuntary dislocation and resettlement, and the overall effect on the life

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199 IBID, 5
quality of local populations. Existing MDBs have attempted to address these issues, particularly since 1990, by instituting robust safeguards.\textsuperscript{201} These include an initial screening process to determine the likely risk level, discerning whether a given project triggers any of the issue areas. If so, there is an intensive process of consolation with local populations and those most affected by the project. In the execution of the loan package, the World Bank or the Asian Development Bank use their own environmental and social policies (ESPs), which have been increasingly tightened, rather than the laws of the host-country to ensure a universal gold standard is always applied.

The manner in which China has conducted its bilateral aid and investment programs has not inspired confidence that the AIIB will meet this high Bretton Woods standard. China has controversially used the rules and regulations of the host-countries in which it conducts business, which tend to be developing countries with poor standards. This bilateral mode of operating is not the policy of the AIIB. All loan packages considered by the AIIB will undergo a screening and categorization phase in which the project will be grouped into one of three categories:\textsuperscript{202}

- Category A: Causes irreversible, cumulative, diverse or unprecedented damage
- Category B: Causes a limited number of potentially adverse environmental and social impacts that can be successfully managed with good practice
- Category C: Causes minimal to no environmental or social impact

If a project is classified as Category A, the AIIB conducts further impact assessment. If it falls into category B, the bank requires the client to conduct an initial review of the implications. Category C projects proceed without assessment. While this framework is still vague and one

\textsuperscript{201} David Dollar, \textit{China as a Global Investor}. 11.
\textsuperscript{202} “Environmental and Social Framework.”
must refrain from final judgment to an extent until it has been put into practice, it does show positive movement toward standards that conform to international rules.

Still, the AIIB’s intention of using “country-systems” has caused fear that in practice the AIIB will revert to conducting projects in a manner similar to China’s bilateral initiatives. Country-systems is the use of local or national laws or regulations to govern the actions of the bank and the companies that it hires to fulfill its project. The World Bank and the regional development banks’ policy is that they will use country systems when the laws and regulations of the recipient are equivalent to the bank’s own ESP. The AIIB has stated that it will use country systems if it determines that the relevant parts of the system are adequate to address the environmental and social risks and impacts of the project. The substitution of the word equivalent for adequate potentially gives the bank more room to use country-systems. In fact, AIIB has made it clear that it will seek to use country systems more frequently, incorporating into its ESP that, “the Bank believes that, in many cases, the best way to strengthen these systems is to use them at the operational level, with adequate support to achieve their objectives, which itself may be an important development outcome for the bank’s financing.” The worry is that regardless of how stringent the AIIB’s ESP framework is, the expanded use of country-systems could undermine these policies and mitigate their effect. The actual impact of this country-system policy will only be known after the first few years of the AIIB’s operations.

However, this potential concern should not detract from the AIIB’s genuine effort to comply with international norms, as the environmental and social policy begins with the statement that the “AIIB aims to promote harmonization of policies with financial

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204 “Environmental and Social Framework.” Requirement H.
205 IBID
institutions…AIIB seeks to cooperate with a view of adopting a common approach to appraisal, environmental and social management requirements.” Furthermore, while the use of country-systems is certainly an area to watch, there is also a legitimate logic behind their employment. Strict ESPs and safeguards have slowed the loan approval process, with the World Bank reporting that it took an average of 28 months to move from initial identification of a project to final disbursement in 2013. For larger infrastructure projects, this time frame can become unreasonably drawn out. In addition to the diversion of focus from infrastructure projects, the sheer length of the loan process has been charged as a contributing factor in the decline in the percentage of World Bank projects directed at infrastructure. David Dollar argues that the World Bank now contributes less than one percent to global infrastructure spending because developing countries who need a road or energy plant relatively quickly are seeking funds elsewhere. The result is that “multilateral development banks have developed gold-plated standards, but they apply to only a tiny fraction of investment.” To address this problem, the World Bank-commissioned Zedillo Report proposed expanded use of country-systems to streamline loan processes. Since then, both the World Bank and the ADB have conducted reports exploring the possibility. How country-systems are used in practice will determine the degree to which the AIIB is challenging the status quo of MDB practices. However, the idea of and desire for extending its use is certainly not radical.

206 IBID
208 David Dollar. China as a Global Investor. 11.
Conditionality

The use of a country’s existing laws and regulations rather than the imposition of a new set of policies relates to what is potentially the largest difference between the Asian Infrastructure Investment Bank and the existing MDB landscape: conditionality. Conditionality is a common practice by international financial institutions. It is defined as the donor making access to loans and aid contingent on the recipient taking certain actions or implementing particular polices. What those required actions and polices are has changed dramatically over the past several decades.

This development can be segmented into three distinct stages. In the early ‘project-oriented’ phase, MDBs focused their attention on financing infrastructure and physical capital improvements, with conditionality limited in scope to the specifics of the project. For example, if the loan were to finance the construction of an energy plant, access to funds would be contingent on the introduction of certain energy policies. During the 1970s and 1980s, as the MDBs drifted from their narrow infrastructure focus towards a broader conception of development, a ‘program phase’ was instituted, which involved a more comprehensive set of conditionality aimed at transforming the economic governance of the country. Access to loans required the adoption of sensible fiscal and monetary policies along with general macro-economic stability. In the 1990s, the scope was widened still further, beyond the economic realm and into a more expansive definition of governance. This change emerged out of both the failure of existing aid programs to deliver growth—particularly with the economic crisis and waves of default in Latin

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America and Africa—and self-confidence in the Washington Consensus following the end of the Cold War. Loans became tied to the re-engineering of governments to protect human rights and adopt democratic practices. This new view of governance can be found in the policy papers of both the World Bank and the ADB during this time.\(^\text{213}\) Officially, the argument was that inclusive political institutions are essential for spurring economic development, and thus necessary for MDBs to address in order to sufficiently achieve their objectives.\(^\text{214}\) However, it is reasonable to question during this third stage of conditionality whether the expansion of political freedoms was the means towards economic ends, or the other way around.

Additionally, there has also been a significant change in how conditionality is executed. In the 1970s and 1980s, during the era of structural adjustment loans, Bretton Woods institutions would provide funds to governments along with a set of policies the country would have to implement to remain eligible for future loans. Countries, however, frequently failed to follow through, and Bretton Woods failed to stick to its tough love policies. In a highly influential piece, David Dollar and Craig Burnside found that there is a positive impact from aid when the recipient country already has good policies in place prior to the engagement. Otherwise, there is little effect.\(^\text{215}\) This sparked a new strategy of conditionality that favors selectively giving loans to countries that already have implemented ‘desirable’ policies, rather than trying to catalyze change through loan packages.

This third stage of conditionality has always been anathema to China. As a non-democratic authoritarian regime, the last thing the CCP is willing to support was international


financial institutions attempting to dictate the government type and social policies of recipient countries. Beijing has endorsed a more traditional, hard definition of sovereignty. It adopted a policy of strict non-interference in its bilateral aid and investment projects. The 2014 Chinese Foreign Aid White Paper declares that:216

When providing foreign assistance, China adheres to the principles of not imposing any political conditions, not interfering in the internal affairs of the recipient countries and fully respecting their right to independently choose their own paths and models of development. The basic principles China upholds in providing foreign assistance are mutual respect, equality, keeping promises, and win-win.

Clearly, there exists a self-defensive motive behind this non-interference policy, but Beijing has always framed this stance through the prism of developing country fraternity and shared norms. The White Paper states that China aims at, “providing assistance to the best of its ability to other developing countries within the framework of South-South cooperation to support and help other developing countries.”217 In terms of China posing a potential challenge to the existing rules that regulate IFIs, and global governance as a whole, this is one of the most important areas, as it is a rare scenario in which Beijing has articulated a coherent position, opposed to the status quo, while attempting to build a coalition of developing states.

In practice, China also exhibits no signs of implementing a Dollar-Burnside strategy of withholding aid or investment from countries with poor governance. Using regressions that account for the relevant exogenous variables, David Dollar finds that unlike the rest of the international community, China’s bilateral investment shows no correlation with rule of law.218

217 IBID
This indifference towards governance has sparked controversy, as Beijing is seen as undermining conditionality and therefore sterilizing the IFIs’ ability to catalyze policy change. China has been charged with undercutting IMF conditionality in Angola with a no-strings-attached loan of equivalent value, doing the same to the World Bank with a railway project in Nigeria, and interfering with an ADB project in the Philippines by constructing a new aqueduct in Manila without due diligence.\textsuperscript{219} The fear is that this practice will be institutionalized with the AIIB.

There is evidence that this practice has filtered into the policies of AIIB, beyond the use of country-systems. The Articles of Agreement states that the bank shall not be influenced by or interfere with the political character of any states. While some have pointed to this as evidence that the AIIB will follow a no-strings-attached approach, the reality is that this is taken nearly verbatim from the World Bank and ADB Articles. What is more important is the language that the bank’s officials have used outside of the official policy papers. At the first annual meeting of the Board of Directors in September 2016, the director from Saudi Arabia declared that:\textsuperscript{220}


AIIB will need to continue to learn from the experience of other MDBs and strive to do better in areas where there is scope in the context of efficiency and responsiveness to client demand. Moreover, conditionality attached to its lending should be fully owned by clients and lending instruments should be designed to ensure efficient delivery. The Bank should avoid getting involved in controversial social issues and respect national laws and be sensitive to cultural differences among its members.

President Jin Liqun has similarly stated in an interview with CCTV in December 2015 that “the bank will strive to be a lean, clean, and green bank with faster loan processing speed to meet the needs of its members. It will minimize undue loan conditionality that hampers project implementation.” The AIIB is not taking the absolutist position expressed in China’s Foreign Aid White Paper, but the relevant question is how much of current conditionality does Jin and the AIIB rule to be ‘undue.’

It is difficult to score the AIIB on this dimension before it undertakes a significant number of independently financed projects. However, the evidence above suggests that here the AIIB will not exactly fit the existing mold. It is the area of divergence with the possibility of having the most significant ramifications for the system. To the extent there exists a Beijing Model, this can be perceived as a mode by which China can spread it, supporting international polices that suggest both that sovereignty is absolute and ought not be infringed upon, and that democratization and rule of (not by) law is not necessary for economic prosperity. In the process it could weaken the ability of the Bretton Woods institutions to enforce their own policies of conditionality. Bretton Woods’ power to impose these policies rests on the maintenance of its monopoly of capital and control. If the AIIB supports a different set of governance policies and standards, Bretton Woods’ conditionality could be rendered ineffective.

221 “Conversation with Jin Liqun.” CCTV (December 11, 2015).
Still, it must be remembered that while the AIIB may not conform to the current norms of conditionality, by encouraging this divergence, Beijing would be operating as a reactionary power rather than a radical revisionist one. Conditionality in its current form is a recent development that is not without its critics, even within the World Bank. Former chief economist at the World Bank Joseph Stiglitz argues against conditionality on the grounds that it both fails to deliver its intended purpose, and is not in line with the international laws and norms of sovereignty and self-determination, writing “there is increasing evidence that conditionality was not effective—good policies cannot be bought, at least in a sustainable way. Equally critically, there is a concern that the way the changes were effected undermined democratic processes.” Similarly, Paul Collier, former director of the Development Research Group of the World Bank, has stated that “the extension of the practice of conditionality from the occasional circumstances of crisis management to the continuous process of general economic policy making has implied a transfer of sovereignty which is not only unprecedented but is often dysfunctional.” The call for MDBs and other international financial institutions to retreat from their mission creep is not a war waged on purely North-South lines. It does not simply pit the West against the rest. It is a genuine topic for debate within Bretton Woods. In this context, China’s level of revisionism with the AIIB might be well within the broader framework of the status quo in the international order.

There are also practical reasons to be sanguine about the AIIB’s use of conditionality going forward. The AIIB is not part of China’s pre-1978 foreign aid that was designed to

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promote Third World and communist solidarity. It is not China’s mission to be a ‘rogue lender’ supporting corrupt and dictatorial regimes. China can be charged with indifference on these matters as it pursues its ultimate goal of building projects that actually improve infrastructure to secure its genuine economic and security interests. However, on this count, China might have learned from its recent global investments that if you attempt to satisfy these interests by sticking your hands into corrupt countries with poor institutions, you run a high risk of getting burnt.

China has been burnt on many of its investments. In the DR Congo it extended a $6 billion dollar resource-backed-loan in 2007 that shows no signs of being repaid. A similar story has unfolded in Angola and Sudan. In Venezuela, China financed the Tinaco-Anaco railroad that Hugo Chavez refereed to as ‘socialism on the rails.’ With the derailment of the Venezuelan economy, the prospects for repayment are minimal. In Asia, China invested substantial sums in Myanmar and Sri Lanka, only to see regimes overthrown and its contracts rendered worthless. What this suggests is that as China desires its investment in the AIIB to pay dividends, and the AIIB to become a premier international institution, it might find it in its interest to steer clear of corrupt regimes with poor rule of law in the future. While China might not call it conditionality by name, in practice, the AIIB will likely follow a policy similar to that recommended by David Dollar and Craig Burnside: extend loans to countries with good policies already in place.

225 David Dollar. *China as a Global Investor*. 4


227 Thomas Miller. *China’s Asian Dream*. 
Moving Forward

The image that emerges from close examination of the AIIB is one of an institution that largely conforms to standards set by the current international financial institutions. Its purpose is in line with that of other MDBs, while its focus on infrastructure provides a *raison d'etre* for the new bank. It is not merely a parallel institution undercutting Bretton Woods.’ Rather, it is deploying funds to meet an important need that is not currently being satisfied. The bank’s membership and governance structure intentionally mimics that of the ADB. Its variation of a non-resident board is not a strategic move to increase the autonomy of a management team selected by Beijing, but a welcomed innovation that brings MDB governance more in line with Western business norms. Furthermore, the management team of the AIIB draws heavily on World Bank and ADB former employees, signaling that these similarities in structure are likely more than window dressing, and will be reflected in the bank’s operations. In the area of AIIB’s operational policies, there has been an effort to harmonize policies with the existing MDBs. There are key differences, most notably the funding of coal-powered energy plants, the appetite for increased use of country-systems, and apparent aversion to conditionality. These breaks with the status quo, however, are well within the bounds of issues regularly debated within the existing MDBs, and in all cases are more reactionary to recent changes in MDB policy than revolutionary.

Further, many of these revisions, such as upholding the framework of noninterference through an aversion imposing conditionality, appear to be highly China-specific, reflecting China’s own unique set of interests based on its particular history and current political system. This also stands in support of the neoliberal institutionalist position that a country’s interests other than security play an important role in shaping foreign policy.
Final judgment on some of these differences will have to be delayed until the AIIB’s operations go into effect. As new members join—in particular, if the U.S. and Japan join—it remains to be seen whether China will employ a strategy similar to that of the U.S. in Bretton Woods and attempt to retain its veto, or if it will cede this power. In its loan packages, the area to watch is whether the AIIB will avoid all forms of conditionality, extending funds to corrupt regimes with poor institutions, using country-systems within these countries where laws and regulations do not come close to international standards, or whether in practice it will implement a variation of the Dollar-Burnside strategy. Only time will tell.

In its first year, the AIIB was involved in nine projects, concentrated in the sectors of energy and transportation. It financed roads in Tajikistan, motorways and hydropower systems in Pakistan, a natural gas corridor in Azerbaijan, energy transportation and distribution centers in Myanmar and Bangladesh, an upgrade of Indonesia’s national slums, and the construction of railways and ports in Oman. From this small sample size, it is difficult to project how the AIIB will act in the future. However, that which makes this projection so difficult is actually a positive signal in and of itself. The AIIB has put its rhetoric of cooperation into practice. In April of 2016, Jin Liqun and ADB President Jim Yong Kim signed a co-financing framework agreement.\(^{228}\) It has since signed similar agreements with regional MDBs. Accordingly, the majority of the AIIB’s projects thus far have been co-financed with the World Bank, ADB or the European Bank for Reconstruction and Development (EBRD).

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Table 1. AIIB’s Approved Projects (February 2017)

<table>
<thead>
<tr>
<th>Project</th>
<th>Sector</th>
<th>Date Approved</th>
<th>AIIB’s Role</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tajikistan: Dushanbe-Uzbekistan Border Road</td>
<td>Transport</td>
<td>June 24, 2016</td>
<td>$27.5 M contribution&lt;br&gt;Second contributor with EBRD</td>
</tr>
<tr>
<td>Pakistan: Tarbela 5 Hydropower Extension</td>
<td>Energy</td>
<td>June 24, 2016</td>
<td>$300M contribution&lt;br&gt;Second contributor with WB</td>
</tr>
<tr>
<td>Bangladesh: Distribution System Upgrade and Expansion</td>
<td>Energy</td>
<td>June 24, 2016</td>
<td>$165 M contribution&lt;br&gt;AIIB has lead role along with Bangladesh government</td>
</tr>
<tr>
<td>Pakistan: National Motorway M-5 Project</td>
<td>Transport</td>
<td>June 24, 2016</td>
<td>$100 M contribution&lt;br&gt;Second Contributor with WB</td>
</tr>
<tr>
<td>Indonesia: National Slum Upgrading</td>
<td>Cross</td>
<td>Sept, 27, 2016</td>
<td>$216.5 M contribution&lt;br&gt;Second Contributor with WB</td>
</tr>
<tr>
<td>Myanmar: Myingyan Power Plant Project</td>
<td>Energy</td>
<td>September 27, 2016</td>
<td>$20 M contribution&lt;br&gt;Tertiary Contributor with IFC and ADB</td>
</tr>
<tr>
<td>Oman: Railway System Preparation</td>
<td>Transport</td>
<td>December 8, 2016</td>
<td>$36M contribution&lt;br&gt;AIIB has lead role along with Oman government</td>
</tr>
<tr>
<td>Oman: Dugm Port Commercial Terminal and Operational Zone Development Project</td>
<td>Transport</td>
<td>December 8, 2016</td>
<td>$265M contribution&lt;br&gt;AIIB has lead role along with Oman government</td>
</tr>
<tr>
<td>Azerbaijan: Southern Gas Corridor Program transport natural gas</td>
<td>Energy</td>
<td>December 21, 2016</td>
<td>Tertiary contributor with EBRD and EIB</td>
</tr>
</tbody>
</table>

In the smaller projects in Oman and Bangladesh, where the AIIB has taken a leading role, the signs have similarly been positive, as the AIIB has operated in accordance with the international norms of due diligence and transparency thus far.²²⁹ Once again, it remains to be seen whether or not this positive trend continues into the future, but there are ample reasons to be cautiously optimistic that the AIIB will be a status quo international financial institution that conforms to existing rules and norms and cooperates with other MDBs.

8. CONCLUSION

Taking stock of the motives behind the creation of the Asian Infrastructure Investment Bank, along with the analysis of the bank itself, the question that remains is whether China is showing the signs and tendencies of a dissatisfied power. This was the fear that rose to the surface when China announced its intention to create the institution, embodied both in the scholarly commentary, such as that of Aaron Friedberg, and in the Obama administration’s policy towards the bank. Were these fears warranted? Was the Obama administration’s skepticism and opposition justified? Does the AIIB serve as further evidence that the coming power transition of the United States and China is destined to be one marked by conflict and violence? Is hegemonic war around the corner?

The answer warranted by the evidence above is no, but to arrive at this answer it is first important to clearly restate the relevant concepts and terms. In Power Transition Theory, a transition is likely to result in hegemonic war if two criteria are simultaneously satisfied: the world system is in a moment of cross-over and the rising power is dissatisfied. It is clear that if the world is not already in a moment of cross-over, assuming China is not dragged down by domestic challenges, it is likely fast approaching. The relevant question thus becomes whether or not China is a dissatisfied power. What does it mean for China to be dissatisfied? It is not that China seeks greater power. It would be difficult to imagine a world in which this would not be true. If this were the definition, all cross-overs would lead to war, yet this is not what is predicted by Power Transition Theory, nor what the empirical evidence shows. It is also not that China desires a greater voice in global governance and more prestige in the international system. Accordingly, being a status quo power does not necessitate that China avoid taking any position
that might challenge the United States’ privileged position as the unrivaled hegemon at the top of the world hierarchy.

So what would make China worthy of the title of ‘dissatisfied power’? It would necessarily mean that China does not accept the fundamental rules and norms that govern the international system as currently constructed. A dissatisfied China would be one that believes its interests are not, and cannot be, satisfied from within the world order that the United States has played a disproportionate role in creating since World War II. It is a China that makes the decision that its interests are better served by playing spoiler to this order, going against the system and attempting to supplant it with a new order—a Sinocentric order that operates by a different logic. It is a calculation that, in the long run, China must break the liberal international order for its project of national rejuvenation ever to be completed. This is the type of dissatisfaction that Organski warned of in his Power Transition Theory.

Is the creation of the AIIB evidence that China is acting in a manner consistent with this definition of ‘dissatisfied power’? The analysis provided above suggests that this conclusion is not warranted. China’s actions surrounding the AIIB ought not be used as data to support the belief that China is a dissatisfied power destined to be a long-term enemy of the United States. This paper has argued this position by both showing that most of Beijing’s motives behind the creation of the bank are not inherently in opposition with the current international system, and by demonstrating that the institution that was ultimately created more or less conforms to the existing status quo in the multilateral development bank landscape.

On the first front, there are strong economic motives behind this new international financial institution. These are not the motives of an autarkic communist state or a purely mercantilist rule breaker. Rather, they are the motives of a country that has wedded its economic
future, and by extension a key pillar of regime stability, to the current international economic structure. The AIIB is designed to help ease many of China’s economic ills as it attempts to make the transition from a growth model predicated on massive investment in heavy industries to the next stage of its role in the global economy, higher up the value ladder in trans-national supply chains. This vision of increased connectivity and improved export markets in Asia signals that China in the wake of the financial crisis is not retreating from its policy of relative openness. It is doubling down, continuing to believe that its economic future is dependent on the realization of many of the goals and ideals at the core of the liberal international system’s economic vision. Economic disputes with China will persist, but to a great degree, to use Edward Steinfeld’s terminology, China has committed to ‘playing our game.’

On the other side of the ledger, many of China’s geopolitical motives behind the creation of the AIIB similarly show a country that remains committed to playing within the current international system. Of the seven geopolitical motives that have been identified, China is primarily driven by those that are not particularly worrying and supply little evidence to support the theory that China is a revisionist power. Many of the motives, such as Beijing’s attempt to retreat from its aggressive posture in foreign affairs and pursue a good neighbor policy to improve its regional and global image, show not that the international system is cracking. Rather, they show that the “hard to overturn, easy to join” mechanism is functionally operating as China is finding its interests are best served by not overstepping and frightening the international community. China may be driving for greater prestige, but in many cases that push is taking place within the international system. Thus, while China is stepping out of the existing architecture and establishing new institutions, this is not indicative of a total break with the current system. From the internationalization of the RMB to the push for increased voting rights
in Bretton Woods, China is primarily seeking greater prestige by increasing its role within the liberal order.

This is not to suggest that there are no worrying elements of China’s geopolitical calculation behind the creation of the AIIB. In particular, the hedging motive of institutional portfolio diversification that creeps into China’s new calculative strategy is troubling. Yet, it is necessary to put this threat in perspective. China as an institution creator has been most active in the MDB sphere, with the AIIB and the New Development Bank. This is a highly diffuse area of the international political economy where there exist minimal network effects. It is therefore hard to claim that China is aiming at fracturing the order. Even to the extent that China is hedging, it is important to be clear what this strategy indicates. China’s role in the world, and in global governance in particular, has been tumultuous. Few would debate this fact. Faced with a deteriorating strategic environment for China’s rise, Beijing may have sought reassurance by diversifying its institutional portfolio. However, this does not necessarily signal that the Thucydides Trap will soon be triggered. Planning for the possibility of choppy waters ahead is not the same as China constructing a trireme headed toward the United States and the liberal international order. It simply means that there are underlying tensions in the relationship that both sides must work through together to effectively manage.

The suggestion that the ultimate motive behind the AIIB’s creation is motive 7—that of institution breaker—is unfounded, relying on fearful conjecture rather than thoughtful analysis of the facts. When proper attention is paid to the institution itself, there is ample evidence that directly opposes this ‘worst case scenario’ mentality. The AIIB is not a radical institution. There are only slight differences between the AIIB and the existing MDBs. More in line with China’s bilateral lending practices, the bank appears less willing to impose conditionality on recipients,
and more likely to use country-systems, even if the rules and regulations of the recipient country do not match the international standard. The confluence of the two policies creates the fear that China might impede social improvement by undercutting existing international financial institutions. However, once again, these differences must not be overstated. The overwhelming image of the AIIB that emerges from close examination is one of a status quo institution. From membership and governance to policies and procedures, there has been a conscious effort to fit the mold provided by the World Bank and regional development banks like the ADB. The AIIB’s structure and actions thus far demonstrate that Beijing’s priority was not to build revisionist or revolutionary MDB. Instead, it was to create a new development bank that would be regarded as a first-class institution—one that effectively provides for China’s real economic and geopolitical interests. This intention supplies ample reason to be sanguine that the AIIB will not follow China’s bilateral lending path of extending loans to corrupt and oppressive regimes that has resulted in both defaults and waves of anti-China backlash. China is unlikely to throw good money after bad, jeopardizing its global image and political capital in the process.

There is a tendency to point to certain departures from MDB norms and certain motives that signal some degree of tension in China’s relationship with the current system and extrapolate a linear projection of how China will continue to drift down the road of revisionism in the future until it is brought into conflict with the United States. This method of analysis stands behind the logic of Randall Schweller and Xianyu Pu’s “After Unipolarity.” It is an approach that leads one to view any point of contention surrounding the AIIB as a sign for ever-increasing future revisionism, culminating in China’s ultimate desire to fracture and supplant the liberal order.

However, such a practice is misguided. The task of determining whether China is a status quo or revisionist power is one of discerning whether China will likely continue to find its
interests better served by maintaining the general rules of the system that have been established by the West, or find that is must supplant this system to achieve its objectives. China may want to make some slight changes to the order, while still wishing to uphold the general system as a whole. Therefore, the strict dichotomy between status quo and revisionist might be less useful than a continuum from the former to the latter. However, the question remains as to whether the gravity of the international system will pull China towards it, or whether it will be ejected by centrifugal forces. The evidence from the AIIB suggests that gravity holds. China, by and large, finds its interests served by the international system, and while it might wish to take on the role of rule maker in certain circumstances, it is unlikely to play rule breaker. Uncritically using the first as evidence that the second is to come is erroneous.

Irrespective of China’s current intentions, it is true that an institution formed for one purpose could eventually be used as a tool for other ends in the future. The AIIB can be viewed as a capability, and if intentions change down the line then there is the possibility that this capability could be leveraged for a purpose that runs counter to the current world order. Such a change in intentions could arise either from an internal transformation in how China conceives of its interests, or by a transformation in the international system, for instance if the United States abandons its leadership role and the current established order begins to crumble as the world enters into a Kindleberger Trap. Such dangers always exist, but what is important is that these outcomes are far from predetermined, and actually appear unlikely, as this analysis has shown that China currently finds its interests served by the international order. Furthermore, as Robert Keohane argues in After Hegemony, world orders and the institutions that uphold them tend to be more durable than often credited. Accepting these caveats, optimism still appears warranted for the power transition.
Once again, not finding revisionism in the AIIB or in this larger sphere of the international political economy does not rule out the possibility that China will exhibit revisionist tendencies in areas outside the scope of this project. There may be aspects of China’s behavior in the security realm, the dimension of the power transition that realists often focus most intently on, that are more threatening to the international order. In the immediate future, there are concerns with China’s actions in the South and East China Seas, where both China’s interpretation of the United Nations Law of the Seas with respect to freedom of navigation within a country’s Exclusive Economic Zone diverges from that of the international community, and there exist longstanding disputes surrounding sovereignty claims. As China continues to grow in military capabilities, there are also concerns over what level of military control China will attempt to assert in the Asia Pacific, notably if it will make significant efforts to dominate the waters within its first, and eventually second, island chains. Beyond security, there are other areas where China may run against the established world order. The clearest example is perhaps human rights, as China has a formulated position that differs from the status quo, providing the potential for China to serve as a disruptive actor.

What is important is how all of these pieces come together to create the larger picture of China’s rise. Just as it would be wrong to look at positive developments on the economic side of the ledger and discount security or other areas of concern, it would be equally incorrect to view aggressive behavior in the South China Sea as the sole dimension of import that will drive U.S.-China relations going forward. Acknowledging this fact, economics is still a critical area in which China’s rise has thus far been most dramatic, interests are strong, institutional arrangements thick, and the reported threat of revisionism high. Discovering that China currently finds its interests served by the international political economy and is acting as a supporter of the
status quo in the international economic system is of great importance. Further analysis that is outside of the purview of this paper is necessary as part of a larger continued project to examine how these various dimensions interact with one another and affect China’s grand strategy going forward. Yet, the AIIB and China’s general role within the world economic order lend credence to a more optimistic outlook for the prospects of a peaceful power transition.

Further evidence supporting this interpretation of the AIIB has emerged following the election of Donald Trump to the presidency of the United States in November 2016. Promoting an ‘America First’ message, questioning the role that the United States should play in the world, doubting the utility of NATO and the economic logic underpinning free trade agreements, Trump’s election poked holes in the liberal international order, creating more of a threat of fracturing the order than has any initiative from Beijing. It is still the early days of the Trump presidency, and it remains to be seen what path Trump will follow, or how precisely Xi Jinping will respond. However, despite these unknowns, much can be discerned from Beijing’s initial reaction to the surprise Trump victory. Two weeks after the election, at the Asia-Pacific Economic Cooperation summit in Peru, Xi Jinping displayed the first signs of what China’s response to Donald Trump would be, declaring “China will not shut the door to the outside world but will open it even wider…(China will) fully involve ourselves in economic integration.”

This was the beginning of a crescendo that would culminate in Xi’s trip to the World Economic Forum in January 2017, where he projected the image of Samuel Huntington’s “Davos Man,” signaling a willingness to pick up the baton of globalization should it be dropped by the United States. China signaled that it would act to avoid the Kindleberger Trap.231 There are whisperings

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230 Shawn Donnan and Andres Schipani. “China Pledges to Lead the Way on Global Trade.” Financial Times (November 19, 2016). https://www.ft.com/content/ad63bc0e-ae88-11e6-a37c-f4a01f1b0fa1.
that China might seek to make changes to the global structure, yet this idea of “re-globalization”\(^ {232} \) has not been fully articulated, nor does it appear that China has a clear idea of what it would look like, as Beijing likely did not expect to be in such a position at this point in time. Yet, the larger narrative is what matters: China has tied its future to many of the main pillars of the existing international order and therefore has a vested interest in not seeing this order crumble.

What this shows is that while differences between the international order that the U.S. has created and a Chinese vision for the world do exist, the similarities that emerge out of a confluence of interests are also real. Differences, as in the case of the creation of AIIB, can often be overstated, leading to policies that treat China with such a degree of strategic distrust that opportunities for cooperation can be overlooked. The logic of China Threat theory that arises from pessimistic realist projects can have dangerous self-fulfilling properties. To the extent that the United States’ opposition to the AIIB was informed by this theoretical perspective, and the extent to which this case study provides an accurate depiction of the AIIB and its situation within the larger framework of China’s rise, policy should be revised accordingly.

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