Strategic Reassurance in Institutional Contests: Explaining China’s Creation of the Asian Infrastructure Investment Bank

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Abstract:
The AIIB has been widely conceived as a Chinese effort to promote reforms of global financial governance. While the existing literature of contested multilateralism tends to focus on the problem of threat credibility, this article highlights the necessity of strategic reassurance in institutional contests. To facilitate incremental reforms of the existing order, rising powers like China need not only to pose credible challenge towards established institutions, but also to demonstrate their benign intentions and commitment to future cooperation. Besides revealing strength and resolve, the creation of a new multilateral regime helps rising powers to signal their self-restraints and reassure other powers. Consequently, the institutional configuration of new multilateral organizations involves a trade-off between the dual needs for threats and reassurance. Chinese behaviours in creating the AIIB can be explained through this framework.

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Introduction

Ever since the global financial crisis in 2008, Beijing has been actively constructing new multilateral financial regimes that are at least partially competing with pre-existing institutions. Nonetheless, while pioneering the creation of parallel institutions, Beijing remains an active member in the Bretton Woods regimes. Those China-led new institutions also cooperate closely with and adopt practices frequently from their established counterparts. A paramount case of Beijing’s activism is the creation of the Asian Infrastructure Investment Bank (AIIB), which has generated various speculations on Chinese motivations behind. With a focus on economic rationales, some analyses underscore Asia’s huge demand for infrastructure investment and China’s need to export its industrial overcapacity to tackle the domestic slowdown. Many others emphasize geopolitical motivations, arguing that the bank is a part of China’s balancing efforts against the U.S. ‘Pivot to Asia’ strategy. A growing number of scholars suggest that Beijing’s primary interest lies in soft power and institutional influence. The AIIB is conceived as a bargaining instrument for Beijing to promote reforms in global financial governance, as it signals Beijing’s discontent with the existing regimes and a warning that China has both the capacity and resolve to bypass the system if necessary.

All of these factors have played a role in Beijing’s creation of the AIIB. However, China’s practices in creating AIIB are more complicated, and several puzzles remained. First, if China has enough resolve and strength to pose credible challenges already, why did Beijing fail to achieve the desired reforms at the first place? Second, if the AIIB was primarily a result of Chinese economic and geopolitical ambitions, Beijing could have pursued those projects on a purely bilateral, state-to-state basis, which would guarantee it more policy autonomy. When a variety of tools exist, why did China choose to bear the cost of creating a new multilateral bank? What is the added value of a new multilateral regime? Finally, while the AIIB is widely regarded as a Chinese ‘external innovation’ to challenge the existing U.S.-led institutions, why...

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does the AIIB also mirror and cooperate with the World Bank and the Asian Development Bank (ADB) so closely? 6

This article addresses the aforementioned puzzles through the lens of bargaining theory in International Relations (IR). It argues that even when rising powers can pose credible threats, serious commitment problems associated with rapid power shifts may obstruct reforms within existing institutions by exacerbating distrusts between rising and established powers. Meanwhile, new multilateral institutions can act as commitment devices for rising powers to ease the problem. Besides magnifying strength and demonstrating resolve, delegating power to multilateral organizations helps rising states signal self-restraints to reassure other states. In turn, rising powers’ dual needs for credible threats and reassurance shape the institutional configuration of those new multilateral organizations they created. As observers have generally agreed, the AIIB was partially meant to strengthen the credibility of potential Chinese options to withdraw its support for the existing Bretton Woods institutions. However, China also needs and has sought to reassure other states by adopting an inclusive approach in developing the AIIB. This reassurance function is a distinctive value of a new multilateral development bank while the AIIB’s institutional configurations clearly reflected this consideration.

This article contributes to the emerging literature of contested multilateralism and China’s strategies toward international institutions in two important ways. First, while existing explanations of institutional adaption tend to emphasize the problem of threat credibility, this article elaborates on the necessity of strategic reassurance for emerging powers. It thus highlights the value of new multilateral institutions in helping rising powers credibly signal their self-restraints. Second, analysing the AIIB within a broader context of Beijing’s pursuit of a peaceful rise, this article elaborates on China’s dual considerations about threats and reassurance in its creation of the AIIB. More specifically, it is in China’s strategic interest to reassure other states by tying its own hands in the new multilateral organisation.

The rest of the article proceeds as follows. The next section maps out the interplay between new regime creation and reforms of the existing order through the lens of bargaining theory. It explains the stagnation of reforms within existing institutions with an emphasis on commitment problems associated with power shifts rather than threat credibility. It then highlights the dual functions of new multilateral regimes in posing challenges and granting reassurance, followed by an illustration of how the tension between these two considerations shapes the configuration of new institutions. After that, the empirical section examines how China encountered the commitment problem and managed to balance the dual needs of threats and reassurance in constructing the AIIB. The article concludes with some further thoughts.

Power Transition and Strategic Reassurance in Institutional Contest
This section develops a theoretical framework about the commitment problems in institutional contests between rising powers and established powers to highlight the importance of strategic reassurance on the development of a new institution. In the anarchic international system, a dissatisfied rising powers must bargain with established powers to increase its institutional benefits and privileges. 7 It could

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choose whether to promote reforms of existing institutions or to withdraw from them. In turn, the established powers can either accommodate or contain the rising power’s “revisionist” efforts. Following Albert Hirschman’s classic work *Exit, Voice, and Loyalty*, recent studies conceptualize the creation of new multilateral institutions as an “exit” move (or an outside option), whose realization can be prevented by changes within the established institutions. Meanwhile, “voice” (promoting reforms of the established institutions) is similarly costly, but it provides a share of the surplus from avoiding “exit” for each side. A state will have more leverage when it has better outside options than its counterparts. The rising power can negotiate better terms if it can make a credible threat of “exit” to undermine the existing institutions’ effectiveness. The credibility of such a threat forms the main condition of institutional adaptions. This is the mechanism that many analyses of the AIIB have relied on.

**Commitment Problems in Institutional Reform Bargaining**

In light of Hirschman’s model, however, a rising power needs not to actually implement its outside (or “exit”) options to promote reform. Since at least one side will suffer utility loss if the bargaining fails, theoretically, a bargaining range emerges for a compromise. Nonetheless, in reality as in the AIIB case, states sometimes create new institutions even when a compromise is in both sides’ interests. James Fearon, Rebert Powell and others have developed two explanations of why states engage in costly conflicts when a bargaining range exists: information asymmetries and commitment problems. Existing works on contested multilateralism emphasize the credibility of threats. If a state that is not intent on replacing existing institutions nonetheless believes that other states have underestimated its strength and resolve, it may initiate an actual “exit” to demonstrate its capabilities and determination.

However, the problem of threat credibility is insufficient to explain the failure of institutional reform bargaining when states have both incentives and means to communicate effectively. According to the information problem logic, competing states might withhold important private information about their own relative power, making it difficult to reach a settlement. Nonetheless, unlike what happens in military conflicts, this might not be so serious an obstacle in issue areas such as development.

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finance, whereby states have limited incentives and capabilities in deceiving and bluffing each other. Economic information is more openly shared. To achieve greater saying in a regime, an actor has to make concrete contributions. Rising states also have other channels to disrupt the function of existing institutions to pose credible threats. As in the IMF reform case, China’s growing financial power and economic influence is widely acknowledged. Its capability to disrupt the liberal international economic order might even be exaggerated by western powers. In this case, the problem lies less in private information but mutual distrust due to rapid power shifts.16

This observation highlights the other source of bargaining failure: commitment problems. Commitment problems refer to situations whereby at least one side expects the others to violate the terms of a settlement. To reach an agreement, actors must commit to certain courses of action. An obstacle arises when these promises are not credible, since some of the players have incentives and means to renege on what they previously agreed to. In the anarchic system of international politics, rapid and uncertain power shifts make it even more difficult for relevant parties to forge binding long-term contracts.17 As previous studies have revealed, while the strengthening of an “exit” option would enhance the power of “voice,” it would also make the “voice” option relatively less attractive.18 Established powers would suspect that the rising power would demand further revisions in the future or abuse its strength even after receiving significant concessions. Moreover, privileges in international institutions are strategic assets. Redistributions imply different strengths and asymmetrical benefits for the negotiating parties in future. The established power thus refrains from making concessions. Even when those challenger’s “exit” options are credible, a dominant state may prefer to live with the current arrangement.19

Institutional reforms thus tend to happen only when the current regime are suffering serious difficulties. To induce cooperation, the established powers, in temporarily weak positions, might accommodate rising powers to a certain degree. However, this requires a series of institutional concessions across several periods during which established powers might expect the power distribution to shift back in their favour. As other states would suspect, once recovering from their temporary difficulties, the established powers would renege on previous concessions. Consequently, in the shadow of the rapid and uncertain shifts of power, institutional reform bargaining between rising and established powers faces serious commitment problems. States might agree on how to divide today’s pie, but they cannot credibly commit to future divisions. In fact, if the power distribution shifts fast enough, few settlements would be time-consistent.20 As each side has an incentive to renege, it is difficult to achieve mutual trust. Thus, even when the threats from rising powers are credible, reform negotiations might be trapped in stagnation. When this happens, rising powers may prefer founding alternative regimes.

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20 Powell, ‘Commitment Problems and Shifting Power as a Cause of Conflict’. 
The Dual Task of the New Institution

The previous section suggests reform bargaining might fail even when neither the rising nor the established powers want to abandon existing regimes and no serious information asymmetry exists. New questions arise then: As rising powers have various tactics to exercise “exit” and fulfil their goals, why do they create new multilateral institutions? What is this option’s distinctive value?

The answer lies in a new institution’s dual potential as inside and outside options, and particularly its utilities in reassuring other states and easing commitment problems. Building new institutions do not necessarily end the rising power’s efforts to reform existing regimes. Although “voice” and “exit” are substitutes initially, they become complements once the “exit” option becomes available and attractive. Even when they are unattractive as an outside option in full sense, new institutions could also be used as an inside option to improve one’s bargaining position.

In the bargaining literature, a player’s inside option is the payoff that it obtains during the bargaining process when the relevant parties are temporarily in disagreement. The development of new institutions offers rising powers additional leverage in a tortuous negotiation process, as they now enjoy alternative multilateral tools of coordination, monitoring and enforcement to achieve policy objectives. In this scenario, rising powers develop seemingly redundant alternative regimes to escape from the deadlocks in institutional reforms and fetch additional leverage vis-à-vis established powers or status-quo institutions.

Investing in the new regime, however, raises another risk of negotiation breakdown in the power shift process. The development of alternative regimes whereby rising powers dominate might send unintended signals that lead others to exaggerate the rising powers’ aggressiveness. While new institution can steadily increase the emerging power’s influence so that someday it can fulfil its long-term goal of overthrowing the established order, this prospect attracts suspicions and containment from other powers.

Rising powers thus face a dual task of compellence and reassurance in institutional contests. This coincides with the key components of any successful coercive diplomacy: states must use clear threats and credible assurance in combination to force target countries to do something or dissuade them from undesirable behaviour. On the one hand, rising powers should pose credible threats to hold up contributions to and even disrupt the operation of established institutions. Meanwhile, the other, at least equally important, task is to reassure that once other states (the current hegemon in particular) make the demanded concessions, they would act as stakeholders and provide more public goods.

It is rational for rising powers to balance threats with reassurance. Otherwise, they would run the risk of incurring unnecessary obstructions and conflicts. Established powers might suspect that rising powers would overtake their leadership and revise the existing rules. Small states and middle powers would be anxious about the prospect of being dominated by new players. For the smooth and sustainable development of the new institution, rising powers should assure other states that their

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24 Pu and Cleveland, ‘Exit, Voice, and AIIB’.
intentions are limited and predictable while the exercise of their influence is, at least to some acceptable degree, circumscribed.

Dealing with this dual task of posing threat and granting reassurance is difficult, but creating new multilateral organizations offers distinctive benefits. First, the availability of alternative organizations increases the credibility of the rising powers’ threats to disrupt pre-existing arrangements. These multilateral institutions would also help rising powers to magnify their influence and transform momentary power advantages into a durable flow of benefits. Moreover, the creation and operation of new institutions involves heavy burdens of coalition building. This is a costly process that tests and signals a state’s resolve and strength.

Nonetheless, the most distinctive value of creating new multilateral institutions, in comparison with other modes of “exit,” lies in reassuring other states by signalling the challengers’ benign intentions and commitment to cooperation. Existing studies of foreign policy signalling suggest that a commitment would be more credible if it creates the possibility that states will become locked into some positions and will refrain from reneging because of significant sunk costs and audiences costs. Combining this logic with insights from neoliberal institutionalism theories in IR, this article suggests that the deliberate development of new multilateral institutions provides a reliable mechanism through which rising powers like China could credibly signal their benign intentions and self-restraints.

Here, the ability to generate costs of reneging is critical. Multilateral regimes provide cost-effective frameworks of exchanges that generate reliable information for the assessment of states’ reputation. They offer an extra mechanism through which a government could credibly commit to public goods provision and alleviate worries about cheating or bad faith. Delegating power to international organizations also sets disciplines and helps a rising power to mitigate other states’ fear of power abuse, while inducing them to accommodate its increasing influence. In the absence of functioning electoral systems and free press, which serve as commitment devices at the domestic level, non-democracies would rely more on international mechanisms to set self-constraints and signal commitments to reassure other players.

To achieve this goal, as G. John Ikenberry suggested, power states can adopt several measures in the configuration of new institutions. Ikenberry’s various discussions focused on the hegemon but rising powers can also resort to “opening itself up” and “tying itself down” to make their exercises of power more predictable and accessible to other states. Here, “opening itself up” means making the new institution’s operations more transparent to other players and providing access for them to have an influence, thereby reducing their suspicions. With regard to “tying itself down,” besides delegating a certain degree of decision-making power to a multilateral organization, the rising state could establish institutional links between the new organization and established regimes. In effect, binding institution

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26 Jupille, Mattli, and Snidal, *Institutional Choice and Global Commerce*.
arrangements create constraints on the way power can be exercised, rendering asymmetric power relations less exploitative. Through these methods, a rising state reassures others that there will be limits on its exercises of growing influences.

Nonetheless, incentives to grant reassurance are not unconditional. Rising states face difficult trade-offs on whether and how to develop a new multilateral institution. In agreeing to abide by the rules of a multilateral organization, a state accepts some constraints on its freedom of action for long term interests. However, temptations to excise power unilaterally and maintain autonomy always exist. Reassurance measures might also erode the effectiveness of threats. No clear-cut choice exists. The option of creating new multilateral organizations will appeal to a state only when it sees the benefits from self-restraints and reassurance exceed the costs of losing autonomy and threat effectiveness. The higher the risks of containment by established powers, the more willing the rising powers become to grant reassurance. A closer examination of the evolving political context would help explain variations and evolutions in a state’s design of new multilateral regimes.

In sum, the obstacle to the adaptations of existing institutional arrangements arises not only from threat credibility problems but also commitment problems inherent in the power shifts process. To promote redistributive reforms of any existing order, rising powers face a dual task of signaling threat and reassurance. The development of new institutions provides them with a proper tool for this dual purpose, while the tension between threat and reassurance shapes how rising powers design and configure these new institutions. As political contexts vary, the development of alternative institutions has complex strategic origins, multiple functions and different institutional configurations.

This bargaining framework suggests following theoretical propositions, which are distinctive from existing studies, to answer the puzzles in the introductory section.

1. Even when the challenge from rising powers is credible, established powers would still obstruct rising powers’ reform efforts out of their anxiety about the settlement’s implications for future power distribution.

2. While there are other options of ‘exit’ to pose credible threats, a reform-oriented rising power might prefer creating new multilateral institution since this option could act both as an inside option and a commitment device to facilitate adjustments of the existing order.

3. The institutional configuration of new multilateral regimes involves a trade-off between the needs to pose a threat and grant reassurance. A reform-oriented rising power would adopt an inclusive and self-restrained approach in configuring new multilateral organizations to reassure other states.

The empirical examination of the AIIB case below testifies the aforementioned arguments by answering three puzzles raised at the beginning of the article.

**China’s Creation of the AIIB and the Bank’s Developments**

Empirically, this article examines China’s creation of the AIIB. For years, Beijing had largely kept a low profile in international financial institutions. As China’s economic influence grows, Beijing’s discontent about these institutions became

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apparent in the early 2000s. The global financial crisis in the fall of 2008 further stimulated an uptick in criticisms from Chinese officials on two issues: China’s underrepresentation in the IMF and the dominance of the U.S. dollar as a reserve currency.34 In the subsequent years, Beijing actively pressed the issue of IMF vote shares reform through the G20 process.35 It also openly linked the under-representation of emerging markets and developing countries to the World Bank’s legitimacy.36

While it continues to call for reforms of the IMF and the World Bank, Beijing proposed the AIIB in October 2013. The bank officially commenced operation in January 2016 and it has now grown to 84 approved members from around the world. Introduced as an alternative source of infrastructure financing for developing countries, the AIIB has great potential to bring new priorities, principles and procedures into multilateral development assistance and compete with U.S.-led world financial institutions including the IMF and the World Bank, as well as the Japan-led ADB.

**Commitment Problems, the Reform Deadlock and the AIIB’s Creation**

The AIIB was created against the backdrop of China’s frustration with the slow pace of reform of the pre-existing international financial system. Although it has become a stakeholder in Breton Woods institutions, Beijing remains dissatisfied with their workings. The increasing weight of China and other emerging economies remains inadequately reflected in those focal institutions. For instance, right before the 2010 reform plan, China had a disproportionately low share of only 3.81 percent of voting right in the IMF quota system. European countries, in contrast, were allocated 27.5 percent.37 As the world’s second largest economy, China had a voting share of 4.42 percent in the World Bank, compared to 16.4 percent for the U.S. and 7.9 percent for Japan.38 Similarly, Japan and the U.S. play a dominant role within the ADB.39 As of December 2016, China’s total holding in the ADB was only 6.4 percent, whereas Japan and the U.S. each held 15.6 percent respectively.40

Despite China’s strong advocacy, its attempts to reshape the global financial order have largely been frustrated by the developed economies. G20 leaders had agreed in 2009 to reform the governance of the IMF and the World Bank, and the executive boards of both organizations decided to modify voting power distribution in 2010.41 In the following five years, however, the reform plan failed to be carried out. As the

western powers are recovering from the financial crisis, the prospect for more balanced representation in the near future appears bleak. It is now widely believed that a significant reason why emerging powers, China in particular, initiated the New Development Bank and AIIB was their shared frustration with the deadlock in reforming Bretton Woods institutions.42 Ironically, the main obstruction facing the IMF reform plan came from Washington, even though it was the European countries not the U.S. that would lose voting share. The Republican-dominated U.S. House of Representatives blocked the reform plan for years.43 Implementing the reform would not increase total U.S. financial commitments to the IMF. The share of U.S. voting power at the IMF falls only slightly, and Washington would still maintain its unique veto power over most policy decisions. Nonetheless, many American legislators were sceptical about the emerging economies’ commitment to the established norms of international financial institutions, and suspected that these countries may prefer strategies less aligned with those of the U.S.44

Washington has long been urging Beijing to behave as a “responsible stakeholder” by contributing more to global governance.45 Nonetheless, the U.S. seems reluctant to sacrifice its own authority and privileges to accommodate China.46 Because of its deep-rooted distrust of China’s political system and rapidly rising power, it suspected that Beijing would disrupt established practices after gaining more institutional authority.47 In fact, ever since the financial crisis, there has been increasing sensitivity among U.S. elites to China’s alleged attempts to take advantage of U.S. difficulties.48 They demonstrate growing anxiety about the erosion of U.S. superiority, with China widely regarded as the most prominent challenger.49 The obstruction of the IMF reform reveals Washington’s suspicion towards China’s bid for more institutional influence.

China’s move to create the AIIB is a part of the “price” paid for this reluctance of accommodation.50 After the U.S. Congress’s repeated refusals to approve the IMF

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reform plan, the deadlock led China to suspect that advanced economies had reneged on their earlier promise of reform. The establishment of the AIIB and other new financial institutions reflect both Beijing’s dissatisfaction about its inadequate representation and its frustration with the slow pace and grim prospect of reform.

It was, however, not the problem of threat credibility that prevented the desired reforms of the IMF. China has clearly accumulated enough economic clout to exploit opportunities in development finance. A striking feature of the AIIB is its concentration on funding infrastructure projects, an area where existing institutions have proved inadequate. The “thirst for infrastructure funding” in the world in general and Asia in particular has been widely acknowledged. The existing multilateral lending institutions such as the World Bank and the ADB lack the capacity to satisfy this huge demand. The inadequacy of pre-existing regimes provides Beijing with a great opportunity to bypass them.

Beijing also has remarkable lending capability to compete with existing institutions. By the end of 2013, China had a huge foreign-exchange reserve of USD 3.82 trillion, with about 1.4 trillion invested in U.S. treasury bonds. In the face of domestic criticisms on the low cost-effectiveness of purchasing U.S. Treasury bonds, Beijing had great incentive to use its capital in more constructive ways. Meanwhile, as the world’s second-largest economy, China has already become a global lender. In fact, its two giant policy banks, the China Development Bank (CDB) and the Export-Import Bank of China (C-EXIM), already hold more assets than the combined sum of the assets of the West-backed multilateral development banks. For borrowers seeking to avoid the strictures of the Bretton Woods framework, China provides an attractive alternative source of funding. Development finance thus is an area where China could pose credible threats with existing policy tools.

In sum, China’s decision to found a new multilateral bank reflects its frustration with the glacial pace of global financial governance reform, which is largely due to...
the commitment problem associated with the power transition process. China obviously can pose credible threat to contest in the area of development finance where existing structures are insufficient. Because of the U.S. Congress’s suspicion of China’s future behaviours, the reform process came to a halt. This in turn stimulated China’s decision to create the AIIB.61

The AIIB as an Inside Option
While creating the AIIB, Beijing has never ceased its advocacy for reforms of the Bretton Woods institutions. China is still the third largest funder of the ADB, the AIIB’s closest competitor, and plays an increasingly active role in the World Bank and the IMF. Chinese officials have continued to request these institutions to fulfil their promise of more realistic representation of developing countries.62 Beijing is using its new regimes not to replace those existing institutions, but to hedge risks and exert competitive pressure to stimulate reforms. While the adaption of pre-existing financial institutions remains stagnant, the AIIB helps China to pursue its economic goals in a more effective way and to offset the loss from the lack of representation in the Bretton Woods system. This in turn strengthens China’s position in promoting reforms of the existing governance structure. The AIIB improves China’s inside option in the continued bargaining.

Multilateral development banks (MDBs) such as the AIIB have two significant advantages. MDBs can provide economic and regional expertise as well as improved monitoring of project spending, thereby promoting more efficient use of creditors’ money. Meanwhile, they also enjoy a degree of autonomy from participating governments.63 In comparison with other modes of investment, the AIIB’s multilateral nature helps ease external suspicions that China is using its growing economic clout to pursue unilateral geopolitical ambitions. It disciplines China’s behavior by tying Beijing’s hands to a multilaterally agreed code of conduct, which would help to increase credibility and reduce moral hazard of lending. China is now a net capital surplus exporter. Previous attempts to diversify China’s foreign investment portfolio, however, have resulted in sizeable losses.64 Beijing expects to utilize the lending experience and specialized expertise of its peers through the AIIB to share risks, reduce moral hazards, and increase China’s foreign investment efficiency.65

61 As an anonymous reviewer points out, it is possible that the frustration of the reform just offered an excuse for China to legitimize its creation of the AIIB and made the bank attractive and consequently successful. This is an interesting argument. However, although the genuine intention of the Chinese government is difficult to ascertain, it does not challenge the article’s argument that the deadlock in reforming the exiting regimes is the key background of the AIIB’s creation.


The AIIB also helps to promote China’s geopolitical interests in a smarter way. The bank was established against the backdrop of a shift in China’s strategic orientation, as policymakers sought to improve both the popularity and effectiveness of Chinese overseas investment. In particular, the launch of the AIIB coincided with China’s ambitious Belt and Road Initiative (BRI). The BRI serves multiple economic purposes, such as exporting China’s economic overcapacity and making efficient use of its abundant foreign exchange reserve. The key political consideration of the BRI is to shift China’s geopolitical priority to Eurasia in response to the American ‘pivot’ to the Asia-Pacific, which Beijing perceives as targeting China. The BRI is also designed to cultivate closer neighbourhood relations and promote Chinese influence through the “improvement of physical inter-regional connectivity.” While the bank is not created solely for the BRI, an important function of AIIB is to spearhead BRI-related projects.

Reassurance Consideration and the AIIB’s Institutional Development

However, other states and the existing international institutional order also influence Beijing’s practices. Chinese policymakers have been propelled to adjust their original plans to ease obstructions and attract other states’ cooperation. The reassurance consideration in turn shaped the AIIB’s institutional configurations.

After the AIIB was proposed in late 2013, Beijing fully mobilized its diplomatic resources to promote the program. It also developed several institutional features to attract partners. For instance, Beijing introduced a founding member privilege into the bank’s voting system, assigning more power to early birds than to latecomers. In addition, similar to the ADB, the AIIB distinguishes regional members from non-regional members. Finally, all countries, members and non-members alike, are able to bid for projects. The bank also hires staff from non-member countries. These features are designed to increase the bank’s attractiveness and inclusiveness.

Nonetheless, the bank still encountered serious suspicions and obstructions. China had attempted to invite Japan and offered the vice president position, but Tokyo showed no interest. Meanwhile, Washington not only openly opposed the AIIB, but also exerted diplomatic pressure on its allies such as Japan, South Korea, and Australia to not join the bank. It reiterated several arguments to justify its opposition. One query is whether the AIIB would achieve sufficiently high standards of corporate governance, lending procedure, and environmental and social

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72 The Economist, ‘A Bridge Not Far Enough’.
73 Etzioni, ‘The Asian Infrastructure Investment Bank’.
safeguards. Another concern concentrated on the possibility that the AIIB would weaken the enforcement mechanism of existing lending regimes.\textsuperscript{74}

The more serious, unstated tension stems from the suspicion that China will use the new bank as a vehicle to project its economic influence in development finance and to pursue geopolitical ambitions.\textsuperscript{75} In the eyes of critics, the AIIB also serves as China’s strategic ploy to disrupt U.S. global leadership.\textsuperscript{76} In particular, critics worried that China would develop its own rules and standards in project lending, thereby undermining the liberal norms underlying the Bretton Woods system.\textsuperscript{77} President Obama clearly expressed this anxiety: “China wants to write the rules for the world’s fastest-growing region. That would put our workers and our businesses at a disadvantage. Why would we let that happen? We should write those rules.”\textsuperscript{78} As a result, the U.S. government openly obstruct the establishment of the AIIB.

Despite obstruction by the U.S., the AIIB appealed to many other states including traditional U.S. allies. The U.S. containment of the AIIB started to collapse in early March 2015 after the U.K. announced its intention to join the AIIB as a founding member.\textsuperscript{79} Germany, France, Italy, Australia, South Korea and Israel soon followed the U.K.’s footsteps to seek founding membership. At the end, 57 countries obtained founding member status at the AIIB. This “victorious campaign against American-led scepticism” was a pleasant surprise for Beijing.\textsuperscript{80} The AIIB also attracted countries from Latin America (e.g. Brazil) and Africa (e.g. Egypt). The bank’s diverse membership transformed it from a regional organization into a development bank of global reach and perspective. The more China proves capable of steering the AIIB, the more credible is its threat to tilt the balance of authority away from the existing regimes.

Nonetheless, it is also in Beijing’s interest to not have the AIIB collide with the existing order and upset other countries. The rise of China has inspired considerable suspicion but China still benefits from and relies on working within the current international order. Integration into the global economy is indispensable for China’s economic growth, which is vital for its domestic stability. Moreover, establishing its credential as a responsible power is important for Beijing to reassure its neighbours and beyond to avoid strategic containment.\textsuperscript{81} In general, China avoids actions that


\textsuperscript{75} Steinbock, ‘American Exceptionalism and the AIIB Debacle’.


directly challenge U.S. hegemony. Noticeably, while arguing that an institutional contest between China and the U.S. is emerging, Chinese officials and scholars also emphasize that such a contest is not a zero-sum game and that Beijing should provide an inclusive and cooperative approach to win political legitimacy.

Throughout the construction of the AIIB, Beijing worked hard to ease suspicions and reassure other powers on the new bank’s goals and intentions. The multilateral nature of the bank affords China more effective tools to convince other powers than other option could. Over the course of the AIIB’s evolution, Beijing made various further adjustments in the bank’s institutional configuration. Ever since the AIIB was proposed, people raised questions about the bank’s governance, staffing, lending standards, while the Bank was questioned as “a bank of China, by China and for China.” Beijing has been striving to ease these anxieties, making strenuous efforts to clarify the bank’s goal and operational rules. In the face of concerns about China’s veto power within the AIIB, both the spokesperson of China’s Ministry of Foreign Affairs and the Finance Ministry’s chief negotiator for the AIIB declared that ‘the issue of China seeking or forgoing the one-vote veto power did not exist’.

Realist sceptics may question these statements as pure rhetoric and suspect that the bank is merely a multilateral cover for Beijing. However, as things turned out, AIIB’s member states enjoy significant influence on the bank’s developments. At its early start in spring 2015, the AIIB was expected to raise USD100 billion as initial total capital, with China contributing half of the amount. Such a design would give China 50% of the total voting power. However, the bank now has many more member states than Beijing had expected. The U.K.’s decision to become a founding member of the AIIB encouraged other advanced European economies to follow suit. Eventually, the size of the AIIB’s founding membership increased from 21 to 57. The unexpected expansion of the AIIB’s membership unavoidably diluted China’s share and influence. At the end, China’s capital share decreased to 30.34 percent when the bank was set up. Nonetheless, Beijing welcomed this expansion as a diplomatic success which strengthened the bank’s legitimacy and credibility.

China temporarily enjoys decisive influence over the AIIB, holding a total voting share around 26 percent. Since major decisions at the AIIB require a super majority of 75 percent, Beijing was slightly above the de facto veto level. However, China’s dominant influence would decline or even disappear with the AIIB’s further expansion. In 2017, the Bank announced the approval of another 27 prospective members, bringing the total approved membership from 57 to 84. As AIIB expects more new and full members in the future, Chinese voting power would be weakened.

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86 Ren, ‘China as an Institution-Builder’, p. 438.
89 Wei and Davis, ‘China Forgoes Veto Power at New Bank to Win Key European Nations’ Support.’
further. Nonetheless, Beijing seems willing to relinquish its de facto veto in support of the bank’s maturation. In fact, in the negotiation stage, Beijing reportedly offered to forgo its veto power in exchange for Japan’s and America’s participation.91 Besides, Beijing has clearly stated that the future president of the AIIB needs not to be a Chinese citizen. The bank has also been inclined to fill its pay roll with former World Bank and ADB officials.92 These arrangements help to ease concerns about Chinese dominance in the newly established institution.

During the early stage of the establishment of the AIIB, Chinese officials often linked the AIIB and the BRI together, indicating that the bank would support the implementation of the BRI initiative.93 Over time, this expression has been toned down as international concerns over Chinese domination grow. To reassure other states, Chinese officials has intentionally created a distance between the AIIB and the BRI since mid-2015. President Jin Liqun has sought on various occasions to clarify China’s position that while the Bank would support BRI projects, the AIIB is “an MDB that must serve the interests of all of its members,” and it “would finance infrastructure projects in all emerging market economies even though they don’t belong to the Belt and Road initiative.”94

While delinking the AIIB from BRI in the official parlance, Beijing seeks to establish institutional links between the new bank and those established regimes. China repeatedly asserted that the AIIB is complementary to and will cooperate closely with existing multilateral financial institutions. Officials of the ADB and the World Bank have also extended a welcome to the new bank, saying that they will work with the AIIB in providing loans and share their professional expertise.95 In May 2016, for instance, the AIIB and ADB signed a memorandum of understanding to strengthen cooperation through co-financing, knowledge sharing and joint policy dialogues and consultations.96 As of December 2017, the AIIB has approved 24 projects, including 16 co-financed with other multilateral development banks—nine with the World Bank Group (including the International Finance Corporation) and five with the ADB.97 These linkages with existing regimes helped ease suspicions about the AIIB.

Moreover, in response to concerns that the AIIB may not live up to internationally recognized environmental, labour and procurement standards,98 China made great efforts to prove that the AIIB would rigorously adopt the best practices of established

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institutions such as the World Bank. In February 2016, the AIIB established its own Environmental and Social Framework (ESF). In practice, because most of the AIIB’s projects are co-financed with the World Bank and the ADB, these projects also follow their environmental and social standards. This helps the AIIB to appease criticisms and attract more partners.

All of these suggest that, during the AIIB’s establishment, Beijing paid great attention to demonstrate its self-restraints and signal its commitment to further international cooperation. Pre-existing institutions and other states have been allowed to shape the AIIB’s development. It is in China’s interest to create and operate the AIIB in a transparent and open manner so as to alleviate external suspicions. An inclusive approach in turn facilitated the bank’s smooth launch. The AIIB thus can be described as a multi-function device for Beijing. It reduces China’s loss from the lack of voice in pre-existing institutions, allows China to make infrastructure investment where existing regimes cannot meet local demand, alerts established powers that Beijing has viable alternatives if pre-existing institutions remain unchanged, and demonstrates China’s self-restraints to appease fears of Chinese domination. All of these serve to enhance Beijing’s leverage in promoting faster and deeper reforms of international financial governance structure, alongside many other political and economic interests underlying the AIIB’s creation.

**Conclusion**

As Ikenberry has suggested, “China and other emerging great powers do not want to contest the basic rules and principles of the international order; they wish to gain more authority and leadership within it.” In a partially globalized world with nuclear weapons and complex transnational interdependence, institutional contests have become a new form of great power competitions. Through a bargaining framework, this article presents two innovative findings. First, the barrier to institutional reforms lies not only in the credibility of the challenger’s threat but also in the commitment problem associated with rapid power shifts. Second, the creation of competitive multilateral regimes could help rising states simultaneously enhance the credibility of their threats and signal cooperative commitments to reassure other states. Both functions are indispensable for the success of the rising powers’ advocacy for global institutional reform in the power transition process.

The AIIB’s development testifies to the aforementioned mechanisms. As the world’s second-largest economy, China believes it deserves more voice in global financial institutions. After Washington blocked Beijing’s call for reform due to the strategic distrust of China’s future policies, Beijing chose to create parallel institutions such as the AIIB. In the AIIB’s inauguration and subsequent evolution, Beijing clearly signalled its self-restraints and commitment to multilateral

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104 Kai He, Institutional Balancing in the Asia Pacific: Economic Interdependence and China’s Rise (New York: Routledge, 2009); He, ‘Contested Regional Orders and Institutional Balancing in the Asia Pacific’.
cooperation, a gesture instrumental to reassuring other players and stimulating the 
reform of established multilateral regimes.

In this sense, the AIIB case gives us both a warning and a hope for understanding 
the current power shift and institutional change. The warning is that even when space 
of compromise exists between rising and established powers, mutual distrust could 
preclude a redistributive adaptation of the global economic governance structure. The 
good news is that the creation of parallel institutions and their rivalry with existing 
regimes does not necessarily lead to a strategic clash. If properly managed, a new 
institution can reveal not only the rising power’s strength and resolve but also its self-
restraints and commitment to multilateralism. The new institution thus helps induce 
incremental and peaceful reforms of the existing order. Even a so-called 
“authoritarian” rising power like China could benefit from it. If international 
institutions imply an optimistic prospect of power transition for a declining hegemon, 
so do they for the rising powers.

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