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THESIS

THE DRAGON'S JOURNEY TO THE WEST: CHINESE-LED ECONOMIC INSTITUTIONS AND THE REFORMATION OF THE LIBERAL INTERNATIONAL ORDER

by

Jessica S. Padoemthontaweekij

December 2019

Co-Advisors: Anne L. Clunan
Christopher P. Twomey

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13. ABSTRACT (maximum 200 words)

This thesis examines Beijing's geopolitical strategy through its use of Chinese-led institutions such as the Asian Infrastructure Investment Bank (AIIB), the Belt and Road Initiative (BRI), and the internationalization of the renminbi and its implication on the Liberal International Order (LIO). The first portion of this paper focuses on the structure of the U.S. hegemonic ordering system and its relationship to the LIO framework. The main analytical portion of the thesis examines the extent to which China has progressed toward creating a new liberal order or a new illiberal order, or sustaining the current Western-led order. Research finds that China has displayed reformist, revisionist, and status quo characteristics across the international order spectrum. This suggests that China is pragmatic in its foreign policy, choosing to challenge norms and order in the institutions that it does not agree with, but maintains and upholds norms in institutions that benefit China. China is also routing around certain international orders while upholding others. Ultimately, China is a reformist state that looks to reshape the LIO more in line with Beijing's interests; however, current international liberal norms will limit the extent to and the likelihood of success with which Beijing can reshape the world.

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THE DRAGON'S JOURNEY TO THE WEST: CHINESE-LED ECONOMIC INSTITUTIONS AND THE REFORMATION OF THE LIBERAL INTERNATIONAL ORDER

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LIST OF ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank
AIIB	Asian Infrastructure Investment Bank
AoA	articles of agreement
ASEAN	Association of Southeast Asian Nations
BRI	Belt and Road Initiative
GDP	Gross Domestic Product
IBRD	International Bank for Reconstruction and Development
IFI	international financial institutions
IMF	International Monetary Fund
LIO	Liberal International Order
MDB	multilateral development bank
MoU	memorandum of understanding
RMB	renminbi
SOE	state-owned enterprise
SWIFT	Society for Worldwide Interbank Financial Telecommunication

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I. INTRODUCTION

As China gains the power and influence to alter the rules of the international order, it raises the question of whether Beijing aims to overthrow the existing order or if it is mostly satisfied with maintaining the current system. Through international economic institutions such as the Asian Infrastructure Investment Bank (AIIB) and the Belt and Road Initiative (BRI), China can externalize new sets of rules and norms that are different from the existing liberal ones, upsetting the foundation of U.S. financial global dominance and, ultimately, the U.S.-led liberal order. China has embraced the Westphalian embedded liberalism of the order, accepted many international norms that underpin the existing system, and has integrated fairly well into the Liberal International Order (LIO). At the same time, however, China is also challenging other aspects of the LIO it does not agree with by creating new institutions that compete with existing U.S.-led institutions and externalizing Chinese norms and ideology. The duality of China's role—challenging existing norms while supporting core liberal principles—demonstrates that Ikenberry's theory on the durability of the international order is a helpful lens to understand the challenges the LIO is currently facing. More importantly, the ability for the liberal international system to influence emerging powers toward more open, rule-based, and cooperative development paths indicates that the LIO may be, for the most part, quite durable.

A. MAJOR RESEARCH QUESTION

The collapse of the Soviet Union after the Cold War changed the distribution of power and transformed the world from bipolarity to unipolarity for the first time in history. Starting at the end of World War II and continuing into the Cold War era, the United States—with its massive economic and military power—became a major initiator and supporter of the establishment of the global economic and political institutions that have helped to promulgate U.S. liberal democratic values around the world. Consequently, this new system helped cement the United States' position at the top of the hierarchical, unipolar international system.[1]

The United States' position as the global hegemonic power has thus far gone largely unchallenged by a countervailing military alliance. However, several recent events have threatened the dominance of the Western market system and the wisdom of the U.S.-liberal world order: the turmoil of the Asian Financial Crisis in 1997; the global economic recession in 2008, which destabilized many of the world economies; and the decline of United States power relative to China. The Western liberal world order laid down in 1945 is under threat. Large, emerging powers such as BRICS (Brazil, Russia, India, China, and South Africa) have shifted the center of economic and political gravity away from Euro-Atlantic countries to Asia.[2] Such ongoing shifts in the distribution of economic and material power are likely to reshape the norms, rules, standards, and institutions that have formed around the interests of Euro-Atlantic powers to better reflect the interests of emerging powers.[3]

Chief among emerging powers, China has been the most active in promoting and establishing new forms of economic institutions that critics view as a direct challenge to U.S. dominance. On the other hand, a strong China can also positively contribute to the stability of the international system as the rising power takes on more responsibility to address the global common goods problem. Arguably, the most debated topic within international relations today concerns the redistribution of power away from the West and toward Asia, specifically from the United States to China (Ikenberry, Feng and He, Johnston, Tang, Mearsheimer, etc.). Despite the ubiquity of this debate, there has been little empirical research conducted that systematically evaluates and measures China's

[1] Yves-Heng Lim, "How (Dis)Satisfied Is China? A Power Transition Theory Perspective." *Journal of Contemporary China* 24, no. 92 (March 4, 2015): 282. https://doi.org/10.1080/10670564.2014.932160.

[2] Christopher Layne "The US–Chinese Power Shift and the End of the Pax Americana." *International Affairs* 94, no. 1 (January 1, 2018): 90. https://doi.org/10.1093/ia/iix249.

[3] Stewart Patrick, "World Order: What, Exactly, Are the Rules?" *The Washington Quarterly* 39, no. 1 (January 2, 2016): 7–27. https://doi.org/10.1080/0163660X.2016.1170477.

relationship to the LIO.[4] This thesis will attempt to add clarity to the current debate by asking how Chinese-led economic initiatives have disrupted the existing liberal norms. This research will define the LIO concept and systematically test the degree to which China complies with, or challenges, the world order. Therefore, the thesis research question is this: How have Chinese-led economic institutions challenged the LIO?

B. SIGNIFICANCE OF THE RESEARCH QUESTION

China's rise as a regional economic power in East Asia may challenge the U.S.-led order and imply a power transition away from the United States. The LIO—the economic and politically liberal principles of rule-based, free-market democracies underpinning the U.S. global power—has been altered by the re-emergence of China as a major economic power in the international arena.[5] Since China's "reform and opening up" (改革开放) in 1978, China has sparked much debate on whether a strong China will attempt to upend the liberal world order, from which the country has significantly benefited—specifically, whether China will challenge the United States as the hegemon or limit its ambitions to pursuing reforms within the system.[6] Notably, Beijing has promoted a Chinese model of state capitalism contrary to the Western market-driven capitalist system.[7] In 2013, President Xi Jinping announced the establishment of the Asian Infrastructure Investment Bank (AIIB), which have been viewed by many as a threat to U.S. interests and a rival to global institutions such as the World Bank, International Monetary Fund (IMF) and the Asian Development Bank (ADB). Additionally, President Xi has also pushed for the creation of the Belt and Road Initiative (BRI), a Chinese global infrastructure building initiative that some have argued resembles the U.S. Marshall Plan.

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[4] Alastair Iain Johnston, "China in a World of Orders: Rethinking Compliance and Challenge in Beijing's International Relations," *International Security* 44, no. 2 (October 2019): 9–60, https://doi.org/10.1162/isec_a_00360.

[5] Naná De Graaff and Bastiaan Van Apeldoorn, "US–China Relations and the Liberal World Order: Contending Elites, Colliding Visions?," *International Affairs* 94, no. 1 (January 1, 2018): 113–31, https://doi.org/10.1093/ia/iix232.

[6] De Graaff and Van Apeldoorn.

[7] Suisheng Zhao, "Engagement on the Defensive: From the Mismatched Grand Bargain to the Emerging US–China Rivalry," *Journal of Contemporary China*, January 14, 2019, 1–18, https://doi.org/10.1080/10670564.2018.1562730.

Ultimately, China poses a challenge to the U.S.-led international order because the country is transforming itself to become an attractive alternative to the U.S. hegemonic system. After WWII, the United States constructed a regional order with the goal that this new order would foster the success of the New Deal at home.[8] This regional order later expanded into a global order after the Cold War. China may attempt to follow a similar path by creating a regional order that is friendlier to Chinese authoritarianism at home. However, as more countries decide to accept or adopt the Chinese development model, which overall has been more autocratic and less transparent than the Western model, the more likely it is for the United States to lose influence and power globally. A world that is more accepting of the Chinese model will be less likely to adopt or support Western liberal norms, reducing the call for democracy, transparency, and other core U.S. principles such as rule of law, freedom of navigation, and human rights. As such, even if China's aim is to construct a new regional order, the consequences of its success will be global.

If Beijing is challenging the LIO through the establishment of new institutions and illiberal norms that are more favorable to Chinese interests, then the LIO may be under threat of being replaced by an illiberal one. However, if these Chinese-led economic initiatives conform to the existing norms, versus challenging them, then the survivability of the LIO and the United States' position within it may not come under serious threat. It is also possible that China is moving toward establishing the necessary economic tools to solve collective action problems while also increasing Beijing's global influence without intending to displace the United States. These different approaches suggest different types of behaviors we should expect from China. Therefore, the significance of this research rests on identifying how much China has adhered to, challenged, or altered the liberal order using strategic economic tools and categorizing the different types of behaviors we have observed from China. U.S. foreign policy must consider these factors, as one version of the "rising Chinese power" discourse is significantly more threatening to the United States than the other. Failure to construct an appropriate foreign policy strategy may harm U.S. interests in the future when the balance of power has shifted to China.

[8] G. John Ikenberry, "The End of Liberal International Order?," *International Affairs* 94, no. 1 (January 1, 2018): 7–23, https://doi.org/10.1093/ia/iix241.

Three key literature areas have been instrumental to the conceptualization of the LIO and the development of this thesis. The areas in concern are 1) the definition of the "liberal" aspect of the LIO, 2) the durability of the LIO, and 3) the "China challenge." These three literature areas help us to define, focus, and form the overall conceptualization of the LIO and have been central in the current discourse and debate concerning a possible power-transition war between the United States and China. The main themes will be discussed in more detail in the following literature review section.

C. POTENTIAL EXPLANATIONS AND HYPOTHESES

The three hypotheses below will assist in identifying the nature of Beijing's economic strategy and its implications for the LIO. The following theories are not strictly competing, as China's strategy could be the construction of a new illiberal world order, a new Sino-centric (but relatively liberal) world order, the preservation of the current LIO or somewhere else within the gamut. It is possible for Beijing to move China's grand strategy fluidly from regional to global influence and from liberal/multilateralism to illiberal/hegemonic power. Although the possibilities are numerous, the following three hypotheses are the most likely scenarios. The hypotheses can provide a useful framework to understand China's strategic approach within the broader international geopolitical environment.

Hypothesis 1. China is a revisionist power. The emergent power is constructing a world order that does not reflect the same principles as the U.S.-led anti-pluralist liberal order. The goal is to maximize Chinese influence while reducing the relative power of the United States.

This hypothesis suggests that China is restructuring the world order to better accommodate Chinese authoritarianism at home and undermine U.S. global dominance. This new international order is characterized by less regard for human rights, less open, less rule-based, and contain more autarkic blocs.[9] In this order, China is revising the current U.S. hegemonic ordering system by limiting the spread of democracy and transparency

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[9] G. John Ikenberry, "Why the Liberal World Order Will Survive," *Ethics & International Affairs* 32, no. 1 (2018): 17–29, https://doi.org/10.1017/S0892679418000072.

while demoting ideological interventionism. This hypothesis is relatively in line with the argument that China is constructing a new order without the United States and the West (Tang's first hypothesis; Mearsheimer; Barma, Ratner, and Weber; He's and Feng's exclusive institutional balancing strategy; and Zhao).

Hypothesis 2. China is a reformist power. Beijing will neither simply join the U.S.-led order nor pose a direct challenge to the current system.

China is "modifying by leading," as the strongest rising power to take the lead on pursuing reforms within the order that will give developing countries, including China, more sway in policy creations.[10] Beijing is readjusting the order to better accommodate the interests of developing countries, with Beijing's interests as primary. This hypothesis is more aligned with the theory that China has found the current world order mostly acceptable but requires Chinese leadership to reform the order to better serve the needs of developing countries. Expected behavior from China via its international institutions is a general acceptance of the norms and practices of liberal MDBs, but opposition to neoliberal principles advocated by the West. Particularly, this hypothesis suggests that China will leave room for negotiation and discussion with other major powers in reforming the current international order. This hypothesis also incorporates He's and Feng's inter-institutional balancing theory as Beijing takes the lead in creating new developmental institutions to counterbalance U.S. dominance (Tang's second hypothesis, Ikenberry and Lim, and He's and Feng's inter-institutional balancing strategy).

Hypothesis 3. China is a status-quo power. Beijing is largely conforming to the current U.S. led-LIO, although it looks to readjust the order to better serve the needs of developing countries by creating new institutions to reduce the costs of cooperation and to address global public goods issues. Ultimately, its multilateral initiatives have supported the LIO.

As an alternative to the first hypothesis, this hypothesis suggests that China is integrating into the LIO and has been conforming to liberal norms for the most part. China

[10] Shiping Tang, "China and the Future International Order(s)," *Ethics & International Affairs* 32, no. 1 (2018): 31–43, https://doi.org/10.1017/S0892679418000084.

has been mostly satisfied with the current order and has followed international norms through participation in multilateral cooperation with the West and other non-Western states. Expected behaviors from China through its international institutions are the active promotion of transparency, government accountability, and rule-enhancing norms and practices (Tang's third hypothesis, Ruggie, He's and Feng's inclusive balancing strategy theory, and Stephan and Skidmore).

D. RESEARCH DESIGN

This research will use comparative case studies to compare liberal economic institutions to Chinese-led multilateral economic institutions. The research is designed to determine the degree of divergence in the nature of Chinese cooperation agreements and those of liberal institutions. It will compare Western-centric liberal institutions/systems such as the World Bank, the U.S. Marshall Plan, and the supremacy of the U.S. dollar to their Chinese-led counterparts such as the AIIB, BRI, and the internationalization of the RMB. Since the goal of this research is to analyze Chinese-led economic institutions as a possible foundation for the establishment of a new world order, it is prudent to analyze Chinese-led economic initiatives based on pre-established liberal economic and financial institutions that have underpinned the current U.S. hegemonic ordering system within the LIO. This research will use primary and secondary source documents such as institutional charters, founding documents, financial reports, lending agreements, official government documents, and approved investment/construction projects dating from the beginning of the Chinese-led economic initiatives in 2013 to the present day.

For specific research methodology concerning China's regional versus global ambitions, I maintain that China's success as a regional power has global consequences. Therefore, I consider the AIIB, BRI, and the internationalization of the RMB as Beijing's initiative to gain global influence, rather than regional.

I will identify and categorize Chinese-led economic institutions/initiatives into those that are either revisionist, reformist, or status-quo in nature. From there I will extrapolate whether China is attempting to largely conform to the LIO or fundamentally restructure the LIO as a revisionist power. Finally, I argue that China's success as a regional power will also change the global balance of power. To clarify my argument, BRI and the internationalization of the RMB are global in scale, and while the AIIB is regional in focus, its membership composition has countries well outside the region, such as the United Kingdom, Canada, and Sudan. Therefore, this thesis will look at Chinese regional (AIIB) and global (BRI and internationalization of RMB) economic initiatives as part of China's global aspirations, two sides of the same coin.

My research premise for distinguishing among different types of institutional behaviors and policies are as follows:

1. Institutional Balancing

He and Feng classify institutional balancing as inclusive institutional balancing, exclusive institutional balancing, and inter-institutional balancing strategies. According to He and Feng, inclusive institutional balancing strategy "involves including a target state into an institution, through which the target state is constrained by the rules and norms of the institution,"[11] which falls in line with China as a status quo power. This is in contrast with exclusive institutional balancing meaning, "[Strategy to] exclude the target state from an institution. The target state is excluded and pressured by the cohesion and cooperation of states inside the institution"[12] which indicates China as a revisionist power. Lastly, inter-institutional balancing strategy is the creation of new institutions in order to compete for influence with existing institutions; it can be either inclusive or exclusive in nature.[13] Inter-institutional balancing strategy denotes China as a reformist power.

2. Norms

AIIB and BRI may disrupt norms by establishing different lending conditions than those of existing institutions. Loans with conditionalities that completely oppose Western liberal principles, show lending preferences to autocratic regimes, and reject international

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[11] Kai He and Huiyun Feng, "Game of Institutional Balancing: China, The AIIB, and The Future of Global Governance," *RSIS Working Paper*, May 2018, 4.

[12] He and Feng, 4.

[13] He and Feng, 4.

lending norms altogether is indicative of China's revisionist intent. AIIB and BRI loans that have requirements similar to existing liberal institutions but with lower loan conditionalities such as reduced standards for transparency and accountability is indicative of China's reformist intent. Lastly, loans that maintain and conform to Western liberal principles and lending conditionalities established by the World Bank, ADB, and the OECD are indicative of China's status quo intent.

3. Defining Revisionist, Reformist, and Status Quo Power

Although emerging powers may not intend—or have the capacity—to form a united bloc to topple the U.S.-led order, the threat lies more in the externalization of new norms and practices that go against liberal ideology and the "revisionist" institutions that promote them. Barma, Ratner, and Weber argue that emerging powers, such as China, are building alternative international political and financial systems, making the United States' role as the underwriter of its world order increasingly irrelevant.[14] Therefore, the biggest threat to U.S. leadership over the global financial system, and perhaps the biggest threat to U.S. hegemony in general, is the formation of alternative institutions that are making the world more favorable to China's authoritarian system, leading to a slow deterioration of Western liberal and democratic values. Those who hold a more hawkish view toward China reason that a world that is more accepting of the Chinese development model will be less likely to adopt or support Western liberal norms, reducing the call for democracy, transparency, and other Western-liberal principles. However, despite the ubiquity of the "status quo vs. revisionist vs. reformist China" debates, there is still much confusion as to what constitutes a status quo, a revisionist, or a reformist power, making it difficult to categorize China as one or the other. It is often assumed that the world will recognize a country as a status quo or revisionist power when it sees one—even less effort has been put into defining what a "reformist" power may be. What has been most helpful so far in attempting to define the

[14] Naazneen Barma, Ely Ratner, and Steven Weber, "A World without the West? Empirical Patterns and Theoretical Implications," *The National Interest*, August 2007, 23–30.

characteristics comes from Morgenthau's definition of a "status quo power" versus Organski's and Kugler's interpretation of a "challenger" (i.e., revisionist state).[15]

According to Morgenthau, "The policy of the status quo aims at the maintenance of the distribution of power as it exists at a particular moment in history. [It opposes] reversal of the power relations among two or more nations."[16] He further caveats that "Minor adjustments which leave intact the relative power positions of the nations concerned are fully compatible with a policy of the status quo."[17] On the other hand, Organski and Kugler characterize "challengers" as emerging powers wanting a "new place for themselves in international society" commensurate with their power.[18] One indicator of a revisionist state is that it will express a general dissatisfaction with the system and a desire to rewrite the rules or norms by which nations interact. Gilpin offers an operationalizable component to identify revisionists: attempts to change the distribution of power, the hierarchy of prestige, and the rights and rules that govern interactions among states.[19] For Gilpin, revisionist states must seek to alter all three components in order to be determined as non-status quo or revisionist.[20] Stephen and Skidmore add to the characterization of a revisionist power by stating, "If China sought to overturn the LIO, the AIIB might embody mercantilist principles, strongly favor state-owned firms, take the form of an exclusive regional economic bloc, or fail to incorporate protection of human rights, the environment, or honest government."[21] A reformist China, on the other hand, straddles the in-between. Cabestan and Nicolas offer that China may reform from the inside by using its growing influence to change existing norms and institutions but does not fundamentally oppose the

[15] Hans J. Morgenthau, *Politics among Nations: The Struggle for Power and Peace*, 5th ed. (New York: Alfred A. Knopf, 1978); A.F.K Organski and Jacek Kugler, *The War Ledger* (Chicago: Chicago University Press, 1980).

[16] Hans J. Morgenthau, Politics among Nations: The Struggle for Power and Peace, 46.

[17] Hans J. Morgenthau, 46.

[18] A.F.K Organski and Jacek Kugler, *The War Ledger* (Chicago: Chicago University Press, 1980), 19–20, 23.

[19] Robert Gilpin, *War and Change in World Politics* (Cambridge: Cambridge University Press, 1981), 34.

[20] Gilpin, War and Change in World Politics, 34.

[21] Matthew D Stephen and David Skidmore, "The AIIB in the Liberal International Order," *The Chinese Journal of International Politics* 12, no. 1 (March 1, 2019): 61–91, https://doi.org/10.1093/cjip/poy021.

established liberal order.[22] The main difference between revisionism and reformism is that a revisionist China will completely reject the liberal order and seek to upend it, while a reformist China will attempt to change certain aspects of the order it does not agree with but still leave room for negotiation with other major powers.

In Table 1, compiled from Stephen and Skidmore; He and Feng; Mazarr, Heath, and Cevallos; and Organski and Kugler, I have created hypothetical criteria by which the subsequent analysis evaluates China's behavior (through Beijing's actions in the AIIB, BRI, and the RMB) to help determine its revisionist, reformist, or status quo orientation and the implications for the LIO. If China's international institutions' observable behaviors fall into one category more than the other, then this will show whether the country is leaning more toward revisionism, reformism, or status quo—which aligns with the assumption row as it explains implicit revisionist, reformist, and status quo intent. Lastly, the implication for the LIO section outlines what the world should see from China as a revisionist, reformist, or status quo power.

If China is a revisionist country, the world can expect Beijing to establish international institutions that reflect authoritarian ideology in official and unofficial practices. Beijing seeks to establish a new world order that places China at the center of international political and economic development. This new international order is distinguished primarily by bilateral relationships that will define state-to-state political and economic interactions, according to Beijing's core interests and preferences. In practice, international institutions established by a revisionist China will promote illiberal ideologies that seek to undermine transparency, accountability, multilateral cooperation, and social protection; thereby, increasing the likelihood of negative externalities such as corruption, human rights abuse, and environmental degradations. The spread of illiberal ideologies, assertion of great power privileges, and actions to undermine Western liberal institutions form the ideological foundation of this revisionist order.

[22] Jean-Pierre Cabestan, "What Kind of International Order Does China Want? Between Reformism and Revisionism," *China Perspectives* 2 (2016): 3–6.; Françoise Nicolas, "China and the Global Economic Order: A Discreet Yet Undeniable Contestation," China Perspectives 2016, no. 2 (June 1, 2016): 7–14, https://doi.org/10.4000/chinaperspectives.6960.

In a reformist system, the international order will contain multiple regional world orders nested within a reformed global order. Inter-institutional balancing strategies will determine the dynamic of state-to-state interactions, especially within rising powers versus established power context. A reordering and redistribution of power, specifically toward China and away from the United States, is the hallmark of this system. In practice, international institutions within this world order will reflect old norms and practices, along with accepting new norms and practices that may conflict with Western ideologies. Although China challenges the United States in this order, the main distinction from revisionism is that there is still room for negotiation between a rising China and the current hegemon.

Lastly, a status quo China will maintain all liberal norms and practices established by Western powers. Chinese-led international institutions will adopt Western liberal practices and further promote liberal values such as transparency, R2P, and the free market. As a status quo, China aims to gain credibility and legitimacy through the adoption of existing liberal templates, demonstrate adherence to key norms, and engage in active participation in multilateral international institutions.

Table 1. Revisionist, Reformist, and Status Quo Indicator[23]

	Revisionist	Reformist	Status Quo
Assumption	International institutions reflect the domestic orders of the leading country, to include official and unofficial practices.	International institutions reflect both prior and new norms and practices—with more acceptance of non-Western ideologies such as substantial state intervention in economic development and political authoritarianism.	International institutions embody and espouse norms of liberal world society that is largely democratic, rule-based, and free market-oriented.
	Seeks new place in the order commensurate with level of power.	Slight modification in the existing distribution of power, more toward China and away from the West.	Maintenance of current distribution of power.
Observable Behavioral Indicators	China's international institutions diverge from existing templates because they reflect Beijing's core interests and domestic order—promoting less liberal forms of economic regulation and state-led capitalism.	China's institutions integrate existing templates with national interests. Prioritizing a balancing strategy in pursuant of international credibility and legitimacy while resisting aspects China sees as illegitimate within the liberal order.	China's institutions copy existing templates in search for credibility and legitimacy.
	Authoritarian system with strong assertion of China-centric version of the region and the world. State-controlled and centralized policy making.	Nested regional orders under a reformed global order. Continued cross-institutional participation but offers alternatives to existing liberal institutions.	Participation and cooperation among AIIB, other MDBs, and existing liberal institutions. Transparent management system/governance structure.
	Establishing different lending conditions than those of existing MDBs. Loans with reduced standards of transparency and accountability: lacking protection of individual rights, fiscal regulations, anti-corruption measures, and environmental protection policies.	Melding of new and old lending practices and conditions with emphasis on Chinese values and ways of doing business.	Lending practice/requirements that are similar to preexisting MDBs and meet OECD financing recommendations.
	Aggressive push to revise the rules in conjunction with consistent efforts to weaken and delegitimize U.S. leadership in key institutions, while also undermining Western institutions internationally.	A mixed motive game that combines opportunities for coordination and negotiation with antagonistic motivations, securing Chinese interests whenever possible.	Effort to demonstrate adherence to key norms and work through multilateral settings.
Institutional Balancing Strategies	Exclusive balancing: alienating target state (i.e., the U.S. and other Western liberal countries) from an institution and imposing pressures on the target state.	Inter-institutional balancing: China can use its institutions to challenge the relevance and role of Western-led institutions.	Inclusive balancing: Inclusion of target state in its institutions (i.e., the U.S. and other Western liberal countries) to constrain target state's behavior through institutional rule-making and agenda-setting techniques.
Implication for LIO	Externalization of alternative norms, challenge to social purpose, spreading of illiberal ideology, and assertion of great power privilege above norms of order.	Competes with U.S. leadership and hegemony but does not upend the liberal economic and political order. China will still be constrained by the Western liberal system even after replacing the U.S. on the top of the international hierarchic order.	Continuation of the institutionalization of current norms, regulations, and practices.

[23] Adapted from Organski and Kugler, The War Ledger. (Chicago: Chicago University Press, 1980) 19-23; Stephen and Skidmore, "AIIB in the Liberal International Order," 75; He and Feng, "China's Institutional Challenges to the International Order," 23-49; Mazarr, Heath, and Cevallos, "China and the International Order," 101.

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II. LITERATURE REVIEW

This chapter will outline the main arguments concerning liberalism within the LIO, the durability of the LIO, and China's challenge to the current world order. Before presenting the main arguments, we must first define what "order" is. Hedley Bull defines order as "a pattern of human activity that sustains the elementary, primary or universal goals of social life."[24] Theoretically, the world would be made up of an international "society of states" (i.e., international institutions) that forms and upholds political order through shared practices, goals, and norms.[25] Shiping Tang adds to this definition by clarifying that "order is the degree of predictability (or regularity) of what is going on within a social system, presumably because [the] agent's behavior, social interactions, and social outcomes within the social system have all come under some kind of regulation."[26] The degree of predictability and regulation over actions taken between states to achieve national interest is the basic definition of the "order."

Transitioning from the definition of order to the concept of the international order, Ikenberry puts forth the following: "International order refers to the settled arrangements between states that define the terms of their interaction. [The] liberal international order refers to international order that is open and rule-based."[27] The LIO is an evolving set of principles and practices characterized by "open markets, international institutions, cooperative security, democratic community, progressive change, collective problem solving, and the rule of law."[28]

[24] Hedley Bull, *The Anarchical Society: A Study of Order in World Politics* (New York: Columbia University Press, 1977), 24.

[25] Evelyn Goh, "Contesting Hegemonic Order: China in East Asia," *Security Studies* 28, no. 3 (May 27, 2019), 614–44, https://doi.org/10.1080/09636412.2019.1604989.

[26] Shiping Tang, "China and the Future International Order(s)," *Ethics & International Affairs* 32, no. 1 (2018), 32, https://doi.org/10.1017/S0892679418000084.

[27] G. John Ikenberry, "Liberal Internationalism 3.0: America and the Dilemmas of Liberal World Order," *Perspectives on Politics* 7, no. 1 (March 2009), 84, https://doi.org/10.1017/S1537592709090112.

[28] Ikenberry, "Liberal Internationalism 3.0," 71.

A. THE "LIBERAL" IN THE LIBERAL INTERNATIONAL ORDER

Ruggie's foundational work on the concept of the "U.S. liberal order" reveals that the United States created the framework of the current order by projecting the experience of the New Deal regulatory state into the international arena.[29] In order to ensure the long-term success of the program, the United States needed to establish a regional order that was compatible with and committed to the institutional means that enabled the success of the New Deal domestically. This belief drove the United States effort to institutionalize a multilateral economic and social international order after World War II.[30] After the Cold War, the collapse of America's only rival—the Soviet Union—allowed for the expansion of U.S. norms globally. Therefore, the "embedded liberal" ideology and norms that were successful within the United States became the new ideology and norms for the international community.[31]

According to Ruggie, although the creation of the current liberal order was dependent on the existence of a hegemon, it was equally important that it was an *American* hegemony—in liberal norms and ideology—that shaped the overall structure of the order.[32] Arguably, had the hegemon been any other country, the international order would have been foundationally different from the rule-based, liberal market-oriented, and Western-centric international order in existence today. However, apart from the origination of the current international order, which most scholars have agreed upon, the understanding of "liberalism" within the LIO is still the subject of much debate.

The first helpful interpretation of "liberalism" within the context of the LIO distinguishes between economic liberalism and political liberalism. Tang posits that the current "liberal" international order is "liberal" only in terms of economic sense (open trading), but not in the political sense.[33] The current international order is not fully liberal,

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[29] John Gerard Ruggie, "Multilateralism: The Anatomy of an Institution," *International Organization* 46, no. 3 (1992): 561–98.

[30] Ruggie.

[31] Ikenberry, "Liberal Internationalism 3.0."

[32] Ruggie, 593.

[33] Tang, "China and the Future International Order(s)."

as not all countries that are within it were able to freely choose to submit to an order, since this order was imposed by the United States and its allies after World War II, and even more so after the Cold War.[34] Therefore, since the world order is liberal only in the economic sense, Tang argues that the system should still be able to accommodate and integrate a politically illiberal rising power such as China, as long as China uses peaceful means to create or reshape specific rules within the international order.[35]

Although both Tang and Simpson would agree that the LIO is only partially liberal, their agreement seems to end there. Simpson expounds upon the "liberal" concept by distinguishing between two forms of liberalism: Charter liberalism and liberal anti-pluralism.[36] According to Simpson, Charter liberalism gives all states equal rights in a liberal society (i.e., domestic jurisdiction, equality, non-intervention) and tolerates the diversity produced by these norms.[37] Charter liberalism is a pluralist-type liberalism that encompasses multilateral institutions such as the United Nations, World Bank, International Monetary Fund (IMF), World Trade Organization, and the Asian Development Bank (ADB).[38] Charter liberalism stands in contrast with the principle of liberal anti-pluralism, wherein states are distinguished, categorized, and given ontological priority based on domestic regime type.[39] While Simpson posits that Charter liberalism is both political and economic liberalism since it does not require domestic governments to conform to a particular Western model, Tang argues that the current LIO countries do not get to willingly submit to an order, as it was imposed on them by the victors of WWII and the Cold War.[40] Thus, a genuine politically liberal order is not possible since weaker countries are forced to accept whatever type of order is imposed by stronger powers that have designed the international political system.

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[34] Tang, "China and the Future International Order(s)."

[35] Tang.

[36] Gerry Simpson, "Two Liberalisms," *European Journal of International Law* 12, no. 3 (2001): 537–71.

[37] Simpson, 541.

[38] Anne L. Clunan, "Russia and the Liberal World Order," *Ethics & International Affairs* 32, no. 1 (2018): 45–59, https://doi.org/10.1017/S0892679418000096.

[39] Simpson, 541.

[40] Tang.

Clunan adds to Simpson's categorization of the liberal concept by breaking down the liberal anti-pluralist principle even further into liberal humanism and economic neoliberalism.[41] These two anti-pluralist forms of liberalism are predicated on individual rights and economic freedom.[42] Most notably, anti-pluralist liberalism elevates the power of the international community over state sovereignty.[43] Liberal humanism is particularly threatening to China as it justifies foreign interventions to spread democratic and human rights norms. China considers these norms as Western-centric; Beijing staunchly views any foreign intervention as intrusions into China's domestic affairs. Economic neoliberalism, on the other hand, rests on the neoliberal principles of complete privatization, liberalization, and deregulation of market economies.[44] Economic neoliberalism, the foundation of the Washington Consensus, came under scrutiny after western economic powers and the IMF failed to resuscitate the Asian countries most affected by the 1997 Asian Financial Crisis, and the 2008 U.S. Global Recession, which was considered by the rest of the world as a direct failure of the neoliberal market principle. The various conceptions of the LIO are key to understanding the complexity in analyzing the durability of the international system, as these distinctions matter in interpreting which aspect of the LIO makes the system more or less durable than others.

The distinction between the shifting "liberal" values of the international order versus the traditional concept is as important as the definition of the liberal order itself. The United States has fashioned itself to be the champion of the LIO that is associated with multilateral institutions, economic openness, and liberal values centered on democracy and human rights.[45] This U.S. version of the LIO is more in line with the anti-pluralist liberalism of liberal humanism and neoliberalism. The inclusion of the liberal values of democracy and human rights is still a contentious matter, as many other countries have viewed these as strictly based on U.S./Western values, especially in regard to the

[41] Clunan, "Russia and the Liberal World Order."

[42] Clunan.

[43] Gerry Simpson, "Two Liberalisms," *European Journal of International Law* 12, no. 3 (2001): 537–71.

[44] Clunan.

[45] Ikenberry, "Liberal Internationalism 3.0." 71.

Responsibility to Protect (R2P). This dichotomy is also reflected in Ikenberry's and Ruggie's differing characterization of the LIO as well. Ikenberry characterizes the U.S.-led LIO as a Western-oriented economic and security system with a modified Westphalian sovereignty. This means a reduction of state sovereign independence for increased intergovernmental capacities, a hierarchical order underwritten by the United States, enforcement of rules by reciprocity and bargaining through institutions, a neo-liberal economic system, and the protection of human rights.[46] The distinction is that Ikenberry associates the liberal values of democracy and human rights with the LIO, while Ruggie does not.

This concern is especially true for Russia and China, where they view the United States' push for the universal acceptance of those values and norms as a violation of state sovereignty and a challenge for the government to maintain control domestically. Contrary to Western values, Moscow and Beijing adhere strongly only to the most fundamental principles of embedded liberalism: domestic jurisdiction, equality, and non-intervention in the affairs of sovereign states. In sum, the U.S.-led anti-pluralist order is now distinct from Ruggie's traditional definition of embedded liberalism. Most importantly, what is considered by developed nations as the essential characteristics of the LIO has evolved over time. Therefore, it is vital that we distinguish between the U.S.-led order (henceforth synonymous with Ikenberry/anti-pluralist order) and the LIO (synonymous with Charter pluralist-type liberalism) prior to assessing the durability of the order itself.

B. THE DURABILITY OF THE LIBERAL INTERNATIONAL ORDER

Today, a rising China is increasingly willing to assert its own vision for the international order that seems to diverge significantly from that of the United States. However, despite the centrality of the LIO to foreign policy discourse, the concept of the LIO and its relationship to the U.S. hegemony is still subjected to much scholarly debate. The major arguments concerning the durability of the LIO and its relationship to U.S. liberal internationalism separate into three main camps: first, the collapse of the current

[46] Ikenberry, "Liberal Internationalism 3.0"

world order; second, the persistence of the LIO as a separate entity from U.S. hegemony; and third, the LIO as a flawed and irrelevant framework in today's evolving geopolitical environment.

The first acknowledged view is realist in principle. According to Mearsheimer, the LIO can only survive in a unipolar system where the leading state is a liberal democracy.[47] In fact, Mearsheimer argues that the LIO is intricately linked to U.S. power and hegemony. The United States' "unipolar moment" came at the end of the Cold War with the dissolution of the Soviet Union, and with it, the end of the bipolar world order. The bounded order that the United States had created to wage security competition against the Soviet Union had remained intact. Most important, the institutions that the United States helped to establish during the Cold War were incorporated into the new world order.[48] These institutions became the building blocks of the new LIO.

Mearsheimer argues that since the United States is a weakening power, the current LIO is bound to fail along with America's decline.[49] This view surmises that the U.S.-led liberal international order contains the seeds of its own destruction as U.S. efforts to promote liberal democracy globally has led to increased nationalism and resistance to the role of international institutions in deciding matters of national sovereignty. In addition, Mearsheimer reasons that hyper-globalization has been a source of economic and political instability that has led to a serious erosion of support for the LIO.[50] As economies become more integrated, hyper-globalization helped China to rapidly transform itself into a great economic power, shifting the global balance of power and putting an end to U.S. unipolarity. Mearsheimer predicts that the future world order will be constituted by three different realist orders: a thin international order and two thick bounded orders, one led by China and the other by the United States.[51]

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[47] John J. Mearsheimer, "Bound to Fail: The Rise and Fall of the Liberal International Order," *International Security* 43, no. 4 (April 2019): 7–50, https://doi.org/10.1162/isec_a_00342.

[48] Mearsheimer.

[49] Mearsheimer.

[50] Mearsheimer.

[51] Mearsheimer.

The second interpretation of the international order separates U.S. hegemony from the order itself. The proliferation of multilateral institutions within the past thirty years has been a remarkable feature of the liberal international order. Neoliberal institutionalists, such as Keohane, argue that the development of multilateral institutions, in conjunction with deepening economic interdependence, should decrease the likelihood of conflict. The cost of economic interdependence has increased the cost for states to resort to military hard power to resolve conflict and decreased the benefits the victor state may gain, making states much less likely to wage costly wars.[52] A fellow institutionalist, Ruggie argues that the arrangement of the international order, based on the organizing principles of multilateralism and multilateral institutions, is extremely robust and adaptive.[53] The international order, although originally built by the United States, has outgrown the need for a hegemonic supporter and "has long since taken off on a self-sustaining institutional path."[54] Moreover, Ruggie argues that changes in the distribution of power do not mean that the multilateral nature of the order will change, so long as the "social purpose" of the international order is agreeable to a rising challenger, such as China.[55]

This argument is similar to Ikenberry's assertion that the LIO will outlast American hegemony. According to Ikenberry, the threat to the LIO is a temporary setback instead of an existential crisis to the order—it is a "crisis of transition" where the U.S.-led liberal order will no longer exist in its current form but will continue to exist under a new configuration of global power and institutions.[56] Ikenberry posits that, although the U.S. hegemonic role in the liberal order is weakening, the more general concept and organizational principles of liberal internationalism are deeply entrenched in world politics. The order itself can adapt and accommodate the needs of rising powers.[57]

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[52] Robert O. Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy*. (New Jersey: Princeton University Press, 1984). http://www.jstor.org/stable/j.ctt7sq9s.

[53] Ruggie, "Multilateralism: The Anatomy of an Institution."

[54] Ruggie.

[55] John Gerard Ruggie, "International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order," *International Organization* 36, no. 2 (Spring 1982): 379–415, https://doi.org/doi:10.1017/S0020818300018993.

[56] Ikenberry, "The End of Liberal International Order?"

[57] Ikenberry.

Furthermore, Ikenberry posits that the LIO will survive because of four characteristics: first, the "multilateral logic" of the system makes it easy for states to join and gain recognition; second, the liberal order offers opportunities for shared authority; third, economic gains are widely shared within the order; and fourth, the order accommodates pluralism in growth and development strategies.[58] For Ikenberry, these four characteristics make the LIO "easy to join and hard to overturn."[59] Additionally, Ikenberry argues that the survival of the LIO also rests on the fact that the alternatives to liberal order are nonexistent. Neither China nor Russia has a grand model that the rest of the world is willing to follow. The only possible alternatives to the LIO will be "various sorts of closed systems—a world of blocs, spheres, and protectionist zones," and the end of liberal internationalism will harm more people than the benefits the alternatives can provide.[60] Importantly, the values and interests that have supported the growth and success of the liberal order have not gone away. Therefore, the LIO is likely to survive as new powers enter the system but can only influence changes to the order from within.[61]

Barma, Ratner, and Weber offer a third interpretation of the LIO. In this view, the liberal order today functions largely as an aspiration and not as an accurate description of how global governance works, or how states behave within an order. The main argument against the actual existence of the LIO rests on the role of institutions, specifically the ineffectiveness of multilateral institutions to advance collective solutions for the most important challenges such as climate change, global financial stability, nuclear proliferation, and R2P. According to Barma, Ratner, and Weber, the LIO has failed to meet its own objective: "a world in which most countries most of the time follow rules that contribute to progressively more collective security, shared economic gains, and individual

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[58] G. John Ikenberry, "Why the Liberal World Order Will Survive," *Ethics & International Affairs* 32, no. 1 (2018): 24-25, https://doi.org/10.1017/S0892679418000072

[59] G. John Ikenberry, *Liberal Leviathan: The Origins, Crisis, and Transformation of the American World Order* (New Jersey: Princeton University Press, 2011).

[60] Ikenberry, "The End of Liberal International Order?"; Ikenberry's views that international regimes will persist after the decline of the hegemon due to the states demand for them are largely consistent with the neoliberal institutionalist argument (Keohane 1984). This argument is based on the premise that global and regional institutions increase the benefits of international cooperation while reducing transaction costs.

[61] Ikenberry.

rights."[62] So far, the world has not seen a worldwide acceptance of multilateral institutions, global norms, exchange of sovereign authority for proactive collaboration on universal challenges, or the steady evolution resembling an "international community" bound by rights and responsibilities to defend individual rights and freedom.[63] What the world has seen so far, however, is the spread of state capitalism and resource nationalism due to its ability to deliver tangible gains for emerging powers.[64] The ability to deliver perceptible gains adds to the attractiveness of this alternative development path. Therefore, rather than seeing a gradual acceptance of liberal values and western-style developmental policies (i.e., the Washington Consensus), global governance has declined in both effectiveness and legitimacy.[65]

Instead of rising powers integrating into the LIO, China, India, and Russia have routed around the existing system by bypassing the fundamental elements of the LIO—its Western institutions and systems.[66] Barma, Ratner, and Weber assert that the prevailing order is so thin and weak that most emerging states, rather than seeking to overturn it or refusing to integrate into it, have effectively routed around or arbitraged against the LIO. According to Barma, Ratner, and Weber, "the ease with which emerging powers route around liberal rules and institutions is perhaps the most conclusive evidence that the liberal order is a myth."[67] The ability for emerging states to veto multilateral actions, create new institutions to bypass the Bretton Woods system, or agree on trade deals using local currencies instead of the U.S. dollar—bypassing the linchpin of the liberal economic system—is the most insidious threat to the liberal ordering system, in their view.[68] It is the gradual siphoning of power, resources, and influence from the West that has become the biggest challenge facing the LIO, not the abrupt overturn of the system by an emergent,

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[62] Naazneen Barma, Ely Ratner, and Steven Weber, "The Mythical Liberal Order," *The National Interest*, April 2013, 56–67.

[63] Barma, Ratner, and Weber.

[64] Barma, Ratner, and Weber.

[65] Barma, Ratner, and Weber.

[66] Barma, Ratner, and Weber.

[67] Barma, Ratner, and Weber.

[68] Barma, Ratner, and Weber.

adversarial power. Emerging powers are building a world with alternative international political and financial systems, making Western powers, particularly the United States, increasingly irrelevant.[69]

C. CHINA CHALLENGING THE EXISTING ORDER

In terms of China's challenge to the international order in the specific domain of economics, the two most likely areas of contestation for potential Chinese leadership are international finance, which covers a range of financial issues from China's voting share in the IMF to the internationalization of the RMB, and economic integration, which covers the Belt and Road Initiative (BRI).[70] Within the international finance domain, China has challenged U.S. dominance through issues such as voting share in the IMF (which Beijing believes should be reflective of China's international status and prestige), internationalization of the renminbi, and the creation of the Asian Infrastructure Investment Bank (AIIB). Within the economic integration realm, China has challenged the U.S.-led order with the announcement and initiation of the Belt and Road Initiative (BRI).[71] This section summarizes the scholarly debates regarding how China challenges the existing U.S.-led economic international order.

Institutional balancing theory provides an overarching analytical framework on how China challenges the LIO. This theory submits that states have learned to use multilateral institutions to balance against or counter their rivals' power and influence.[72] Specifically, China is said to be using institutional balancing to counter U.S. influence within the LIO. He and Feng posit that China, the United States, and other countries have employed three types of institutional balancing strategies to compete for regional and global influence: inclusive institutional balancing, exclusive institutional balancing, and inter-institutional balancing.[73] According to He, "inclusive institutional balancing strategy

[69] Barma, Ratner, and Weber, "A World without the West? Empirical Patterns and Theoretical Implications."

[70] Tang, "China and the Future International Order(s)," 2018.

[71] Tang.

[72] Kai He, "Contested Multilateralism 2.0 and Regional Order Transition: Causes and Implications," *The Pacific Review* 32, no. 2 (March 4, 2019): 210–20, https://doi.org/10.1080/09512748.2018.1465455.

[73] He and Feng, "Game of Institutional Balancing: China, The AIIB, and The Future of Global Governance."

includes the target state in a multilateral institution, through which the target state's behavior is constrained or shaped by the rules and norms of the institution."[74] This is in contrast to exclusive institutional balancing, "where the target state is excluded from an existing institution. Other states within the institution can then pressure or act as balance against threats from the target state."[75] Lastly, an inter-institutional balancing strategy is the practice of supporting or creating new institutions in order to balance against existing institutions and can be either inclusive or exclusive in nature.[76] His argument concludes that an order challenger, such as China, will utilize both inclusive and exclusive institutional balancing to gain international legitimacy and maximize its power in a new world order.[77] In contrast to an order defender, like the United States, is likely to practice exclusive institutional balancing strategy.[78] According to He's and Feng's argument, the AIIB is China's tool to employ "soft power" via inclusive institutional balancing in response to the United States' "pivot to Asia" policy.[79]

Tang offers a broad set of hypotheses regarding Chinese challenges to the liberal international order. According to Tang, China may challenge the existing international order in three ways. First, China can become a revolutionary state and fundamentally restructure the order to better accommodate Chinese interests (revisionist). Barma, Ratner, and Weber's argument that China is creating a world without the West falls under this hypothesis. Second, China believes the existing order is mostly acceptable but needs Chinese leadership to readjust the order to better serve the needs of developing countries (reformist). Third, the current world order is largely satisfactory and only requires fine-

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74 Kai He and Huiyun Feng. "Game of Institutional Balancing: China, The AIIB, and The Future of Global Governance," *RSIS Working Paper*, (May 2018): 1-20

75 Kai He and Huiyun Feng.

76 Kai He, "Role Conceptions, Order Transition and Institutional Balancing in the Asia-Pacific: A New Theoretical Framework," *Australian Journal of International Affairs* 72, no. 2 (March 4, 2018): 92–109, https://doi.org/10.1080/10357718.2018.1437390.

77 He and Feng, "Game of Institutional Balancing: China, The AIIB, and The Future of Global Governance."

78 He, "Role Conceptions, Order Transition and Institutional Balancing in the Asia-Pacific."

79 Lai-Ha Chan, "Soft Balancing against the US 'Pivot to Asia': China's Geostrategic Rationale for Establishing the Asian Infrastructure Investment Bank," *Australian Journal of International Affairs* 71, no. 6 (November 2, 2017): 568–90, https://doi.org/10.1080/10357718.2017.1357679

tuning via multilateral cooperation between the West and other non-Western countries that will lead to the reshaping of this order (status quo).[80] The latter two hypotheses would be consistent with Ruggie's argument regarding the possibility of norm-governed change in world politics.

In concurrence with Tang's second and third hypotheses, Ikenberry and Lim surmise two possible ways in which China can challenge the LIO and reduce the outsized U.S. influence within the broader economic system. First, China takes primary leadership roles over major multilateral institutions in the form of increased voting rights in the IMF and the World Bank, as well as promoting the AIIB over ADB (inclusive institutional balancing). From this leveraged position, Beijing can oversee substantial operations in the world's most dynamic economic region. Second, China demonstrates an "exit" option through AIIB, which gives Beijing the credibility to threaten withdrawal from global financial institutions if its demands for greater formal authority are not met (inter-institutional balancing).[81]

According to Stephen and Skidmore, however, Tang's third hypothesis is most accurate. In their view, the creation of the AIIB primarily addresses China's dissatisfaction with the functional deficiencies of long-established institutions such as the IMF and the World Bank. AIIB is unlikely to substantially challenge the LIO due to the bank's membership composition that constrains Chinese influence over key AIIB lending decisions. Furthermore, the AIIB has largely conformed to date to existing norms and regulations already established in the international Multilateral Development Bank (MDB) structure, making the normative divergence between China and the LIO less pronounced.[82] In other words, the normative structure of the liberal international order has shaped the development of the AIIB to conform to liberal principles. Similarly, Ikenberry and Lim

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[80] Tang, "China and the Future International Order(s)."

[81] G John Ikenberry and Darren J Lim, "China's Emerging Institutional Statecraft," *Project on International Order and Strategy at Brookings*, April 2017, 17–29.

[82] Stephen and Skidmore, "The AIIB in the Liberal International Order."

conclude that AIIB's operation is trending in favor of the existing order due to the effective counter-hegemonic constraints within the current liberal international system.[83]

On the other side of this debate is Suisheng Zhao, who argues that the rise of a strong China has increased China's intent to delegitimize U.S. presence in East Asia.[84] Beijing has promoted a China model of state capitalism contrary to the Western market-driven capitalist system. Most importantly, President Xi Jinping has challenged U.S. leadership by launching China-led regional initiatives, such as the AIIB, as direct competitors to the U.S.-led international institutions such as the World Bank and the IMF.[85] In addition to the AIIB, President Xi's global infrastructure development project, BRI, is vaguely reminiscent of the U.S. Marshall Plan, albeit with Chinese characteristics. Zhao's argument falls relatively in line with Tang's first hypothesis and Barma, Ratner, and Webster's approach discussed earlier.

Chan argues that China's effort to establish and build BRI and the AIIB is part of China's strategy to create a Eurasian zone of economic influence in order to offset the vast and entrenched influence of the United States. Through the interlinked economies and infrastructures of BRI, China can gain additional leverage to enforce economic and security cooperation in the Eurasian region. Through AIIB, China has engaged in negotiations with other member states in setting the rules and norms of the institution. In addition to reshaping international rules and norms, China is also building a way to gain international prestige and confidence in taking on leadership roles and responsibility within the international community. This status symbol can arguably be one of Beijing's top priorities as power is not only supported by material resources but confidence, trust, and influence as well. Through Chinese-led multilateral economic institutions, China can attempt to rebalance the distribution of power from the inside by creating new norms that are more suitable to China and other developing countries or challenging existing norms that have been more favorable to the West, in line with realist arguments. Additionally, in creating

[83] Ikenberry and Lim, "China's Emerging Institutional Statecraft."

[84] Zhao, "Engagement on the Defensive."

[85] Zhao.

alternative institutions and infrastructure, Beijing can wield considerable influence over the behavior of member states, while at the same time, leveraging it against potential adversaries.

Sino-American economic competition is being increasingly institutionalized, especially in East Asia. The Free Trade Area (FTA) networks (i.e., Regional Comprehensive Economic Partnership, U.S.-Korea FTA, and the Asia-Pacific Trade Agreement) are competing regional economic networks that, by design, include one major power while excluding the other.[86] This is reflective of He's institutional balancing theory in which China, an order challenger, practices inclusive and exclusive institutional balancing by initiating or supporting the AIIB, BRI, and the Shanghai Cooperation Organization; while the United States, an order defender, practices exclusive institutional balancing against a rising power by excluding itself from joining the AIIB.[87] Ultimately, the crux of the China challenge to the LIO is domestic. Beijing aims to return the world order to one resembling the post-1945 Westphalian embedded liberal order, while rejecting the post-Cold War anti-pluralist order that supports interventionism over state sovereignty. The biggest threat to U.S. dominance is the formation of alternative institutions that are making the world more favorable to China's authoritarian system, leading to a slow deterioration of Western liberal and democratic values.

D. LITERATURE REVIEW CONCLUSION

Despite contending interpretations of the LIO and the challenges facing it, the overarching factor that ties these three key areas of literature together is the core understanding that emerging powers have upset the current distribution of power, which is shifting the center of economic gravity away from the West. Ultimately, the aforementioned literature helps to outline the following:

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[86] Jae Chung, "The Rise of China and East Asia: A New Regional Order on the Horizon?" *Chinese Political Science Review*, Vol. 1, (March 2016): 53.

[87] He, "Role Conceptions, Order Transition and Institutional Balancing in the Asia-Pacific."; The Trump administration signed an executive order withdrawing the United States from the TPP in January 2017. Other signatories of the TPP reached an agreement to go ahead without the United States in July 2017. By March 2018, 11 countries signed a free-trade deal called the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) in Santiago, Chile.

1. The “liberal” definition of the Liberal International Order is not static, making the existence and durability of the LIO itself debatable; and

2. The emergence of multiple rising powers (not just China) has created tension within the current system by threatening to change or reshape the world in some form or another, primarily through economic institutions and security cooperation.

Whether this shift in the center of gravity will result in a new form of international ordering system is up to debate, and the goal of this thesis is to add clarity to this discourse.

Overall, the pieces of literature in the review section allude to the degree to which these Chinese-led initiatives have broadly conformed to or challenged liberal norms. Given the relatively new existence of Chinese-led economic initiatives, the norms and practices of these institutions and the resulting implications on the LIO are, so far, understudied and subjected to a large amount of speculation. Therefore, this thesis will attempt to add to the current literature by empirically examining Beijing’s use of the AIIB, BRI, and the internationalization of the RMB to assess how destructive to the LIO Chinese behavior is in practice.

For the purpose of this research, I will use Simpson’s concept of Charter liberalism as the definitive characterization of the LIO and the basis of analysis: a pluralist-type liberalism that encompasses multilateral institutions and gives all states equal rights in a liberal society (i.e., domestic jurisdiction, equality, non-intervention) and tolerates the diversity produced by these norms.[88] These criteria are a lower bar than Ikenberry’s U.S.-led anti-pluralist international order, but more similar to Ruggie’s definition of Westphalian embedded liberalism.

[88] Simpson, “Two Liberalisms.”

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III. ASIAN INFRASTRUCTURE INVESTMENT BANK

In 2013, President Xi Jinping announced the launch of the Asian Infrastructure Investment Bank (AIIB) as part of China's initiative to boost economic connectivity in the Asia-Pacific region and as a regional financing mechanism for BRI.[89] AIIB is a multilateral development bank (MDB) that has disbursed $4.2 billion in financing since the start of its operations in 2016. Figure 1 depicts AIIB's size and scale and the global reach of its development financing projects.

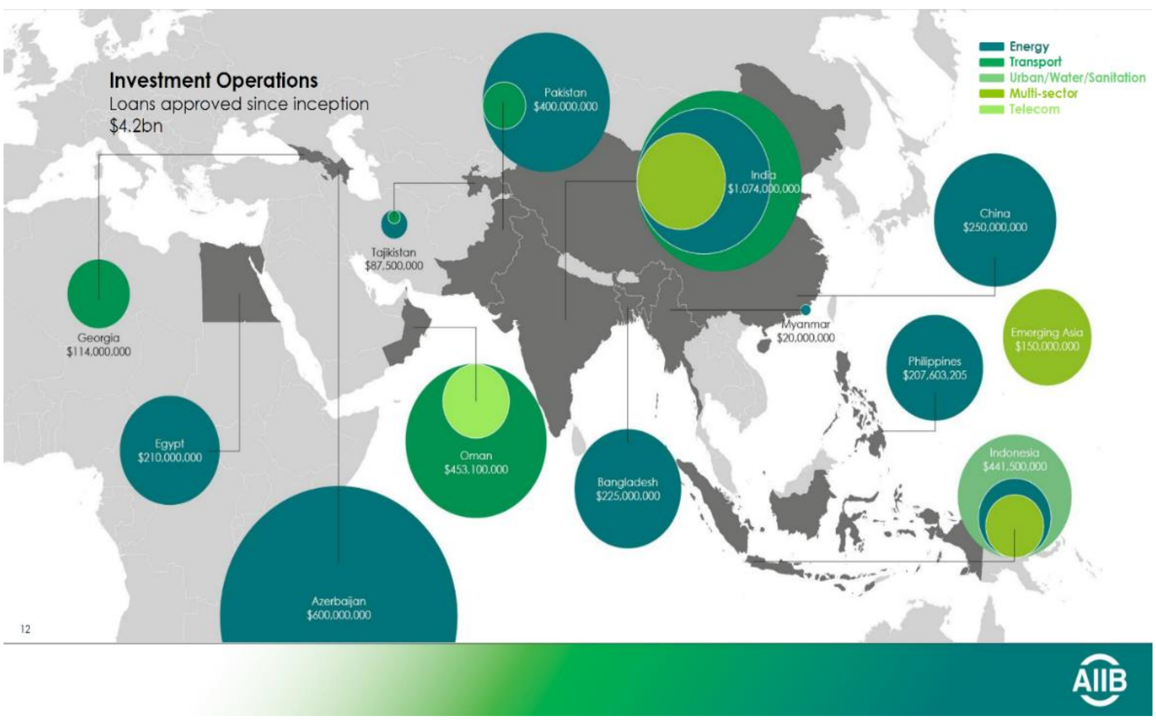

Figure 1. AIIB Investment Operations[90]

[89] Martin A Weiss, *Asian Infrastructure Investment Bank (AIIB)*, CRS Report No. R44754, (Washington, DC: Congressional Research Service, 2017), https://fas.org/sgp/crs/row/R44754.pdf

[90] Source: Asian Infrastructure Investment Bank, "Asian Infrastructure Investment Bank, Update January 2018."

Since 2016, AIIB has evolved into a multilateral financial institution with over 70 member states and 27 prospective members (as of June 2019).[91] With $100 billion in authorized initial capital, the AIIB can provide significant contributions to closing the infrastructure financing gap, not only in Asia but throughout the world. However, many observers view the AIIB as a direct effort to challenge the United States for international political and economic power.[92] Many have argued that China is seeking to create a competing alternative to the World Bank and the Asian Development Bank (ADB).[93] In addition to the potential challenges it poses to U.S. leadership within global development financing, many policymakers also fear that Beijing will use AIIB as a tool to advance its own strategic interests.[94] Most notably, the major argument against AIIB concerns the bank's lack of conditionalities that could pose a threat to the current world order, undermining liberal norms and principles upheld by Western institutions.

This research concludes that in comparing the three MDB's (the World Bank, ADB, and AIIB) missions, voting system, leadership and membership criteria, terms of financing, and loan projects—AIIB has primarily displayed status quo characteristics in maintaining neoliberal norms and practices when co-financing projects. However, in non-jointly financed projects, AIIB exhibits reformist tendencies through low-conditionality loans. Therefore, AIIB in general does not pose a significant threat to the current world order as the organization does not compete with existing institutions or promote the spread of illiberal norms to subvert the LIO.

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[91] "Members and Prospective Members of the Bank," Asian Infrastructure Development Bank, accessed June 19, 2019, https://www.aiib.org/en/about-aiib/governance/members-of-bank/index.html

[92] Sabrina Snell, "China's Development Finance: Outbound, Inbound, and Future Trends in Financial Statecraft," *U.S.-China Economic and Security Review Commission*, Staff Research Report, December 16, 2015, 89.

[93] Jamil Anderlini, "China Expands Plans for World Bank Rival," *Financial Times*, June 24, 2014, https://www.ft.com/content/b1012282-fba4-11e3-aa19-00144feab7de.

[94] Snell, "China's Development Finance: Outbound, Inbound, and Future Trends in Financial Statecraft."

A. WORLD BANK, ADB, AND AIIB ASSESSMENT

1. Missions of the World Bank, ADB, and AIIB

Examining the missions of the World Bank, ADB, and AIIB is the first key in understanding how the MDBs compare to each other. Specifically, the core missions reveal that AIIB is more of a complementary investment mechanism to support infrastructure development in the Asia-Pacific region than opposition to existing Western-MDBs. First, the World Bank's core mission:

> The World Bank Group is one of the world's largest sources of funding and knowledge for developing countries. Its five institutions share a commitment to reducing poverty, increasing shared prosperity, and promoting sustainable development.[95]

ADB's core mission:

> The purpose of the Bank shall be to foster economic growth and cooperation in the region of Asia and the Far East (hereinafter referred to as the "region") and to contribute to the acceleration of the process of economic development of the developing member countries in the region, collectively and individually.[96]

From AIIB's Articles of Agreement (AoA):

> 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 addressing development challenges by working in close collaboration with other multilateral and bilateral development institutions.[97]

In general, AIIB and ADB's mission statements are more similar to each other than to the World Bank's. Both AIIB and ADB aim to promote regional economic growth through development. Whereas the overarching goal for the World Bank is to eliminate poverty

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[95] "Who We Are," The World Bank Group, accessed 01 December 2019, https://www.worldbank.org/en/who-we-are

[96] Heath McMichael, "Banking on the Future of Asia and the Pacific: 50 Years of the Asian Development Bank," *Bulletin of Indonesian Economic Studies* 53, no. 3 (September 2, 2017): 359–62, https://doi.org/10.1080/00074918.2017.1432979.

[97] "Articles of Agreement," Asian Infrastructure Investment Bank, accessed June, 19, 2019, https://www.aiib.org/en/about-aiib/basic-documents/articles-of-agreement/index.html

worldwide. To note, although ADB's mission at the signing of its establishing charter was similar to AIIB's, ADB's mission has evolved over time. Specifically, ADB shifted its focus toward poverty reduction in the 1990s. But it did not start with this focus on global poverty reduction originally.[98] All three MDBs focus on sustainable economic development, cooperation, and partnership to advance their agendas.

2. Voting Shares and Veto Power

MDBs' voting share distribution and veto power have a significant role in determining how MDBs operate. The voting and veto structure thus provides insight into what type of relationships, whether multilateral or bilateral, the bank may lean toward and illustrate the hierarchy and power relationship of the member states (if any exists).

The World Bank Group has a weighted system of voting where all members' votes consist of share votes (one vote for each share of capital stock held) plus basic votes. Similarly, ADB members' total voting power consists of the sum of their basic votes and proportional votes. The number of proportional votes for each member is equal to the number of shares of the capital stock of ADB held by that member.[99] AIIB members' voting share is slightly different from ADB's and the World Bank's. AIIB members' total voting power is the sum of basic votes, share votes, and founding member votes.[100]

Although the voting share calculation for AIIB is similar to the World Bank and ADB, the major difference is that AIIB founding members get an additional allocation of 600 votes.[101] Additionally, basic votes only constitute up to only 5.5% of the World Bank (IBRD) voting share, in contrast to AIIB's 12%. The increased basic voting shares give developing countries more sway within AIIB. According to Stephan and Skidmore, this gives more voice and a much larger role to poorer member states in the AIIB than in other

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[98] McMichael, "Banking on the Future of Asia and the Pacific."

[99] "Annual Report 2018: Members, Capital Stock, and Voting Power," Asian Development Bank, 31 December 2018, https://www.adb.org/ar2018

[100] "Asian Infrastructure Investment Bank, Update January 2018," Asian Infrastructure Investment Bank, last modified January 2018, https://www.aiib.org/en/index.html

[101] Asian Infrastructure Investment Bank, "Asian Infrastructure Investment Bank, Update January 2018."

MDBs.[102] Arguably, this type of voting distribution makes AIIB more representative and democratic than existing MDBs.

In comparison, China's representation within the World Bank (IBRD) is not commensurate with its global economic contributions, as it only holds 4.53% versus Japan's 7.02% and the United States' much larger voting share portion of 16.28%[103] According to the World Bank data, China is responsible for approximately 16.3% of global GDP (nominal), Japan for 5.95%, and the United States for 24.8% as of 2019.[104] Although China's share of global GDP is almost three times Japan's, China has less voting power in the World Bank than Japan does. Similarly, within ADB, China's shareholding is at 6.4%, compared to that of Japan and the United States, which is at 15.6% each.[105]

This discrepancy between China's voting share and economic power in major MDBs is noted in a CRS report on the *2018 World Bank Capital Increase Proposal*, "Despite its increase in voting power, China's World Bank voting power remains well below its share of the global economy."[106] Table 2, taken from Xie and Han's 2019 research, depicts voting shares of the United States, Japan, Germany, the United Kingdom, France, and China at major global financial institutions. Specifically, China's voting shares are generally the lowest within the four organizations making up the World Bank: The International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), the International Finance Corporation (IFC), and the Multilateral Investment Guarantee Agency (MIGA). The only exception is within the IBRD, where China has more shares than the United Kingdom, Germany, and France.

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[102] Stephen and Skidmore, "The AIIB in the Liberal International Order."

[103] *Martin A. Weiss, 2018 World Bank Capital Increase Proposal*, CRS Report No. IF10895 (Washington, DC: Congressional Research Service, 2018), https://fas.org/sgp/crs/misc/IF10895.pdf

[104] The World Bank, "GDP (Current US$,) accessed 1 December 2019, https://data.worldbank.org/indicator/NY.GDP.MKTP.CD

[105] "Shareholder," Asian Development Bank, accessed June 19, 2019, https://www.adb.org/site/investors/credit-fundamentals/shareholders

[106] Weiss, 2.

Table 2. Voting Shares at Major Global Financial Institutions (% of Total).[107]

	U.S.	Japan	Germany	UK	France	China
IMF	16.52	6.15	5.32	4.03	4.03	6.09
IBRD	16.28	7.02	4.11	3.85	3.85	4.53
IFC	20.99	6.01	4.77	4.48	4.48	2.30
IDA	10.30	8.42	5.44	6.33	3.80	2.19
MIGA	15.02	4.22	4.20	4.03	4.03	2.64

China's original intention was to contribute 50% of AIIB's capital, which would equate to Beijing having absolute veto power on any issues requiring a simple majority. However, after more countries became founding members, China reduced its shares to 30% and voting rights to 26.61%.[108] Both emerging economies, such as Russia and India, and developed economies (e.g., five members of the G7 except the United States and Japan) are members of AIIB. Distribution of total capital shares is divided into 75% for regional members and 25% for non-regional members, ensuring that regional members' interests are represented while at the same time enhancing international support.

Notably, Beijing holds blocking power only on issues that require a supermajority vote (e.g., Presidential elections, increase in capital stock and member capital subscription, amendments to the Articles of Agreement, and revision to the composition of the Board of Directors).[109] Within the World Bank, the U.S. holds the singular veto power with a voting percentage at 15.68% (China's voting power is at 4.37%).[110] The United States also holds veto power over the World Bank's most important decisions (i.e., those requiring 85% majority), which is similar to China's veto power against supermajority (at least 75%

[107] Tao Xie and Donglin Han, "In the Shadow of Strategic Rivalry: China, America, and the Asian Infrastructure Investment Bank," *Journal of Contemporary China*, April 2, 2019, 1–16, https://doi.org/10.1080/10670564.2019.1594104. Source: World Bank voting shares, http://www.worldbank.org/en/about/leadership/votingpowers (accessed 19 June 2019); Note: IBRD: International Bank for Reconstruction and Development; IFC: International Finance Corporation; IDA: International Development Association; MIGA: Multilateral Investment Guarantee Agency.

[108] Asian Infrastructure Investment Bank, "Asian Infrastructure Investment Bank, Update January 2018."

[109] Asian Infrastructure Investment Bank, "Asian Infrastructure Investment Bank, Update January 2018."

[110] "IBRD Country Voting Table," the World Bank, accessed June 19, 2019, http://pubdocs.worldbank.org/en/795101541106471736/IBRDCountryVotingTable.pdf

majority) voting decisions.[111] Notably, China has chosen to limit its own veto power within the AIIB. Unlike the United States, which has the ability to change the special majority to retain its veto power. China has chosen a "fixed" special majority method where no country is allowed to change the special majority in the AIIB, as new members join and reduce China's overall voting share.[112] Arguably, comparing China's membership structure with the United States, Beijing is mostly following Washington's prior established norm in terms of veto power and voting shares, but with the added restriction on its own influence within the AIIB.

3. Governance and Leadership Structures

AIIB's structure, governance, and operating procedures are also reflective of existing liberal MDBs since many of AIIB's policies were either copied or jointly crafted with ADB and the World Bank.

The World Bank's Board of Governors consists of one governor and one alternate governor appointed by each member country. The board is the senior decision-making body according to the World Bank's Articles of Agreement (AoA). However, the board delegates most decision-making powers to the Board of Directors. Executive directors are appointed or elected by the governors—the current Board of the World Bank Group consists of 25 directors. The executive directors select the World Bank President, and the President sits as the Chairman of the Board of Directors. However, the president has no vote except as a tie breaker in board decisions.[113] ADB's governance structure mirrors the World Bank's system. ADB also has a Board of Governors composed of one representative from each member nation, a 12-member Board of Directors elected by the governors, and a president.[114]

[111]"Asian Infrastructure Investment Bank, Update January 2018," Asian Infrastructure Investment Bank, https://www.aiib.org/en/about-aiib/basic-documents/_download/AIIB_IR-Presentation.pdf

[112] He and Feng, "Game of Institutional Balancing: China, The AIIB, and The Future of Global Governance."

[113] "Boards of Directors," The World Bank, accessed 1 December 2019, https://www.worldbank.org/en/about/leadership/directors

[114] "How We're Organized," Asian Development Bank, accessed 1 December 2019, https://www.adb.org/about/how-were-organized

Likewise, AIIB's Board of Governors is composed of governors directly appointed by individual AIIB members, also one from each country. According to AIIB's AoA, all powers of the AIIB are also vested in the Board of Governors. The bank's board of directors is composed of 12 directors (nine are elected by regional members with more than 1% voting shares and three elected by non-regional members) that is responsible for the management and operation of the bank. The bank president heads the board of directors but has no voting power. The current president is Jin Liqun from China, but future presidential terms are open for election. The board of governors elects the president, with the only stipulation is that presidential candidates must be from a regional state. The president then recommends prospective vice presidents for appointment by the board of directors.[115] The bank's vice-presidents can come from regional or non-regional members; the current five are from the U.K., India, South Korea, Indonesia, and one representative from the World Bank.[116]

The AIIB's governance structure (board of governors, the board of directors, and management team) mostly mirrors that of the ADB and the World Bank.[117] The only major difference is the AIIB has a non-resident board of directors. This difference is significant because the principal role of the board is to provide oversight of the management team, ensure that the bank represents the interests of its shareholders, and improve the transparency of the bank for all stakeholders. For example, the resident board of ADB represents 67 country shareholders, has daily contact with the management team, and can influence the development of projects and policies.[118] However, the AIIB's non-resident board is a potential issue because it reinforces the perception that the bank is under Beijing's central control, inhibits transparency and accountability over management of

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[115] Asian Infrastructure Investment Bank, "Asian Infrastructure Investment Bank, Update January 2018."

[116] Alice De Jonge, "Perspectives on the Emerging Role of the Asian Infrastructure Investment Bank," *International Affairs* 93, no. 5 (September 2017): 1061–84, https://doi.org/10.1093/ia/iix156.

[117] "How We are Organized," Asian Development Bank, accessed June 19, 2019, https://www.adb.org/about/how-were-organized; "Leadership," the World Bank, accessed June 19, 2019, http://www.worldbank.org/en/about/leadership

[118] Robert M. Orr, "Why the Asian Infrastructure Investment Bank Needs Resident Directors," *China Dialogue*, August 23, 2016, https://www.chinadialogue.net/article/show/single/en/9206-Why-the-Asian-Infrastructure-Investment-Bank-needs-resident-directors

projects, and limits civil society groups' access to the management team, which is typically facilitated by a resident board.[119] At this point, it is too early to say how a non-resident board may affect the overall management of the bank.

4. Loan Conditionality, Transparency, and Terms of Financing

Lending provided by international financial institutions (IFIs) are generally associated with high conditionally requirements—the World Bank in particular. However, conditionalities are not restricted to IFIs as they have been used by many donor countries as a precondition to receive development aid, by the EU to expand membership,[120] and by USAID to promote privatization efforts in aid recipient countries.[121] According to Lee Mizell, "The primary justifications for IFI conditionality include protecting the lender's resources (ensuring repayment), preventing avoidance of costly reform (moral hazard) and improving the policy environment to increase the likelihood of aid effectiveness."[122] In general, many IFIs (the World Bank and ADB included) will implement loan conditionalities such as improvements in public sector governance, fiduciary arrangements, public sector reforms, social protection, and trade and economic management.[123] Therefore, Liberals' critique of the AIIB is mostly concerned with AIIB's low loan conditionality lending practices. The argument is that AIIB's low conditionality loans will be more attractive to developing countries. This will reduce the need for developing countries to take on Western-backed loans, which typically require recipient countries to undertake public governance and financial sector reforms, including budget deficit reduction, privatization, market liberalization, and anti-corruption measures to

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[119] Orr.

[120] Lee Mizell, "Conditionality in Practice: Emerging Lessons for Public Investment," *Organization for Economic Co-Operation and Development*, April 28, 2017, 57.

[121] USAID, "20 Years of USAID Economic Growth Assistance in Europe and Eurasia," July 2013, 171. https://www.usaid.gov/sites/default/files/documents/1863/EE_20_Year__Review.pdf

[122] Mizell, 7.

[123] The World Bank, "Review of World Bank Conditionality," (The World Bank, September 2005), http://siteresources.worldbank.org/PROJECTS/Resources/40940-1114615847489/webConditionalitysept05.pdf.

increase the likelihood of loan repayment.[124] Paola Subacchi argues that if AIIB offers divergent investment standards and more lenient terms on its loans, existing MDBs will find it difficult to impose their lending conditions and investment standards on borrowing countries, especially if China's more lenient and forgiving alternative is readily available.[125] This is a direct challenge against existing practices as the AIIB makes lending without political or ideological conditions a new global norm.[126]

On the point of conditionality, AIIB differs drastically from other MDBs. First, AIIB's AoA stipulates that it will take a politically neutral approach to finance loans by affirming "the Bank, its President, officers, and staff shall not interfere in the political affairs of any member, nor shall they be influenced in their decisions by the political character of the member concerned. Only economic considerations shall be relevant to their decisions."[127] Beijing has been very vocal against Western interference in other countries based on human rights, an issue Beijing deems as a strictly domestic concern. China sees the interference as a direct violation of state sovereignty and has espoused a policy of non-interference in the affairs of other countries.

In practice, however, the majority of AIIB's approved projects are led by partner development banks, with the AIIB as the junior partner.[128] In 2016, the AIIB signed Memorandum of Understanding (MoU) on jointly financed projects with both the World Bank and ADB. The agreement outlines parameters of co-financed infrastructure development projects in accordance with the World Bank/ADB's procedures and guidelines, which requires the World Bank/ADB to supervise all co-financed projects.

According to AIIB's 2018 update report, only 26% of approved projects are solely funded by the AIIB, 74% are co-financed with at least one partner from the World Bank,

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[124] Michael Mazarr, Timothy Heath, and Astrid Cevallos, *China and the International Order* (RAND Corporation, 2018), https://doi.org/10.7249/RR2423.

[125] Subacchi.

[126] Subacchi.

[127] "Articles of Agreement," Asian Infrastructure Investment Bank, accessed June 19, 2019, https://www.aiib.org/en/about-aiib/basic-documents/articles-of-agreement/index.html

[128] De Jonge, "Perspectives on the Emerging Role of the Asian Infrastructure Investment Bank."

the International Finance Corporation, ADB, the European Bank for Reconstruction and Development, or the European Investment Bank.[129] Total funding cost for all financing projects is $21.5 billion; AIIB contributes approximately $4.2 billion or 19.5% of total financing.[130] The dominance of co-funded projects reveals that AIIB is willing to cooperate with more established partners and institutions. This is also indicative of AIIB's willingness to accept and adopt norms of existing liberal economic institutions of environmental regulation and financial standards, according to co-financing agreements. Therefore, Subacchi's argument has yet come to fruition as a large part of AIIB's lending projects have been jointly financed with other Western-led MDBs.

Additionally, AIIB has significantly increased its effort to be more transparent in its operations. AIIB has made its financial reports, Environment and Social Framework, and Sustainable Energy for Asia studies readily available online. Moreover, AIIB has also published its AoA, detailed project reports and updates, project goal targets and evaluation, and project safeguard policies available on the bank's main website.

It is possible for the balance to shift toward AIIB-led development projects in the future; however, whether the concern that Beijing will use the AIIB as a tool reflecting China's geopolitical priorities remains to be seen. According to Stephen and Skidmore, "the AIIB has adopted norms, rules, and procedures that are much closer to global standards than those China practices in its bilateral aid programs."[131] The current trend in the development of the AIIB has been more reflective of China's intent to reassure smaller states of China's commitment to multilateral infrastructure development and adherence to transparent international lending standards.

5. Case Studies of AIIB's Financed Projects

The following cases are selected because they are either co-financed with ADB or the World Bank and have reached sufficient level of project completion, or solely financed

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[129] Asian Infrastructure Investment Bank, "Asian Infrastructure Investment Bank, Update January 2018."

[130] Asian Infrastructure Investment Bank, "Asian Infrastructure Investment Bank, Update January 2018."

[131] Stephen and Skidmore, "The AIIB in the Liberal International Order," 80.

by AIIB and has reached a similar level of project completion. In general, the terms of financing between AIIB-financed and jointly financed projects remain the same (e.g., maturity period, interest rate, grace period, etc.) However, AIIB-financed projects have extremely low conditionalities and tend to defer to local government requirements, while jointly financed projects maintain ADB's and the World Bank's loan conditions.

a. Case 1: Indonesia, AIIB, and the World Bank Group

The National Slum Upgrading Project is a $1.7 billion project to improve access to urban infrastructure and services in targeted slums in Indonesia. The project will support the government's program of urban slum infrastructure investments for 154 cities throughout Indonesia. The goal of the project is to improve quality of living and access to quality urban infrastructure for 9.7 million slum dwellers in the country.[132] The project is co-financed by the World Bank, which contributed $216.5 million in addition to AIIB's $216.5 million. The World Bank is the lead co-financier for the project and will administer AIIB's loan on the bank's behalf.[133] AIIB's portion of the loan has a maturity period of 16.5 years, a seven-year grace period, and a standard interest rate for sovereign-backed loans. According to the key covenants within the official project document,

> The Government of Indonesia has assured AIIB and the World Bank that implementation of the project shall conform to all applicable Bank and World Bank policies, including those concerning anti-corruption measures, environmental and social measures, procurement, consulting services, and disbursement, as described in the loan documents.[134]

[132] Asian Infrastructure Investment Bank, "Republic of Indonesia National Slum Upgrading Project" (Asian Infrastructure Investment Bank, June 9, 2016), https://www.aiib.org/en/projects/approved/2016/_download/indonesia/document/approved_project_document_national_slum_upgrading.pdf.

[133] Asian Infrastructure Investment Bank, "Islamic Republic of Pakistan National Motorway M-4 Project" (Asian Infrastructure Investment Bank, June 6, 2016), https://www.aiib.org/en/projects/approved/2016/_download/pakistan-national-motorway/document/approved_project_document_pakistan_national_motorway.pdf.

[134] Asian Infrastructure Investment Bank, 2.

As of July 2019, AIIB disbursement stands at 38.3% and is expected to catch up to the original projections in late 2019.[135] Total disbursement up to December 2019 is projected to reach $115 million. Although the project is behind on achieving outcome targets for 2018, the overall result has been improved access to urban areas, regular solid waste collection, and the establishment of functional task forces for slum alleviation at local government.[136]

b. Case 2: Pakistan, AIIB, and ADB

The National Motorway M-4 (Shorkot-Khanewal Section) Project is a $273 million, 64-km motorway construction project that will link Shorkot to Khanewal, Pakistan.[137] The project will help to build an efficient and safe transport corridor between Islamabad, Faisalabad, and Multan and enhance connectivity between various parts of Pakistan. The M-4 project is co-financed by ADB which contributed $100 million in addition to AIIB's $100 million. ADB is the lead co-financier for the project and will administer AIIB's loan on the bank's behalf.[138] AIIB's portion of the loan has a maturity period of 20 years, a five-year grace period, and a standard interest rate for sovereign-backed loans. The National Highway Authority of Pakistan is the project executing agency. According to the key covenants within the official project document,

> The Government of Pakistan and National Highway Authority have assured AIIB and ADB that implementation of the project shall conform to all AIIB and ADB policies, including those concerning anti-corruption measures, environmental and social measures, and other safeguards, procurement, consulting services, and disbursement, as described in the loan documents.[139]

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[135] Asian Infrastructure Investment Bank, "SBF Project Implementation Monitoring Report, Indonesia: National Slum Upgrading Project" (Asian Infrastructure Investment Bank, July 20, 2019), https://www.aiib.org/en/projects/approved/_download/2016/indonesia_national-slum-upgrading.pdf.

[136] Asian Infrastructure Investment Bank, "SBF Project Implementation Monitoring Report, Indonesia: National Slum Upgrading Project."

[137] Asian Infrastructure Investment Bank, "Islamic Republic of Pakistan National Motorway M-4 Project."

[138] Asian Infrastructure Investment Bank.

[139] Asian Infrastructure Investment Bank, 2.

Although the project met some delays, it was completed in early 2019 and is currently in use.

c. Case 3: Sultanate of Oman and AIIB

The Duqm Port Commercial Terminal and Operational Zone Development Project is a $353.33 million project to improve transport efficiency, strengthened logistic services, and reduce supply chain delivery time for a wide spectrum of industries within the Duqm Special Economic Zone.[140] The project is financed by AIIB without another foreign co-financier. AIIB will contribute $265 million to the project, in addition to the Special Economic Zone Authority of Duqm's contribution of $88 million.[141] AIIB's loan has a maturity period of 25 years, a five-year grace period, and a standard interest rate for sovereign-backed loans.[142] The project's key covenants included deadlines for the establishment of a project review committee and a project steering committee, and required all project activities, to include environmental impacts, are within government regulations according to Omani Laws.[143] As of July 2019, the Duqm Port project implementation is progressing with no major execution issues and is expected to be completed within the original loan closing date.[144]

This case study demonstrates that in projects solely financed by AIIB, the bank's requirements are significantly lower since it defers to local government's regulations and laws as primary. The low conditionality term is applied to all other AIIB-financed projects as well. AIIB loans do not have the additional loan conditionalities required by the World Bank or ADB. However, although China may offer more lenient lending requirements than

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[140] Asian Infrastructure Investment Bank, "Sultanate of Oman Duqm Port Commercial Terminal and Operational Zone Development Project" (Asian Infrastructure Investment Bank, December 8, 2016), https://www.aiib.org/en/projects/approved/2016/_download/duqm-port-commercial/document/20161213051938915.pdf.

[141] Asian Infrastructure Investment Bank.

[142] Asian Infrastructure Investment Bank.

[143] Asian Infrastructure Investment Bank.

[144] Asian Infrastructure Investment Bank, "SBF Project Implementation Monitoring Report, Oman: Duqm Port Commercial Terminal and Operational Zone Development Project" (Asian Infrastructure Investment Bank, July 12, 2019), https://www.aiib.org/en/projects/approved/_download/2016/oman_duqm-port.pdf.

the World Bank's or ADB's, the majority of AIIB's 52 approved projects are co-financed with partner-MDBs.[145] Moreover, the World Bank and ADB have an increase in the number of loan commitments globally.[146] If AIIB's lack of loan conditionality lending poses a challenge to liberal MDBs, then we should see a downward trend in the overall number of lending projects, or a slower growth in the total number of commitments, but this is not the case.

B. CHAPTER CONCLUSION

Beijing is using Chinese-led economic institutions to improve its credibility, legitimacy, and influence to create a new place within the order that is commensurate with China's increased power and capability. China has challenged the U.S. hegemonic ordering system within the LIO with the establishment of the AIIB, and along with it, the externalization of new practices—specifically, low loan conditionality lending. However, China is also largely keeping in practice liberal project requirements, voting systems, and multilateral governance structure that is either a direct copy or almost an exact replication of Western-led MDBs.

Therefore, the overall trajectory of the AIIB's development suggests that China is leaning more toward reformist characteristics in terms of revising certain aspects of the current system that China does not agree with, such as interventionism and neoliberal economic policies but retains many of liberal MDB's practices and norms as well. China also supports other aspects of the LIO that it does agree with, such as state sovereignty and equality, the rule of law, international institutions, and collective problem-solving. However, it does not want a system where democracy, political transparency, and human rights are internationally normative.

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[145]Asian Infrastructure Investment Bank, "Approved Projects," accessed 1 December 2019, https://www.aiib.org/en/projects/approved/index.html

[146] Asian Development Bank, "Asian Development Bank Annual Report 2018: Sustainable Infrastructure for Future Needs," ADB Annual Reports (Manila, Philippines: Asian Development Bank, April 2018), https://doi.org/10.22617/FLS189307; The World Bank, "The World Bank Annual Report 2018" (The World Bank, June 30, 2018), http://documents.worldbank.org/curated/en/630671538158537244/The-World-Bank-Annual-Report-2018.

China's reformist identity is reinforced by the AIIB's position within the larger global financial governance structure. He and Feng posit, "the AIIB is China's first attempt at challenging U.S. leadership in global financial governance. It does not mean, however, that the AIIB will be the rival institution to replace the Bretton Woods Institutions. The AIIB might be more complementary than competitive to these existing institutions."[147] The growing demand for infrastructure development in Asia and China's need to redirect excess capacity also drove the country to create new investment initiatives to fill in the gap left by other developmental banks. According to ADB, "Developing Asia will need to invest $26 trillion from 2016 to 2030, or $1.7 trillion per year, in infrastructure until 2030 to maintain its growth momentum, tackle poverty, and respond to climate change."[148] However, the World Bank and ADB together can only lend about $20 billion per year. Developing countries have also leaned away from existing MDBs due to their slow response, bureaucratic red tape, and high transaction costs.[149] Currently, the infrastructure investment gap is estimated to be at 2.4% of the region's projected GDP for the 4-year period (2016-2020).[150] Since the AIIB is a medium-size development bank among many other MDBs, it is nearly impossible for the AIIB to replace larger MDBs like the World Bank or ADB. Furthermore, the AIIB alone cannot single-handedly meet the global demand for infrastructure. Therefore, the AIIB will most likely continue to cooperate and complement existing development institutions rather than attempt to replace them.

Base on the research evidence, there are still reasons to remain optimistic about the future. Although China displays reformist behaviors, there is still room for negotiation between major powers. While China may create new institutions that challenge the dominance of U.S.-led institutions, the AIIB does not challenge the liberal international order *per se*. China will likely find ways to maintain a significant level of influence within the AIIB, but the bank has also been receptive to outside input, especially inputs by the

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[147] He and Feng, "Game of Institutional Balancing: China, The AIIB, and The Future of Global Governance," 19.

[148] Asian Development Bank, eds., *Meeting Asia's Infrastructure Needs* (Mandaluyong City, Metro Manila, Philippines: Asian Development Bank, 2017).

[149] David Dollar, "The AIIB and the One Belt, One Road," *The Brookings Institution*, Summer 2015, https://www.brookings.edu/opinions/the-aiib-and-the-one-belt-one-road/

[150] Asian Development Bank and Asian Development Bank, *Meeting Asia's Infrastructure Needs*.

member and prospective member countries. This factor is crucial because it gives liberal democracies the opportunity to shape the AIIB to be a complementary infrastructure-development institution, rather than competitive to existing Western institutions. Most importantly, the ability for other nations (apart from the United States) to exert pressure and influence on Beijing and on Chinese-led economic institutions to be more open, transparent, and liberal indicates that the LIO is still powerful and will likely survive the rebalancing of power away from Washington.

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IV. BELT AND ROAD INITIATIVE

In 2013, President Xi Jinping announced the establishment of the Belt and Road Initiative (BRI). BRI is a behemoth infrastructure project with the ambitious goal of making China the world's geopolitical and economic center of gravity, and to stimulate transcontinental economic development by providing much-needed funding for infrastructure throughout the world. The potentially $8 trillion initiative aims to build a vast interconnected network of transportation, energy, and telecommunications infrastructure that connects Europe, Africa, and Asia via three land routes and two maritime transport routes.[151] Figure 2 depicts the size and scale of BRI projects, which span more than 70 participating countries and touch 62 percent of the world's population.[152] The "Belt" portion of the project will link Eurasia by land, while the "21st Century Maritime Silk Road" will link a string of naval ports connecting China with Southeast Asia, South Asia, Africa, the Middle East, and Europe through the South China Sea, the Indian Ocean, and the Mediterranean.[153] BRI will comprise of "hard" and "soft" infrastructure—e.g., seaports, telecommunication, transportation, energy infrastructure, financial integration, and political coordination—all linked to China.[154]

[151] Xin Zhang, "Chinese Capitalism and the Maritime Silk Road: A World-Systems Perspective," *Geopolitics* 22, no. 2 (April 3, 2017): 310–31, https://doi.org/10.1080/14650045.2017.1289371.

[152] Source: Thomas Eder and Jacob Mardell, "Merics Belt and Road Tracker," Merics Mercator Institute for China Studies, updated 28 August 2019, https://www.merics.org/en/bri-tracker/interactive-map, (accessed 10 September 2019)

[153] Nadège Rolland, "China's 'Belt and Road Initiative': Underwhelming or Game-Changer?," *The Washington Quarterly* 40, no. 1 (January 2, 2017): 128, https://doi.org/10.1080/0163660X.2017.1302743.

[154] Rolland, 127.

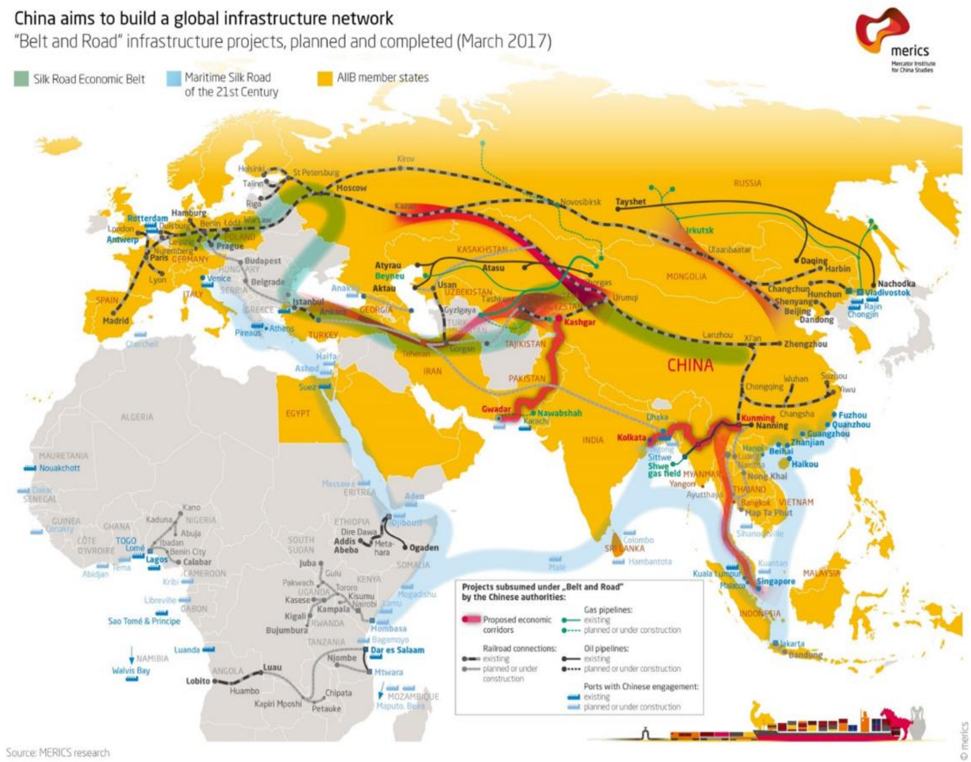

Figure 2. Belt and Road Initiative, Planned and Completed Global Infrastructure Network (2017)[155]

BRI has become an essential part of Beijing's foreign policy as well as a domestic strategy to address China's economic issues; it has the potential to reshape global trade and become one of the defining economic and political projects of the 21st century.[156] Nadège Rolland states, "If the project succeeds as Beijing hopes, it will transform Eurasia's geopolitical landscape and cement China's position as the preponderant regional power."[157]

155 Source: Merics Mercator Institute for China Studies (www.merics.org)

156 Zhang, "Chinese Capitalism and the Maritime Silk Road."

157 Rolland, 127.

President Xi's overarching foreign policy ambition for BRI is to economically bind loan-recipient countries more closely to Beijing.[158] Although local infrastructure projects are generally for public use—meaning the infrastructure would be open for use commercially and would not be restricted to uses permitted by Beijing—the projects would bind participating countries to China through the creation of regional production chains. The initiative would integrate national economies in which China aims to be the center of advanced manufacturing, innovation, and technological standards.[159] For example, BRI has facilitated the relocation of textile and clothing manufacturing from China to ASEAN countries (e.g., Cambodia, Indonesia, Bangladesh, and Myanmar) and the construction of new factories along the BRI corridors—allowing for a more cost-effective production chain.[160] BRI opens up opportunities for low-cost labor and labor-intensive manufacturing to shift to lower-income countries, while also potentially moving China up the value chain, and create a production network of interconnected countries.

Domestically, China is suffering from overproduction and excess capacity in the energy, infrastructure construction, and industrial sectors.[161] As the country modernizes, Beijing hopes to fix the deepening regional disparity between rural and urban development, redirect its chronic excess capacity problem, encourage regional development of much-needed infrastructure projects, and proactively export China's technological and engineering standards to promote the advancement of Chinese industries via BRI.[162]

BRI critics generally advance three major arguments regarding the threat of BRI to U.S. interests. First, critics argue that BRI projects are a part of Beijing's unstoppable, centrally controlled, top-down directed plan to advance Chinese core interests under the guise of addressing global infrastructure problems. Second, BRI opponents argue that

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[158] Peter Cai, "Understanding China's Belt and Road Initiative," *Lowy Institute for International Policy*, March 2017, 26.

[159] Cai, 5.

[160] Man Hin Eve Chan et al., "The Belt and Road Initiative's Impact on Textile and Clothing Supply Chains in Asia: Views from Hong Kong Industrial Stakeholders," *International Journal of Applied Business and International Management* 4, no. 2 (August 20, 2019), https://doi.org/10.32535/ijabim.v4i2.561.

[161] Zhang, "Chinese Capitalism and the Maritime Silk Road."

[162] Cai.

Beijing is practicing "debt-trap" diplomacy, in which China intentionally extends excessive credit to extract economic or political concessions from loan recipient countries that default on loans. Third, analysts frequently compare BRI to the U.S. Marshall Plan—suggesting that BRI will have the same capacity to reshape the world as the United States did in rebuilding the European economy after WWII. They argue that Beijing can leverage China's economic and political power to push foreign policies that are more favorable to Beijing and upset the foundation of U.S. global dominance and the liberal world order.

This research concludes that BRI faces many challenges that may prevent the project from reaching a successful completion, is not exclusively an effort on China's part to wield the "debt trap" tool to gain leverage over loan recipient nations, and is not the same as the U.S. Marshall Plan. However, BRI projects will most likely provide China with significant geostrategic advantages over the long term as regional economies become more integrated and dependent on China's economic power and Beijing's leading role as the facilitator of economic interconnectivity.

A. BRI, THE U.S. MARSHALL PLAN, AND DEBT TRAP DIPLOMACY

1. Challenges to Beijing's Control

One of the primary concerns raised by critics of BRI is that the project is a monolithic, top-down, highly centralized, and therefore actionable plan led and controlled by Beijing. So far, however, BRI activities have been more scattered and opportunistic than centrally planned and guided. Since President Xi's announcement of the initiative five years ago, China's BRI projects have yet to materialize as promised. In reality, BRI projects face five major challenges that may prevent the initiative from achieving real success. These constraints have severely limited the overall level of control Beijing has on the initiative.

The first major challenge for BRI is the size and scale of the initiative. The project spans over 70 participating countries with an estimated $1 trillion in investments pledged by the Chinese government.[163] There are severe limitations in navigating through so many different countries' requirements and divergent standards. The government's effort to coordinate a BRI-wide trade agreement may be more difficult than Chinese bureaucracies can handle, if not impossible.[164]

Second, the initiative lacks administrative coordination and official definition of what qualifies as a BRI project. The BRI "brand" is ever-expanding and extremely ambiguous. This ambiguity undermine any real attempts to create centralized management and planning.[165] The projects may range from fashion shows, art exhibitions, marathons, industrial parks, casinos, and other activities unrelated to infrastructure building.[166] Many Chinese-funded projects that share the same characteristics as BRI projects were also planned for non-BRI participating countries.[167] Statistical analysis conducted by CSIS on 173 BRI infrastructure projects shows that Chinese investment falls as much outside of the officially sanctioned six economic corridors as within them.[168] BRI projects within the proposed economic corridors lack details and clarity.[169] Policymaking and regulation are divided between five state commissions and ministries.[170] Ultimately, BRI is much less coordinated than Beijing hopes and many critics fear.

Third, Beijing faces both internal and external control problems—specifically from international and domestic interest groups. Interest groups both inside and outside China are manipulating and twisting President Xi's foreign policy vision for personal economic

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[163] Jonathan Hillman, "China's Belt and Road Is Full of Holes," *Center For Strategic & International Studies*, September 4, 2018, https://www.csis.org/analysis/chinas-belt-and-road-full-holes

[164] Jonathan Hillman, "China's Belt and Road Initiative: Five Years Later," *Center For Strategic & International Studies*, January 25, 2018, 13.

[165] Yuen Yuen Ang, "Demystifying Belt and Road," *Foreign Affairs*, May 22, 2019, https://www.foreignaffairs.com/articles/china/2019-05-22/demystifying-belt-and-road.

[166] Ang.

[167] Hillman, "China's Belt and Road Is Full of Holes," 6.

[168] Hillman, "China's Belt and Road Is Full of Holes," 6.

[169] Jacob L. Shapiro, "One Belt, One Road, No Dice," *Geopolitical Futures*, January 12, 2017, https://geopoliticalfutures.com/one-belt-one-road-no-dice/

[170] Hillman, "China's Belt and Road Is Full of Holes," 6.

and political gain. Within China, both local and regional interest groups and State-Owned Enterprise (SOEs) at the national levels are incentivized to repackage existing work as supporting BRI, in addition to finding new investment projects under the same veneer, mostly for the political spoils that come with advancing President Xi's signature foreign policy initiative.[171] The allure of self-enrichment and political gains have led opportunists in China toward corruption and abuse of the official BRI brand.[172] Provincial governments are also undercutting each other by offering more and more subsidies for infrastructure projects.[173] Projects predominately emerge from the bottom up, through private company proposals, rather than directed from the top down.[174] The drive to increase profits by private companies has led to unscrupulous business practices and scandals that have been problematic for Beijing.[175] Therefore, it is very likely that both legitimate infrastructure development activities and rent-seeking will continue under the BRI umbrella, further deteriorating the potential for the project to achieve real success.

In addition to conflicting domestic interest groups, the Chinese government has even less control over partner nations. Each country has its own plans for connectivity that may not fit with Beijing's vision, along with customs processes, regulations, rights and other challenges that Chinese officials will have to navigate and coordinate.[176] On the surface, the initiative may seem like a calculated strategic plan with centralized implementation. Structurally, the project is highly fragmented. Any attempt at centralized planning by the state has proven to be a difficult challenge.[177]

Fourth, BRI projects suffer from a significant lack of political trust between participating countries and China. BRI loans create many common challenges for

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171 Hillman, "China's Belt and Road Is Full of Holes."

172 Ang, "Demystifying Belt and Road."

173 Hillman, "China's Belt and Road Is Full of Holes."

174 Shahar Hameiri and Lee Jones, "The Misunderstood AIIB," *The Interpreter,* May 17, 2018, https://www.lowyinstitute.org/the-interpreter/misunderstood-aiib

175 Shahar Hameiri and Lee Jones.

176 Hillman, "China's Belt and Road Is Full of Holes."

177 Shahar Hameiri and Lee Jones.

borrowing states. These seven challenges include 1) erosion of national sovereignty in the form of equity arrangements in many contracts; 2) lack of transparency (in bidding process, financial terms, and contracts); 3) unsustainable financial burdens; 4) disengagement from local economic needs; 5) geopolitical risks through compromise of vital national infrastructure and great power strategic competition; 6) negative environmental impacts; and 7) increased local government corruption (Figure 3).[178]

[178] Daniel Kliman, Rush Doshi, Kristine Lee, and Zack Cooper., "Grading China's Belt and Road," *Center for a New American Security*, April 2019: 1-40.

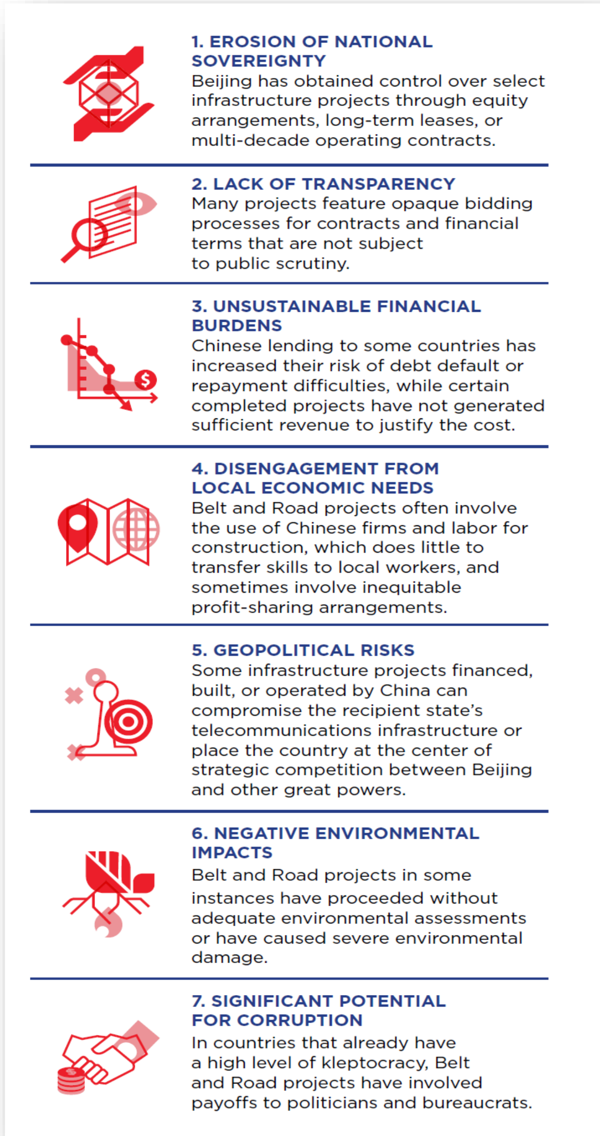

Figure 3. Seven Challenges Created by Chinese Investment[179]

In 2019, CNAS conducted a study of ten BRI loans that spread over seven regions (Latin America, Europe, Africa, the Middle East, South and Central Asia, Southeast Asia, and the Pacific Islands) and cover five infrastructure categories (ports, power, railways,

[179] Source: Daniel Kliman, Rush Doshi, Kristine Lee, and Zack Cooper., "Grading China's Belt and Road," *Center for a New American Security*, April 2019: 2.

pipelines, and digital). The study found that all ten BRI projects surveyed presented significant challenges for the recipient states; all had at least three or more of the seven challenges (Table 3).[180]

Table 3. Chinese Infrastructure Projects: A Snapshot.[181]

REGION	PROJECT	CHALLENGES PRESENT
Latin America	Coca Codo Sinclair Hydroelectric Dam, Ecuador	6 Challenges
	Space Complex, Argentina	4 Challenges
Europe	Budapest-Belgrade Railway, Hungary	3 Challenges
Africa	Facial Recognition Project, Zimbabwe	4 Challenges
Middle East	Haifa Port, Israel	3 Challenges
South and Central Asia	Coal Plants, Pakistan	5 Challenges
	Chinese-Turkmen Pipeline Line D, Tajikistan	4 Challenges
Southeast Asia	Kyaukpyu Port, Burma	7 Challenges
	Jakarta-Bandung High-Speed Railway, Indonesia	3 Challenges
Pacific Islands	Luganville Wharf, Vanuatu	4 Challenges

The most common challenges these cases face are lack of transparency, unsustainable financial burdens, and erosion of national sovereignty. BRI projects strongly favor Chinese contractors over the recipient country's local or foreign contractors, causing the bidding process to be less transparent and less open to local and international competition.[182] According to Hillman,

[180] Kliman et al.

[181] Source: Daniel Kliman, Rush Doshi, Kristine Lee, and Zack Cooper., "Grading China's Belt and Road," *Center for a New American Security*, April 2019: 2.

[182] Hillman, "China's Belt and Road Initiative: Five Years Later."

> Out of all contractors participating in Chinese-funded projects within the Reconnecting Asia database, 89 percent are Chinese companies, 7.6 percent are local companies (companies headquartered in the same country where the project was taking place), and 3.4 percent are foreign companies (non-Chinese companies from a country other than the one where the project was taking place). In comparison, out of the contractors participating in projects funded by the multilateral development banks, 29 percent are Chinese, 40.8 percent are local, and 30.2 percent are foreign.[183]

The lack of competition and transparency means that loan-recipient countries are often stuck with excessive project costs and inferior construction quality.[184]

The Kliman et al. study also suggests that these challenges are not inherent to all foreign infrastructure investment projects, although it is a common feature across BRI projects. The study compared these BRI projects to a similar non-BRI port construction project in Vanuatu. The project involved external powers but created none of the challenges BRI posed to recipient countries. The Port Vila Wharf in Vanuatu was a joint development project by the Japan International Cooperation Agency, Australia Aid, and the Asian Development Bank.[185] According to the study, the project was found to be free of the seven challenges that define China's BRI projects.[186] Notably, the most important conclusion from the study is that recipient countries have the ability to avoid these challenges if the loan-recipient countries negotiate better terms for the loans and properly manage the projects.[187]

As a result of these challenges, many countries have opted to cancel cooperation with China, scaled back the size of construction projects, or sought to renegotiate contract terms. In 2016, Bangladesh canceled a deep-water port project with China in favor of

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[183] Hillman.

[184] Robert Looney, "China's Belt and Road," *Milken Institute Review*, January 3, 2019, 3.

[185] "The Port Vila Lapetasi International Multi-Purpose Wharf Development Project," Ministry of Infrastructure and Public Utilities, Government of Vanuatu, August 2016,https://vpmu.gov.vu/images/newsletter/newsletter_august_2016.pdf.

[186] Kliman et al., "Grading China's Belt and Road."

[187] Kliman et al.

Japan.[188] Nepal canceled a hydroelectric dam project due to cost overruns.[189] In 2018, Burma canceled a dam project and scaled back a port project due to debt concerns.[190] The Maldives renegotiated contract terms after pro-China politicians were voted out of office.[191] Even Pakistan, a close partner of China, canceled a $14 billion dam project to renegotiate the financial terms of a BRI flagship project, the China-Pakistan Economic Corridor (CPEC).[192]

Fifth, on top of growing international resistance and poor administrative control, China may fall victim to the "obsolescing bargain model," in which the investing country loses bargaining power if it overcommits funds and resources in a project.[193] Large, bulky, and semi-permanent infrastructure development programs, like many BRI projects, have zero economic value if left unfinished.[194] Once a project starts, China may be forced to concede to higher demands by borrowing countries if it still wants to recoup any profit. Paradoxically, the BRI may prove to be more of a headache for Beijing than a mechanism through which the country can effectively exercise revisionist intent.

Although BRI may seem like a centrally controlled, heavily directed, and unrelenting Chinese agenda to expand its geopolitical control and influence throughout the world, the project faces many daunting challenges that Beijing may or may not be able to surmount. Given the size and scope of the projects, lack of top-down, centralized planning, internal and external control issues, the pressure to export China's excess capacities, and distrust between countries, BRI may not turn out to be as successful as Beijing would like or as threatening as its opponents fear.

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[188] Kliman et al, 4.

[189] Kliman et al, 4.

[190] Kanupriya Kapoor and Aye Min Thant, "Myanmar Scales Back Chinese-Backed Port Project Due to Debt Fears," *Reuters*, August 2, 2018, https://www.reuters.com/article/us-myanmar-china-port-exclusive/exclusive-myanmar-scales-back-chinese-backed-port-project-due-to-debt-fears-official-idUSKBN1KN106.

[191] Kliman et al, 4.

[192] Kliman et al, 4.

[193] Yasheng Huang, "Can the Belt and Road Become a Trap for China?," *Project Syndicate*, May 22, 2019, https://www.project-syndicate.org/commentary/china-belt-road-initiative-trap-by-yasheng-huang-2019-05

[194] Yasheng Huang.

2. "Debt Trap" Diplomacy

Critics also often advance the idea that China is using BRI and the Asian Infrastructure Investment Bank (AIIB) as a form of coercive "debt-trap diplomacy" in which China is intentionally extending excessive credit to extract economic or political concessions when the debtor country defaults on the loan. In 2018, U.S. National Security Advisor John Bolton's remark concerning U.S. African policy highlighted the debt-trap concern:

> China uses bribes, opaque agreements, and the strategic use of debt to hold states in Africa captive to Beijing's wishes and demands…such predatory actions are sub-components of broader Chinese strategic initiatives, including 'One Belt, One Road'—a plan to develop a series of trade routes leading to and from China with the ultimate goal of advancing Chinese global dominance.[195]

Bolton's concerns largely echo the Trump administration's position on China's foreign policy strategy. The concerns are not unfounded: China's $6 billion BRI loan to Laos for a high-speed rail line construction project was equal to one-third of Laos' annual GDP for 2017.[196] Likewise, the Center for Global Development concluded that eight BRI recipient countries—Djibouti, Kyrgyzstan, Laos, the Maldives, Mongolia, Montenegro, Pakistan, and Tajikistan, shown in red in Figure 4—are at high risk of "debt distress";[197] the figure illustrates the estimated changes in debt-to-GDP ratios resulting from BRI projects and the changes in shares of Chinese debt relative to the country's external public and publicly guaranteed debt.[198] These countries are likely to face unsustainable debt repayment problems in comparison to countries represented with blue arrows. In spite of the risks, Beijing attracts high-risk countries to take bilateral loans from China by offering the

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[195] Abdi Latif Dahir, "The Trump Administration's Africa Policy is All about Countering China's Influence," *Quartz Africa,* December 14, 2018, https://qz.com/africa/1495859/bolton-unveils-trump-africa-strategy-to-counter-china-russia/

[196] The World Bank. *World Development Indicators*. (Washington, D.C.: The World Bank, 2019). http://datatopics.worldbank.org/world-development-indicators/

[197] John Hurley, Scott Morris, and Gailyn Portelance, "Examining the Debt Implications of the Belt and Road Initiative from a Policy Perspective," *Journal of Infrastructure, Policy and Development* 3, no. 1 (March 2018): 1–39, https://doi.org/10.24294/jipd.v3i1.1123.

[198] Hurley, Morris, and Portelance.

"better" alternative to Western loans in three aspects: China is willing to work with any government, provide loans with less social and environmental requirements, and is flexible in negotiating payment terms.[199] Perhaps the most concerning for the United States is that BRI loans do not come with demands for improvements in governance or the business environment as many Western-led MDBs do,[200] which may potentially lead to the slow erosion of neoliberal norms promoted by the West.

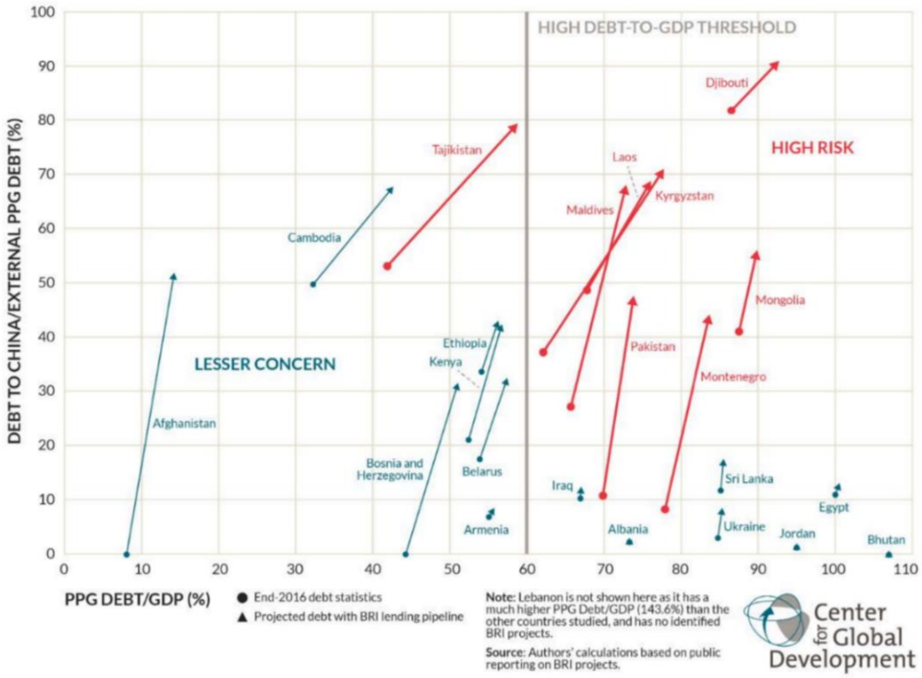

Figure 4. Impact of BRI Lending[201]

The most often cited example of debt trap diplomacy is the Sri Lankan case. In 2017, the Sri Lankan government was unwilling to service an $8 billion loan (bilateral loan at commercial rates) for the construction of the Hambantota Port. The Sri Lankan government later halted the construction of the port, which delayed the port's ability to

[199] Hillman, "China's Belt and Road Initiative: Five Years Later."

[200] Looney, "China's Belt and Road."

[201] Hurley, Morris, and Portelance, "Examining the Debt Implications of the Belt and Road Initiative from a Policy Perspective," 12.

generate revenue. Additionally, the Sri Lankan government initiated debt renegotiations, and China agreed to a debt-for-equity swap accompanied by a 99-year lease for managing the port.[202] Although the Sri Lankan case unleashed a storm of international backlash against BRI, China was able to take control of an important strategic point for the Chinese navy within the Indian Ocean.[203] Beijing may view the Hambantota port swap a worthwhile trade given what seems to be only temporary setbacks in international relations.

However, China has also demonstrated a willingness to extend additional credit to borrowers to help those countries to avoid default. For example, according to Hurley et al., in 2017, Beijing extended a 15 billion RMB swap line to Mongolia for three years in support of an IMF Extended Fund Facility.[204] If Beijing were indeed practicing debt trap diplomacy, China would not have extended the credit swap line and let Mongolia default, which most likely would have forced Mongolia into a debt-for-equity swap. Moreover, China has also extended interest-free loans[205] to Pakistan on top of commercial rate loans (totaling approximately 6.5% of total BRI spending from 2013-2018),[206] indicating China's willingness to help reduce pressure on loan-recipient countries from defaulting on commercial rate loans.

In fact, BRI is less a vehicle for predatory debt-diplomacy lending than an initiative that suffers from mismanagement and lack of foresight by both China and the loan recipient countries. According to a study on China's Maritime Silk Road (MSR) activities and investment in Djibouti, David Styan concludes that debt leverage was not an intentional tool of Beijing's BRI policies.[207] In 2015, the China Railway Construction Corporation negotiated a debt-for-equity swap in exchange for Djibouti's portion of the rail operating

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[202] Jonathan Hillman, "Game of Loans: How China Bought Hambantota," *Center For Strategic & International Studies*, March 2018, 4.

[203] Looney, "China's Belt and Road."

[204] John Hurley, Scott Morris, and Gailyn Portelance, "Examining the Debt Implications of the Belt and Road Initiative from a Policy Perspective," *Journal of Infrastructure, Policy and Development* 3, no. 1 (June 28, 2019): 20, https://doi.org/10.24294/jipd.v3i1.1123.

[205] Hurley, Morris, and Portelance, 4.

[206] Veasna Kong et al., "The Belt and Road Initiative—Six Years On," *Moody's Analytics*, June 2019, 13.

[207] David Styan, "China's Maritime Silk Road and Small States: Lessons from the Case of Djibouti," *Journal of Contemporary China*, July 10, 2019, 1–16, https://doi.org/10.1080/10670564.2019.1637567.

company when Djibouti could not afford to pay for the electrification of the rail lines. However, Styan determines that the Djibouti case "reflects a lack of foresight and adequate planning by both African and Chinese sides"[208] rather than China's desire to use debt leverage to extract political concessions.

Additionally, China is not the only consequential actor in terms of developmental finance, and competition has shaped its lending practices.[209] Although China is often the biggest spender, Japan is outspending China in Southeast Asia and European funders remain dominant in Eastern and Central Europe in independently financed infrastructure projects.[210] As China is not the only game in town, it is forced to compete with and adapt to other actors in the region if Beijing wants to ensure connectivity. Moreover, BRI lending rates are comparable to other infrastructure development banks' rates (such as the European Investment Bank, among many others),[211] which are primarily at or close to market rates. Such market-rate loans offered by Western institutions, including the European Investment Bank and Deutsche Bank, lack political conditionalities just as BRI loans do.

However, critics are right to be concerned about Beijing's intentions. While it is highly unlikely that Beijing is intentionally engaging in debt trap diplomacy, BRI is part of Beijing's more coherent economic statecraft strategy to use its economic clout to advance Chinese presence and influence abroad.[212] This practice poses more of a threat to the U.S. hegemonic order than the "debt trap." The major concern to U.S. interests is that Beijing will leverage BRI, and the growing geopolitical and economic power that comes with the initiative, to advance its diplomatic and strategic objectives—primarily over BRI-participating countries. BRI projects are generally consistent with Beijing's objective to broaden China's geostrategic interests and reach. One prime example is the $62 billion

[208] Styan, 16.

[209] Hillman, "China's Belt and Road Initiative: Five Years Later."

[210] Hillman.

[211] European Investment Bank, *The European Investment Bank in the ACP Countries: Financing Conditions and Instruments.* (Luxembourg: EIB, 2013).

[212] William J. Norris, *Chinese Economic Statecraft: Commercial Actors, Grand Strategy, and State Control* (Cornell University Press, 2016).

CPEC.[213] Both the Chinese and Pakistani governments have enthusiastically promoted the project. The funds for this project will be provided by China through the AIIB and bilateral loans.[214] The corridor will connect Kashgar in Xinjiang province with the Port of Gwadar in Pakistan's Baluchistan province. This port could be used as a transshipment and supply point to meet China's rapidly growing energy demands and removing the need to go through the Strait of Malacca.[215] According to the terms of the loan, the China Overseas Port Holding Company will get a 91 percent share of the revenue of port operations and 85 percent of the revenue generated by the free trade zone.[216] Moreover, the Gwadar commercial port is also deep enough to accommodate submarines and aircraft carriers, possibly to support future naval operations, and further expand China's naval presence.[217] As such, Rolland posits that the,

> increasingly dense and intricate web of regional economic interconnections created by BRI will help alleviate any remaining 'contradictions' between China and its neighbors. As more countries benefit from Beijing's largesse, they will come to realize that common development is more urgent and important than disputing China's interests or challenging its views…[countries] will find it increasingly difficult to challenge Beijing on political issues.[218]

Rolland adds that this acquiescence to Beijing's interests has already begun:

> Eager for Chinese capital, and fearful of provoking a backlash, several comparatively wealthy West European nations have recently scaled back criticism on issues such as human rights, even as their own citizens have been the victims of Beijing's latest crackdown. One can cite as examples the weak French government's response to the expulsion from China of journalist Ursula Gauthier in December 2015 or the more recent December

[213] Gurmeet Kanwal, "Pakistan's Gwadar Port: A New Naval Base in China's String of Pearls in the Indo-Pacific," *Center For Strategic & International Studies*, March 2018, 5.

[214] Kanwal.

[215] Cai, "Understanding China's Belt and Road Initiative."

[216] Kanwal, 3.

[217] Cai, "Understanding China's Belt and Road Initiative."

[218] Rolland, "China's "Belt and Road Initiative," 134.

> 2016 joint statement the Norwegian government signed with China, promising not to support future actions undermining China's interests.[219]

It is likely that China also used its economic leverage to pressure Cambodia, Laos, and Myanmar into blocking the ASEAN stand against China's claims in the South China Sea as well.[220] This is most concerning since Beijing's execution of its economic statecraft strategy has led to actual political concessions and the slow erosion of liberal norms such as human rights. Overall, China is using its economic weight as leverage to gain political concessions—BRI adds to the party's grand strategy. However, Beijing's plan to use BRI to advance its economic statecraft is perhaps not as effective as the party would like due to the lack of centralized government control over most BRI projects.

3. Comparison of BRI and the U.S. Marshall Plan

Many researchers have likened BRI to the Marshall Plan; however, this interpretation of BRI is problematic because it ascribes to it characteristics of the Marshall Plan that do not exist within BRI. BRI is not the U.S. Marshall Plan. Therefore, drawing the conclusion that China will reshape the world as the United States shaped Europe after World War II is erroneous.

First of all, the relatively healthy domestic conditions of aid-recipient countries of the Marshall Plan made the implementation of the plan more successful than for BRI loan-recipient countries. The Marshall Plan was a $14 billion U.S. aid program designed to help rebuild Europe after WWII.[221] According to Huang, the Marshall Plan was so successful because aid-recipient countries were already generally well governed to begin with and aid given through the plan acted only as a stimulus that triggered further growth.[222] Several BRI countries, on the other hand, are plagued by domestic issues, political instability,

[219] Rolland, 134.

[220] Looney, "China's Belt and Road."

[221] Ikenberry, *Liberal Leviathan: The Origins, Crisis, and Transformation of the American World Order*, 198.

[222] Yasheng Huang, "Can the Belt and Road Become a Trap for China?," *Project Syndicate*, May 22, 2019, 3.

corruption, economic volatility, and other governance problems. Two-thirds of BRI loan recipient countries have a sovereign credit rating below investable standard.[223]

Second, the Marshall Plan aid was a collective European undertaking, with the United States giving aid to Europe as a whole to encourage European cooperation and integration, in addition to guarding against any development toward bilateralism, autarky, and political conflict.[224] The Marshall Plan gave Europeans autonomy in how the funds are spent, which eliminated coordination problem for the United States and well as increased the level of control local European governments had on their infrastructure projects.[225] In addition to increasing U.S. soft power through the promotion of multilateralism over bilateralism, the plan was also indicative of the benign nature of U.S. hegemony as the program mainly dispersed aid in the form of non-repayable grants.[226] In contrast, BRI is a principally bilateral initiative that seeks to employ some multilateral mechanisms to attract borrowers. Unlike the Marshall Plan, many BRI loans are issued at close to commercial rates (around 6%)[227], which makes debt sustainability for many countries a major issue. Moreover, there are no indications that BRI loan approval will be contingent on the project's projected ability to make sufficient revenues to meet the debt service requirements, increasing the likelihood of sovereign default.[228]

Third, a comparison between the Marshall Plan's and BRI's guiding documents shows how different the programs are from the start, which likely contributed to how successful the Marshall Plan was in contrast to BRI. BRI projects lack guidance and a clear delineation of responsibilities. BRI guiding document from 2015 to 2017 contains just seven pages of broadly outlined principles such as "guiding ideology," "work objectives,"

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[223] Hurley, Morris, and Portelance, "Examining the Debt Implications of the Belt and Road Initiative from a Policy Perspective," 39.

[224] Ikenberry, 199.

[225] Ikenberry, 205.

[226] Dylan Gerstel, "It's a (Debt) Trap! Managing China-IMF Cooperation Across the Belt and Road," *Center For Strategic & International Studies*, no. 16 (October 17, 2018), https://www.csis.org/npfp/its-debt-trap-managing-china-imf-cooperation-across-belt-and-road.

[227] Hurley, Morris, and Portelance, "Examining the Debt Implications of the Belt and Road Initiative from a Policy Perspective."

[228] Hurley, Morris, and Portelance. 17.

and “safety measures.”[229] The Marshall Plan, on the other hand, was codified into U.S. law under the Foreign Assistance Act of 1948. The 23-page legal document established clear guidelines and delineated lines of responsibilities for the administration of funds, advisory boards, and even compensation for the officials in charge.[230]

Lastly, BRI lacks the same level of support and enthusiasm that the Marshall Plan had from borrowing countries to take on these large infrastructure-building loans.[231] During the period of the Marshall Plan reconstruction, Europe wanted and needed the U.S. dollar in order to finance the rebuilding of European economies and infrastructure. BRI loan recipient countries do not need the loan to the same degree that Europe needed aid during the post-WWII rebuilding period. There is also a lack of international interest in using China’s renminbi (RMB), and BRI has been unsuccessful in promoting RMB-denominated contract. This poses a problem for Beijing as China has a finite amount of U.S. dollar in the reserves. This limited supply of currency puts a restriction on China’s capacity to meet its BRI goals. Specifically, if China’s current account shifts from a surplus to a deficit (as it did in the first half of 2018)[232], Beijing will have a problem financing future BRI projects as it will need the accumulated dollars to pay for its domestic expenditures instead.[233]

Overall, not only are BRI loans different from those granted under the Marshall Plan, but the lending conditions, loan-recipient countries’ domestic circumstances, and the global economic and political environment of BRI and the Marshall Plan are also very different. Therefore, it is unlikely that BRI will be able to successfully reshape the world as the U.S. Marshall Plan had reshaped Europe after WWII.

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[229] Source: https://www.yidaiyilu.gov.cn/wcm.files/upload/CMSydylgw/201702/201702150616033.pdf; Ang, “Demystifying Belt and Road.”

[230] Source: https://www.cia.gov/library/readingroom/docs/1948-04-03b.pdf; Shapiro, “One Belt, One Road, No Dice.”

[231] Hurley, Morris, and Portelance, “Examining the Debt Implications of the Belt and Road Initiative from a Policy Perspective.”

[232] Looney, “China’s Belt and Road.”

[233] Colby Smith, “BRI Dollar Problem.Pdf” (FT Alphaville, December 18, 2018), https://ftalphaville.ft.com/2018/12/18/1545130791000/The-Belt-and-Road-s-dollar-problem/; Looney, “China’s Belt and Road.”

B. WHAT BEIJING CAN ACHIEVE WITH BRI

As research indicates, Beijing's ability to achieve all it has set out for BRI is unlikely; many factors within BRI are not working together in harmony. BRI poses many difficult challenges to the centralization of government control and hinders the CCP from achieving many of the political goals laid out above. However, this does not mean that China will not be able to at least accomplish parts of its goals. In fact, the CCP has shown its ability to adapt to and tackle certain challenges that will help to achieve some of the party's less ambitious goals.

In the face of these challenges, BRI remains at the core of Beijing's foreign policy.[234] Moreover, far from being paralyzed, the CCP has taken measures to counter international criticisms. According to Rolland, some of the countries that had put BRI projects on hold due to debt unsustainability concerns have come back to the negotiating table (i.e., Malaysia, Myanmar, and Nepal).[235] Although many factors with BRI are not working in harmony, the party is very much practicing the oft-referenced Dengism of "crossing the river by feeling the stones." Additionally, at the BRI summit in April 2019, President Xi acknowledged the criticisms against the initiative and declared, BRI is "building high-quality, sustainable, risk-resistant, reasonably priced, and inclusive infrastructure [that] will help countries to utilize fully their resource endowments."[236] Although Beijing's actions may turn out to be different from stated intent, President Xi's acknowledgment does signify an effort to make BRI more aligned with international standards in the hope to gain international acceptance. It is highly unlikely that Beijing will succeed in creating a new Sino-centric, socialist-type political and economic order through BRI; however, Beijing will likely be successful in creating a regional, if not global, network of more integrated economies and pushing Chinese manufacturing and technological standards to the wider international arena. The most likely success Beijing can achieve through BRI, as of current projection, is moving China up the global value chain,

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[234] Nadège Rolland, "Reports of Belt and Road's Death Are Greatly Exaggerated," *Foreign Affairs*, January 29, 2019, 5.

[235] Rolland.

[236] Huang, "Can the Belt and Road Become a Trap for China?"

addressing some of the party's major domestic concerns, and facilitating the growth of economic interconnectivity for BRI-participating countries.

C. CHAPTER CONCLUSION

Although BRI poses a number of challenges to U.S. hegemony, BRI is unlikely to achieve all it has been set out to do. BRI is not the same as the U.S. Marshall Plan, and the projects face many challenges that may prevent it from reaching successful completion. Furthermore, BRI is not exclusively an effort on China's part to wield the "debt trap" tool to gain leverage over loan recipient nations. However, over the long-term, the initiative has the potential to provide China with significant geopolitical advantages as loan recipient countries adopt new norms and rules advanced by Beijing. In particular, many BRI participant countries that were excluded from reaping the full benefits of post-WWII globalization and economic integration (e.g. the Central Asian countries and some parts of South Asia and Southeast Asia)[237] may look to China's BRI as an answer to their development problems. According to Xin Zhang, "China's initiative provide[s] some visions to integrate these economies in a process where China will play a leading role through an open, equal, and participatory manner, thus even heralding new types of world socialist solidarity or new types of internationalism."[238] In other words, BRI embodies Beijing's vision to create a new Sino-centric order that is free of Western neoliberal rules, norms, and values that Beijing views as unfair and obsolete.[239]

Overall, the ambitious goals Beijing has set for BRI cannot be considered status quo, as it looks to make global trade, investment, and infrastructure more Sino-centric. Additionally, BRI loans often violate international lending practices concerning procurement, transparency, and dispute settlement.[240] China has championed lending conditions that are different from Western MDBs such as low loan conditionalities that present a normative challenge to the liberal world order. Therefore, both the reason why

[237] Zhang, "Chinese Capitalism and the Maritime Silk Road."

[238] Zhang, 326.

[239] Rolland, "Reports of Belt and Road's Death Are Greatly Exaggerated."

[240] Gerstel, "It's a (Debt) Trap! Managing China-IMF Cooperation Across the Belt and Road."

and the process of how BRI has been established are more revisionist in nature. However, the likelihood that Beijing will accomplish this revisionist goal is doubtful.

BRI alone is not a threat that can unseat the United States in global dominance. There are potential golden opportunities for the United States to reshape the initiative to minimize possible threats to the U.S. hegemonic order. Additionally, BRI-participating nations can maximize the value of global infrastructure development and economic connectivity. With the right international engagement and management, Beijing's Belt and Road Initiative may turn out to be more of a net positive for global advancement than a zero-sum maneuver to seize power.

V. THE U.S. DOLLAR, RMB CHALLENGE, AND EVALUATION

Deng Xiaoping's economic reforms launched in 1978 propelled China into a spectacular thirty-year ascent to power. The rise of China toward superpower status, along with the relative decline of the United States, has cast doubt on the durability of U.S. preeminence. The stakes are high, as Beijing's push to internationalize the RMB has been viewed by many as a direct challenge to the dollar's hegemonic position within the international financial system. This chapter will look into the factors that propelled Beijing to internationalize the RMB, evaluate the likelihood of its success, and examine how the internationalization of China's currency will alter the LIO. Ultimately, this chapter finds that China's goal to reform the current international financial system in order to lessen the global dependency on the U.S. dollar may prove to be more revisionist than intended.

A. U.S. CURRENCY, POWER, AND PRIVILEGES

At the Bretton Woods Conference in 1944, the United States solidified the U.S. dollar's position as the world's dominant currency, replacing the United Kingdom's pound sterling.[241] The U.S. dollar's favorable position was reinforced through a new multilateral monetary and financial regulatory framework underpinned by the establishment of the International Monetary Fund and the International Bank for Reconstruction and Development (now the World Bank).[242] In addition to having the most widely used currency, the U.S. also became the gatekeeper for the world's most integrated financial system, the Society for Worldwide Interbank Financial Telecommunication (SWIFT) network, which processes the majority of the world's global financial transactions.[243] The global use of the dollar, the United States' control over access to SWIFT, and the dollar acting as the world's reserve currency all contributed to the continuing exceptionalism of the greenback relative to other currencies in the world.

[241] Benjamin J Cohen, *Currency Power* (New Jersey: Princeton University Press, 2015).

[242] Paola Subacchi, *The People's Money: How China Is Building a Global Currency* (New York: Columbia University Press, 2017).

[243] Benjamin J Cohen, "Renminbi Internationalization: A Conflict of Statecrafts," *Department of Political Science, University of California, CA*, June 2017, 20.

Even during financial turmoil, the dollar has been a safe haven for foreign investors. The United States' ability to honor its debt obligations and, most importantly, the faith that foreign investors have in the United States' ability to do so, underpins the dollar's dominance as the leading reserve currency. The U.S. Treasury bill and bond market is also the single largest and most liquid financial market in the world, with the widest variety of assets for investors to choose from—which makes the U.S. financial system nearly impossible for another country to simply replace or replicate. The exceptionalism of the U.S. dollar and dollar-denominated trade contracts give the United States advantages beyond other currencies in the market. First, the United States can keep printing dollars to finance its foreign debt obligations. The willingness of foreign countries to take the U.S. dollar in exchange for their goods, essentially as an interest-free form of IOUs, gives the United States the ability to finance deficits with its own currency—which other countries cannot do without causing massive inflation. Second, the United States can maintain large and sustained current account deficits without concerns of political ramifications or loss of state autonomy—the U.S. has been running large deficits since the 1970s.[244] Third, this relaxed payment constraint indirectly benefits the United States in many other ways. The enhanced borrowing capacity conferred by having a global currency allows the United States to pursue ambitious foreign policy goals through the use of diplomatic, economic, and military instruments: the U.S. can offer side-payments to entice countries, impose costly sanction to punish countries, or finance military spending around the world without the concern of running out of money or risking a payment crisis.[245]

Lastly, in addition to the dollar's domination of the international monetary system, the U.S. government's leverage over SWIFT gives the United States international leverages that other countries do not have. For example, after Russia invaded and annexed Crimea in 2014, the United States, the European Union, and a number of NATO members imposed financial sanctions on Russia.[246] These financial sanctions made it impossible for anyone

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[244] Cohen, *Currency Power*.

[245] Cohen.

[246] Barry Eichengreen, "The Renminbi Goes Global: The Meaning of China's Money," *Foreign Affairs*, April 2017, 14.

to use credit cards issued by Russian banks outside of Russia.[247] The measure was enforceable only because the cards relied on dollar-based payment networks operated by U.S. firms such as Visa and Mastercard. Furthermore, the United States was also able to threaten Russia with exclusion from SWIFT, meaning that Russia would no longer be able to conduct the vast majority of its cross-border financial transactions.[248]

B. INTERNATIONALIZATION OF THE RMB

1. The Motivation

China hopes to similarly benefit from the prestige and privileges that come with having a global currency. According to Paola Subacchi, "China needs an international currency to complete its rise to power, expand its influence in monetary affairs, increase its geopolitical weight, and put it on a par with the United States."[249] Barry Eichengreen describes Beijing's rationale as "[a] first-class country should have a first-class currency."[250] However, beneath this strong national sentiment lie much more practical motives to internationalize the RMB: to reduce China's overdependence on the U.S. dollar, to drive the country toward broader financial reforms, and to insulate China from strategic risks.

Beijing's first key motivation is to reduce China's dependence on the U.S. dollar. The internationalization of the RMB would act as a buffer for China in the event of a massive exchange rate fluctuation of the dollar. Incomplete internationalization makes the RMB an immature currency, defined as a country that cannot lend in their own currencies.[251] Having an immature currency comes with significant limitations. For example, China cannot borrow abroad in their own currency, they can only borrow in hard currencies, such as the dollar—this puts more burden on China as the cost of borrowing

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[247] Eichengreen.

[248] Eichengreen.

[249] Paola Subacchi, *The People's Money: How China Is Building a Global Currency* (New York: Columbia University Press, 2017), 3.

[250] Eichengreen, "The Renminbi Goes Global: The Meaning of China's Money."

[251] Subacchi, *The People's Money: How China Is Building a Global Currency, 88*.

will be higher if domestic currency depreciates.[252] Additionally, China cannot reduce its aggregate exchange rate risk by denominating more of its foreign investments in RMB.[253] As China expands its investments around the world and provides large loans for high risk of default countries, China faces higher risk if the value of its loans drop, on top of the debtor defaulting.[254]

Furthermore, the Asian Financial Crisis of 1997–98 and the U.S. recession of 2008, made Chinese officials increasingly concerned with the developing Asian countries' overreliance on the U.S. dollar.[255] This concern is especially acute for China: its vast amount of dollar reserves, to the tune of $3.1 trillion in 2019,[256] make it vulnerable to sudden shifts in exchange rates.[257] Were the dollar to weaken (or the value of the RMB to appreciate), the total value of China's official reserves—a component of the nation's total wealth—would potentially drop by trillions of dollars. For example, in a 2010 estimate, China could suffer an approximate loss of 1.8 trillion RMB ($256 billion U.S. dollars) in the case of a 10 percent appreciation of the RMB.[258] Additionally, the financial havoc that wrecked major Asian economies unable to repay large foreign loans denominated in U.S. dollars demonstrated to China how overly dependent the world economy is on the dollar.

The second key motivation for Beijing's push to internationalize the RMB is due to the CCP's effort to drive faster and broader financial liberalization and regulatory reforms at home. Pro-reform factions within China want to use the internationalization of the RMB to encourage domestic reforms (otherwise difficult to sell domestically, i.e., freeing up of China's capital account). Chinese officials know that foreigners will embrace

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[252] Subacchi, 90.

[253] Subacchi, 90.

[254] Subacchi, 90.

[255] Benjamin J. Cohen, "Renminbi Internationalization: A Conflict of Statecrafts," *ISA International Conference 2017 Hong Kong,* (June 2017), 6

[256] "China Foreign Exchange Reserves," Census and Economic Information Center, accessed 4 December 2019, https://www.ceicdata.com/en/indicator/china/foreign-exchange-reserves

[257] Xijun Zhao and Song Xiaoling, "RMB Internationalization under the World Financial Crisis: Opportunities and Challenges," *Asia-Pacific Economic Review* 6 (November 2009), 17-22.

[258] Subacchi, *The People's Money: How China Is Building a Global Currency*. Sourced from: http://data.imf.org/?sk=e6a5f467-c14b-4aa8-9f6d-5a09ec4e62a4&sId=1408243036575

the renminbi only if they can buy and sell it freely, which means that Beijing will have to lift the restrictions on foreigners and Chinese citizens who want to conduct cross-border financial transactions in China.[259] The successful internationalization of the RMB would lower Chinese financial institutions' borrowing costs and boost the overseas expansion of Chinese companies and financial institutions. In addition, it further improves China's economic and political position in the world and reduces China's reliance on the U.S. dollar. The wide use of the RMB will also lower the costs of transactions for countries doing business with China. Broad domestic financial regulatory reforms will, in turn, increase the attractiveness of the RMB to foreign investors, which will help to internationalize the RMB even further. The internationalization of the RMB would help to strengthen China's economy and protect it from external manipulation as the RMB would act as a viable currency alternative to the U.S. dollar and the U.S. controlled financial trading systems.

Beijing's third key motivation to internationalize the RMB is to minimize China's strategic risks: encouraging the development of an alternative international payment system based on the RMB, not dependent on U.S. dollars or controlled by the United States, reduces U.S. strategic leverage over China's economy and financial systems.[260] The United States' ability to leverage such influence has added to Beijing's sense that China needs to develop an alternative international payment system not dependent on U.S. dollars or subject to disruption and influence by the United States.[261] An alternative system based on the RMB would give China more freedom to act on its own interests and be less constrained by U.S. influence—adding the RMB to IMF's Special Drawing Rights (SDR) basket is in line with this goal. However, Beijing's decision to include the RMB in the SDR basket and to internationalize the RMB has provoked concerns within the international community. If the RMB supplants the dollar as the international currency, then the U.S. losses its "exorbitant privilege"[262] and the power that comes with having these privileges.

[259] Eichengreen, "The Renminbi Goes Global: The Meaning of China's Money."

[260] Eichengreen, "The Renminbi Goes Global: The Meaning of China's Money."

[261] Eichengreen.

[262] Cohen, *Currency Power*.

2. The Method

China's push to internationalize the RMB is implemented through two main methods: first, adding the RMB to IMF's SDR Basket[263] and second, adopting the two-prong approach of promoting RMB-denominated contracts in international trade and developing offshore financial markets for RMB.[264]

China has argued that Western official development assistance was unable to meet the growing financial needs of developing countries,[265] and the wider use of SDRs will increase investment funds available to poor countries. As the Chinese economy grew larger, Beijing started to lobby for the wider use of the SDRs and more equitable distribution of the synthetic currency. China's stance continued to evolve as the country kept growing in economic power and status. In 2010, the same year that China became the world's leading exporter and in the wake of the Global Financial Crisis, Beijing initiated the first line of effort to internationalize the RMB by applying to enter the RMB into the SDR basket. This gave the RMB the official recognition that the currency is a full member of the international monetary system.[266] The value of the SDR is now based on five currencies—the U.S. dollar, the European euro, the Chinese RMB, the Japanese yen, and the British pound sterling.[267] The RMB was not formally admitted into the basket until 2015.[268]

In addition to adding the RMB into the SDR basket, the PRC has adopted a two-pronged approach to encourage the internationalization of the RMB.[269] The first prong is to encourage domestic and foreign companies to use RMB in their trade settlements.[270]

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[263] The SDR is an international reserve asset, allocated to IMF members to supplement the member countries' official reserves.

[264] Subacchi, *The People's Money: How China Is Building a Global Currency*.

[265] Cohen, "Renminbi Internationalization: A Conflict of Statecrafts."

[266] Subacchi, *The People's Money: How China Is Building a Global Currency*.

[267] "Special Drawing Right," International Monetary Fund, last updated March 8, 2019, https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/51/Special-Drawing-Right-SDR

[268] International Monetary Fund.

[269] Subacchi, *The People's Money: How China Is Building a Global Currency*.

[270] Subbachi 109

Encouraging renminbi-denominated trade settlements is a less risky approach since the settlements can use the merchandise being traded as collateral, which gives Beijing more control than the full liberalization of China's financial markets. When foreign firms receive payments in RMB, they make deposits with local banks, which circulates that money in Chinese financial markets. Trade settlements naturally encourage the use of Chinese money in financial investments.[271] One example is China's and Russia's energy trade agreement. Russia, because of the strategic concerns over U.S. dominance and European sanctions, is looking to expand and find new markets in Asia and other parts of the world. The two countries have signed energy trade agreements that are denominated in rubles and RMB, in addition to establishing a rubles-RMB payment system to facilitate trade and settlement transactions.[272]

The PRC's first prong in advancing the internationalization of the RMB is using different forms of trade and investment settlements such as the BRI, oil futures contracts, currency swaps, RMB bond issuance, and other RMB-denominated investments, which would theoretically increase the use of the RMB worldwide. Most notable among these efforts is the push for RMB-denominated contracts for the construction of BRI projects. The BRI is a part of Beijing's ambition to expand and cement its global influence by building the world's largest trade infrastructure, connecting over 65 countries, and acting as a vehicle to transform the RMB into a powerful global currency. Furthermore, China seeks a better return on capital investment as the country's economic growth is increasingly reliant on such investments.[273] China's capital investment rate is already among the highest in the world at 45 percent; however, despite strong overall economic growth, China's capital return rate is in sharp decline.[274] As of 2019, China owns about $1.1 trillion in U.S.

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[271] Eichengreen

[272] Andrew Galbraith, "China establishes yuan-ruble payment system," *Reuters*, October 11, 2017, https://www.reuters.com/article/us-china-yuan-rouble/china-establishes-yuan-ruble-payment-system-idUSKBN1CH0ML; Georgi Kantchev, "China and Russia are Partners—and Now Have a $55 Billion Pipeline to Prove It," *The Wall Street Journal*, December 1, 2019, https://www.wsj.com/articles/china-and-russia-are-partnersand-now-have-a-55-billion-pipeline-to-prove-it-11575225030.

[273] Zhang, "Chinese Capitalism and the Maritime Silk Road."

[274] Zhang.

Treasury securities, while Treasury rates sit at historic lows.[275] BRI projects have the potential to give China higher returns[276] on their dollar-denominated investments, in addition to creating more opportunities for China to push RMB-denominated contracts. However, the PRC is limited to accomplishing only one thing at a time, as it cannot increase the return on China's dollar holdings and demand contracts in RMB simultaneously. China is forced to choose between one or the other, which creates a dilemma for Beijing in pursuing internationalization of the RMB or advancing BRI projects for higher returns.

Additionally, according to an analysis by British Petroleum, China's demand for crude oil will grow 30.6 percent to 753 million tons per year in 2040 from 462 million tons in 2018.[277] The growth of China's demand for crude oil that can be purchased through renminbi-denominated contracts will increase Beijing's influence over the pricing of crude oil to Asia and decrease China's dependence on the dollar. The Shanghai crude futures contract could also help to increase the exchange market's viability by providing an additional currency option for trade. The Shanghai contract will challenge the petrodollar system (oil deals executed in U.S. dollars) and decrease the demand for the greenback in global financial markets, potentially boosting U.S. inflation.[278]

The PRC's second prong is relying on offshore markets to develop a financial clientele for the RMB.[279] China has designated its Big Four banks to act as an official clearing bank at various foreign financial hubs. Financial centers from London to Singapore have begun encouraging the direct trading of their countries' currencies against

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[275] U.S. Department of the Treasury, *Resource Center*, (Washington, D.C.: U.S. Department of Treasury, 2019). https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/Historic-LongTerm-Rate-Data-Visualization.aspx

[276] Mike Callaghan and Paul Hubbard, "The Asian Infrastructure Investment Bank: Multilateralism on the Silk Road," *China Economic Journal* 9, no. 2 (May 3, 2016): 121, https://doi.org/10.1080/17538963.2016.1162970.

[277] Chen Aizhu, "China December Crude Oil Imports At Second Highest, Gas Imports At Record," *Reuters*, January 13,2019, https://www.reuters.com/article/china-economy-trade-crude/china-december-crude-oil-imports-at-second-highest-gas-imports-at-record-idINKCN1P808A

[278] Kate Duguid, "China Oil Futures Launch May Threaten Primacy of U.S. Dollars: UBS," *Reuters*, March 26, 2018, https://www.reuters.com/article/us-china-oil-futures-dollar/china-oil-futures-launch-may-threaten-primacy-of-u-s-dollar-ubs-idUSKBN1H227E

[279] Subacchi, *The People's Money: How China Is Building a Global Currency*.

the RMB.[280] The two prongs should reinforce each other, the cross-border trade settlement will allow the proceeds of the trade to be held in bank deposits or RMB-denominated assets in offshore markets, and the development of the RMB offshore markets provides a way for foreign investors to invest the RMB through trade. This process would then expand the liquidity of the RMB pool in offshore markets.[281] However, Beijing has not been very successful with this endeavor as foreign investors are reluctant to trade in RMB-denominated contracts or invest in RMB offshore markets.

3. The Roadblocks

So far, Beijing has not made significant headway in its push to make the RMB a globally recognized currency, a widely circulated medium of exchange, or as a trusted store of value—the three functions a global currency must fulfill.[282] China has failed to reach its RMB benchmarks in three main avenues: BRI projects, oil futures contracts, and domestic financial reforms. These benchmark failures have significantly stalled Beijing's drive to internationalize the RMB.

First, the BRI has "a dollar problem."[283] The fundamental difference between the U.S. dollar and the RMB—and perhaps the biggest obstacle for China to achieve its ambition—is that while the world wants and needs U.S. dollars to support its economy, BRI countries do not need or want Chinese RMB.[284] The harsh reality is that BRI contractors prefer to conduct business and get paid in U.S. dollars, and all major lending and recapitalization of funds toward the construction of the BRI have been in dollars—even in Chinese-led development initiatives, the dollar still dominates.[285] According to Smith,

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[280] Subbachi, 109

[281] Subacchi, 109

[282] Colby Smith, "The Belt and Road's Dollar Problem," *Financial Times,* December 18, 2018, https://ftalphaville.ft.com/2018/12/18/1545130791000/The-Belt-and-Road-s-dollar-problem/

[283] Smith, "BRI Dollar Problem."

[284] Mike Bird and Saumya Vaishampayan, "Dominant Dollar Bests Challengers."

[285] Mike Bird and Saumya Vaishampayan, "Dominant Dollar Bests Challengers," *Washington Street Journal*, January 20, 2019, https://www.wsj.com/articles/dominant-dollar-bests-challenger-11547994049

> Given the RMB's limited scope as a global currency, contractors have typically preferred dollars in exchange for their work building the roads, bridges, ports, and more of the initiative…there is an imposed limit to what China can achieve with the BRI. If the RMB was a global currency and the BRI could be funded using the currency, the government could technically print RMB as it saw fit.[286]

As a result, although Chinese officials have touted that BRI will act as a vehicle to transform the RMB into a global currency, the dream has not yet come to fruition six years since the establishment of the BRI.[287] Therefore, the potential for the RMB to take hold over the international currency market within the next 10 years via the BRI is limited at best.

Additionally, Beijing's effort to internationalize the RMB through RMB-denominated crude oil futures contracts also faces serious difficulties due to the lack of demand. Although the Shanghai futures contracts were at a record high in 2018, the futures contract faces the same problem that is characteristic of Beijing's effort to internationalize the RMB—the lack of diverse participants or recognition by international investors.[288] Although RMB-denominated contracts for oil futures have overtaken the Dubai Mercantile Exchange's oil contract, and those of Tokyo and Singapore, the RMB share is trivial relative to the dollar-denominated contracts. Figure 5 shows the comparative market-share size between Shanghai (RMB), West Texas (U.S. dollars), and Brent (U.S. dollar).[289] Furthermore, China's commitment to invest more in renewable energy also reduces oil and gas contracts with Russia.[290]

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[286] Smith, "BRI Dollar Problem."

[287] Smith.

[288] Damon Evans, "Shanghai Shakes Up Global Oil Trading," *Nikkei Asian Review*, October 17, 2018, https://asia.nikkei.com/Business/Markets/Commodities/Shanghai-shakes-up-global-oil-trading

[289] Evans, "Shanghai Shakes Up Global Oil Trading."

[290] Viviana Zhu, "China-Russia Energy Cooperation: Hot or Cold?," *Institut Montaigne*, October 10, 2019, https://www.institutmontaigne.org/en/blog/china-trends-3-china-russia-energy-cooperation-hot-or-cold.

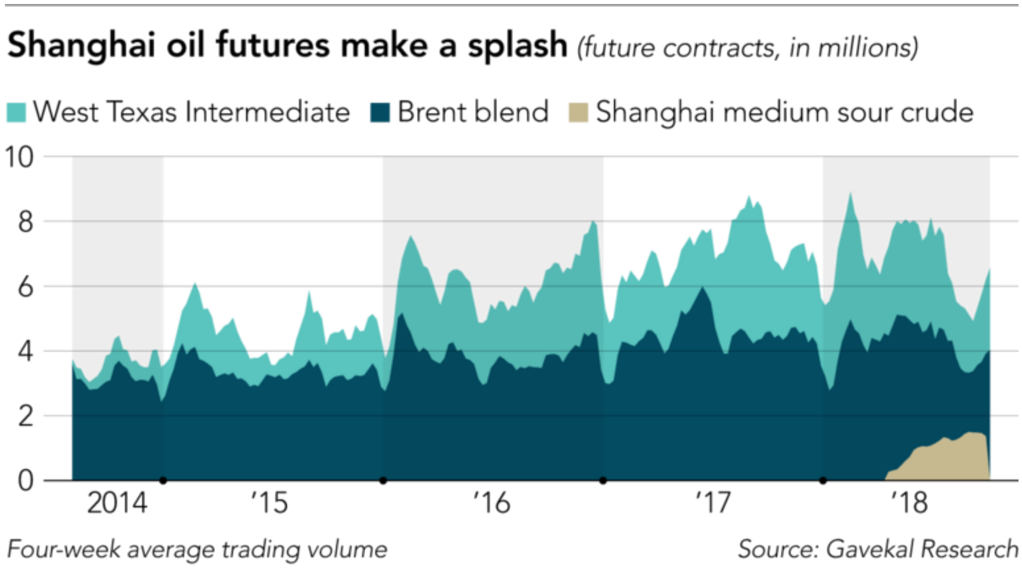

Figure 5. Shanghai Oil Futures Make a Splash[291]

To attract international participants, China must introduce new domestic laws and regulations that will allow the RMB to liberalize and move away from pegged currency. This will ensure that the RMB truly mirrors U.S. dollar value and reassure traders against government initiated foreign exchange risks. However, Beijing has so far been able to adopt reforms only in small increments due to the lack of domestic support for financial liberalization.[292]

Third, resistance from vested interests and the built-in tension between financial liberalization and China's growth model have contributed to the uneven pace of the reform.[293] Primarily, resistance to China's financial reforms comes from domestic vested interest groups. So far, the party faces strong resistance to domestic regulation and financial reforms from SOEs that have benefited from the government's control over interest rates and subsidized credit allocation.[294] Further financial liberalization also challenges broad tenants of the Chinese system given the centrality of the PRC's use of providing

[291] Source: Gavekal Research; Evans, "Shanghai Shakes Up Global Oil Trading."

[292] Cohen, "Renminbi Internationalization: A Conflict of Statecrafts," 5.

[293] Eichengreen, "The Renminbi Goes Global: The Meaning of China's Money."

[294] Cohen, *Currency Power*.

preferential access to financing in order to promote certain SOEs. Additionally, producers also want to keep the value of the RMB low to preserve export competitiveness.[295]

More importantly, the internationalization of the RMB also acts as a double-edged sword: for the Chinese currency to be more internationally recognized, Beijing must loosen its control over the exchange rate and open China to larger and freer capital inflows and outflows. Loosening the government's rein over China's financial markets will further expose the Chinese economy to sporadic fluctuations of the international market. However, not enough liberalization of China's financial market would mean that the RMB will never gain the international popularity that Beijing seeks, constraining China to maintain its dependence on the United States. Additionally, Subacchi points out that Beijing has always relied on state-owned banks to direct credit toward certain industries and enterprises. This model of economic growth will be put under serious strain as the government suddenly lessen its role in directing the economy and its control over the banking sector.[296] The biggest challenge for Beijing is to figure out how to maintain economic growth and political stability during this process of reform.

The preservation of China's economic stability and growth, which is linked directly to the preservation of the Chinese Communist Party's rule, continues to be the predominant factor in Chinese economic policies. Above all else, the party is concerned with China's economic stability and has taken efforts to slow the internationalization of the RMB in fear of creating a financial crisis.[297] Beijing's effort to internationalize the RMB is only to the extent that it will reduce China's overall dependence on the U.S.-backed economic system. The party has remained cautious of rapid liberalization if it would expose China to the risk of a major financial crisis. Therefore, China's efforts to internationalize the RMB have so far been an uphill battle.

[295] Cohen.

[296] Paola Subacchi, The People's Money: How China is Building a Global Currency, 140.

[297] Winni Zhou, Zheng Li, and Andrew Galraith, "China Central Bank Bars Offshore Lending in Latest Move to Support Yuan," August 16, 2018, https://www.reuters.com/article/us-china-yuan-liquidity-exclusive/exclusive-china-central-bank-bars-some-offshore-lending-in-latest-move-to-support-yuan-idUSKBN1L10PO

C. WILL THE RMB RISE TO THE CHALLENGE?

Although the RMB's acceptance into the SDR basket is an important achievement, the true test of the RMB's ability to challenge the U.S. dollar lies in its capacity to become the next global reserve currency. For the RMB to become a true contender of the dollar, China must surrender partial control of its currency, and most importantly, the RMB must be trusted enough by domestic and foreign investors that people will want to use it. Additionally, there are burdens in being a global reserve currency: the issuing country must surrender partial control of its own monetary policy, it must issue a superabundance of currency to lubricate global commerce, and it must be able to endure massive, running trade deficits. As the IMF explains, "If the United States stopped running balance of payments deficits, the international community would lose its largest source of additions to reserves. The resulting shortage of liquidity could pull the world economy into a contractionary spiral, leading to instability."[298] So far, the burden looks like more than China can bear. Therefore, even if the internationalization of the RMB was done offensively to target the economic dominance of the United States, the position of the U.S. dollar still looks very secure for the foreseeable future.

Ultimately, the primacy of the U.S. dollar is not under imminent threat. Faith in the currency is one of the main advantages that RMB-denominated securities do not have, which is highly unlikely to change in the near future. Over the last half-century, the U.S. dollar has faced contenders that seemed, at the time, likely to surpass its leading position in the international monetary system. However, even the strongest competitors—the Japanese yen and the European euro—gradually faded over time.[299] This trend may also be true for the RMB. When the RMB was first added to the IMF's basket of currencies in 2015, it was the world's fifth most-active currency for domestic and international payments at 2.8 percent share of exchanges on SWIFT. By 2018, however, it had slipped to 1.70

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[298] "Money Matters: An IMF Exhibit—The Importance of Global Cooperation," International Monetary Fund, https://www.imf.org/external/np/exr/center/mm/eng/mm_sc_03.htm

[299] Benjamin J. Cohen, "Renminbi Internationalization: A Conflict of Statecrafts," *ISA International Conference 2017 Hong Kong*, (June 2017), 3

percent.[300] The 2018 IMF report also confirms the dominance of the U.S. dollar as the global currency reserves. Since 1996, global central banks have held around 60 percent or more of their reserves in U.S. currency.[301] Additionally, the current instability within the eurozone and the forecasted economic slowdown in China have made the future of the dollar's preeminence in the international financial system safer than ever. If tensions continue to increase during the Trump administration's tariff war, the increased volatility in the RMB exchange rate will make the currency even less attractive to investors.

D. CHAPTER CONCLUSION

The United States derives substantial benefits from having the U.S. dollar as the world's currency. The widespread use and popularity of the dollar add to the United States' ability to exert global influence to achieve its political, economic, and security interests. The dollar's dominance of the international monetary system lowers U.S. borrowing costs and gives Washington additional leverage in the international system by cutting countries and organizations off from the world financial system. In addition to the size of the U.S. economy and its level of trade, the attractiveness of the U.S. dollar lies in the transparency, predictability, and the credibility of the U.S. financial system.[302]

It only makes sense for China, as a growing regional power with ambitions to stand equally among other great powers, to seek ways to reduce its dependence on the United States. Beijing believes that the internationalization of the RMB will allow China to achieve this dream by reducing the country's dependence on the dollar, driving the country toward much-needed domestic financial reforms and insulating China from strategic risks. Although the size of the Chinese economy is large enough to compete with the United States, its currency does not float freely, and China's monetary policy is too opaque for investors to trust. China's dream of the internationalization of the RMB may still be far

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300 Colby Smith, "The Belt and Road's Dollar Problem," *Financial Times*, December 18, 2018, https://ftalphaville.ft.com/2018/12/18/1545130791000/The-Belt-and-Road-s-dollar-problem/

301 Colby Smith, "China's Currency Will Not Replace the US dollar," Financial Times, September 18, 2018, https://ftalphaville.ft.com/2018/09/19/1537329600000/China-s-currency-will-not-replace-the-US-dollar/

302 Colby Smith, "China's Currency Will Not Replace the US dollar," Financial Times, September 18, 2018, https://ftalphaville.ft.com/2018/09/19/1537329600000/China-s-currency-will-not-replace-the-US-dollar/

away, but the will is there, and the trajectory of China's progress may make the RMB a stronger contender over time.

China's motivation to internationalize the RMB is defensive in nature. The push toward a global RMB is done primarily to achieve practical and calculated goals—to strengthen the country so that it may stand equal as a great power. What China strives for is to be strong enough not to be easily threatened by the United States, reducing the possibility of a fear-induced security spiral, rather than an attempt to unseat the current hegemon.

However, in analyzing the internationalization of the RMB and its implication on the LIO, the *how* may be more important than the *why*. Although Beijing is not looking to replace the U.S. dollar with the RMB, it is looking to create a new international monetary system composed of multiple currencies to lessen China's, and consequently the world's, dependence on the dollar—a system that, Beijing believes, is a truer reflection of the world economy, no longer dominated by the U.S.[303] If the influence of the U.S. dollar wanes and greenback no longer remains as the lynchpin of the international market and financial system, the United States may lose the exorbitant privileges that come with being the only true global currency. If the version of a new international monetary system that China envisions becomes a reality, the availability and usage of other currencies in global trade and reserve currencies will threaten U.S. dominance and position within the U.S.-led LIO. However, this new monetary system may be more in line with the pluralistic, Charter liberalism form of the world order. Ultimately, although China's intention to internationalize the RMB is reformist in nature—the consequences may be more revisionist than intended.

[303] Subacchi, *The People's Money: How China Is Building a Global Currency*.

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VI. CONCLUSION AND POLICY RECOMMENDATION

This thesis began by defining the liberal international order and outlining the different explanations of what this order consist of and how durable it is. Although there are many debates concerning the strength, size, and depth of the LIO, the general consensus is that there is some type of order out there. In analyzing Chinese-led economic initiatives, it is important to recognize that China may choose to adopt certain aspects of the order and reject other aspects of it. These aspects subsumed within the LIO can be further divided into suborders (e.g., military, human rights, trade, and the environment).[304] As Alastair Johnston contends, "China interacts differently with different orders, supportive of some, unsupportive of others, and partially supportive of still others."[305] Although we can differentiate between them, these suborders are not truly discrete. In fact, they are intricately interconnected, which makes analyzing how China reacts to different orders even more complex.

This complexity likewise characterizes China's activities in the economic realm, illustrated in Table 4. AIIB rejects neoliberal practices by championing alternative-type loans that do not include foreign intervention in domestic reforms (reflecting reformist intent). However, in practice, because the AIIB is a multilateral organization, it has largely upheld liberal norms and practices by adopting Western lending standards and conditionalities in all co-financed projects (indicating status quo action). The consequences of its actions lean more toward maintaining the current norms and practices of the LIO as it does not significantly deviate from the practices of existing U.S.-led financing institutions (suggesting no change to LIO). In BRI, China aims to create a new Sino-centric economic order and seeks to revise the current system to put itself in a position that Beijing believes is more commensurate with the size of its economic power (indicating revisionist intent); however, the challenges against BRI will most likely permit Beijing to only reform some aspects of the global economic order (causing reformist action), but not replace the

[304] Johnston, "China in a World of Orders."

[305] Johnston.

current LIO with a new Sino-centric one (leading to some change to LIO). Lastly, Beijing is seeking to reform the dollar-dependent international financial system (displaying reformist intent). If the U.S. dollar is replaced by another currency as the international currency and the global reserve, the consequences will be immense. However, it is unlikely that the RMB will replace the U.S. dollar given that the dollar is so deeply integrated with the global economy and Beijing's reluctance to liberalize China's domestic financial markets. Additionally, Beijing has largely followed what other "dollar challengers" have done in the past (suggesting status quo action). Therefore, the overall effects of the internationalization of the RMB have, so far, been largely benign to the durability of the LIO (producing no change to LIO).

Table 4. Intentions, Actions, and Consequences of Chinese-Led International Institutions.

	Intentions	Actions	Consequences
AIIB	Reformist	Status Quo	No change to LIO
BRI	Revisionist	Reformist	Some change to LIO
RMB	Reformist	Status Quo	No change to LIO

Nevertheless, to many scholars and politicians, the establishment of Chinese-led international economic institutions outside of the current Bretton Woods system exemplifies the strategic rivalry between the United States and China. The existing institutions and networks within the LIO do not sufficiently accommodate emerging powers in a way that satisfies their ambitions to have more say in crafting the rules of the system, which has led to the creation of alternative institutions and the "routing around" of the liberal ordering system. According to Zhang,

> [In] a similar fashion that Chinese political elites introduced economic reforms in the 1980s, such a "parallel world" strategy intends to keep the

> old system intact while allowing the new system to grow in tandem. While the two systems do not engage in head-to-head competition directly, the new paradigm may gradually grow to such an extent that the old system becomes increasingly irrelevant.[306]

Likewise, Barma, Ratner, and Weber posit that "the ability for emerging states to create new institutions to bypass the Bretton Woods system—the linchpin of the liberal economic system—is the most insidious threat to the liberal ordering system."[307]

However, Zhang's "increasingly irrelevant" may be too stark of a prediction. The growth of one system or "regime" does not necessarily lead to the decline of another. The U.S. dollar will remain the world's most powerful currency for the foreseeable future, even if the RMB does gain more footing as an international currency—mainly because there is no viable alternative to replace the dollar and the U.S. financial system, which are the linchpin of the global economy. Moreover, there is more than enough need for infrastructure development worldwide. Therefore, AIIB will not replace the World Bank, ADB, or other MDBs as the need for them will continue to grow. Infrastructure projects and loan commitments for the World Bank, ADB, and other Western-led MDBs have been on an upward trend, not downward. And although BRI is, so far, the only "big game" in town as far as global economic infrastructure connectivity, China is not the only country that invests heavily in the region. Consequentially, Chinese bilateral lending is also being shaped by competition from other countries.

Additionally, the threat may not be so insidious as these "alternative" institutions have, in practice, not functioned that differently from existing "liberal" ones. Relationships within AIIB are institutionalized within a multilateral forum. It has, by and large, cooperated with partners and loan-recipient nations largely based on economic interests and not regime types. AIIB has so far operated similarly to institutions like the World Bank and ADB. Although AIIB loan conditionalities deviate from the Western norm, China has not exported illiberal practices, strong state intervention, or autocratic political system to loan-recipient countries through the AIIB engagement. Nor has it shown any lending

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[306] Zhang, 325.

[307] Barma, Ratner, and Weber, "The Mythical Liberal Order."

preferences for non-democracies.[308] In over half of AIIB's approved infrastructure projects, the bank has largely remained status quo in terms of abiding by preexisting norms established by Western-liberal MDBs. Concurrently, China is pushing back against neoliberal practices Beijing views as threatening to its core interests by deviating from Western loan conditionality practices. AIIB is growing through a process of development, changes, and the "growing pains" of being a multinational financial institution, much like other MDBs.

Likewise, with BRI, China is not establishing an "alternative" institution or routing around the old ones—it is making a completely new "regime" altogether. Although BRI is unlikely to achieve all the goals Beijing has set for it, it is a part of China's economic statecraft that can facilitate the expansion of China's economic and political leverage in the future. The internationalization of the RMB so far has followed in the footsteps of other dollar "challengers" (i.e., yen, euro, pound sterling). Definitively, the dollar predominance will remain for the long term, and the United States will continue to enjoy the exorbitant privileges that comes with it.

Determining the trajectory of Chinese-led economic institutions is not as simple as tallying up the number of reformist, revisionist, or status quo checkmarks. Some institutions will undoubtedly matter more than others. Additionally, the existence of Chinese-led international institutions although not a direct threat to the LIO, is a threat to the U.S. hegemonic ordering system within the larger liberal order. Overall, however, based on Table 1, the complete profile of Chinese-led international economic institution points to China being a reformist power (hypothesis 2).

Beijing will neither join the U.S.-led order nor pose a direct challenge to the current liberal world order. It does, however, seek to reform certain aspects of the current order—specifically by challenging U.S. hegemony and the neoliberal dominance within the ordering system. Through Chinese-led international institutions such as AIIB, BRI, and the internationalization of the RMB, China is seeking to modify the existing distribution of power away from the West and more toward China. The AIIB has integrated existing

[308] Johnston, "China in a World of Orders," 35.

templates with new practices that are more aligned with Chinese interests while prioritizing a balancing strategy pursuant of international credibility and legitimacy. Through BRI, China is creating a new type of regional order nested within a reformed global order. Beijing will continue to participate in the global order but offers Chinese alternatives to existing liberal international institutions. Most importantly, although China may succeed in reforming the LIO to be more to its liking, it will still be constrained by the Western liberal system, which will remain as the foundation of the international order. Beijing is readjusting the order to better accommodate the interests of developing countries, with Beijing's interests as primary. China's initiative in establishing AIIB, BRI, and internationalizing the RMB therefore fits largely within He's and Feng's inter-institutional balancing theory. In short, Beijing is taking the lead in creating new developmental institutions to counterbalance U.S. dominance, but not to destroy the broader LIO.

In recent years, American views have grown increasingly antagonistic toward China—for many good reasons. Intellectual property theft cyber espionage, trade wars, maritime disputes, single-party authoritarianism, and human rights abuses have only reinforced these antagonistic views. Some politicians, believing in the inevitability of an existential clash between China and the United States, call for the U.S. to start the process of decoupling the two economies and to disengage wherever possible to protect and insulate America from the Chinese threat.[309]

However, "decoupling" U.S.-China relations will hurt the United States more than help it. There are areas where the United States needs to protect itself—against predatory practices, cyber espionage, and intellectual property theft. However, to decouple from the world's largest manufacturer and trader is a risky proposition. There are enormous gaps in global infrastructure and economic development, and China is looking to fill in the gaps. Through engagement, the United States can influence the way Chinese-led institutions fill in these gaps. Therefore, there is no advantage for the United States to decouple from China as the rest of the world is coming closer together. Additionally, the United States should

[309] Jonathan D Pollack and Jeffrey A Bader, "Looking before We Leap: Weighing the Risks of US-China Disengagement," *Brookings Institution*, July 2019, 12.

further increase its active engagement within current U.S.-led institutions such as the World Bank by providing better alternatives for developing countries through increasing foreign infrastructure development programs. This will provide developing countries access to Western-standard loans that promote improved domestic governance, anti-corruption measures, and higher environmental protection standards.

Ultimately, a reformist China means that there is still room for negotiation between the current power, the rising power, and the rest of the world. U.S. policymakers must learn to look at the competition in a new light. Competitors are not de facto enemies. According to capitalist ideology, more diversity means more competition, which means more push toward reforms that will make current institutions more streamlined, responsive, and efficient to developing countries. If the U.S. retrenches into itself, it will inadvertently condition not only China but the rest of the world to be independent of the United States. Moreover, decoupling and retrenching will convince U.S. allies that partnering with the United States is a risky endeavor—that there is a need for allies to diversify away from the U.S., possibly forcing them closer to our adversaries. Therefore, the United States must learn to accept that competition is a good thing and that engaging with China is the best and only way to protect U.S. interests and to ensure that the world does not move on without the United States.

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