

## SYMPOSIUM ON INTERNATIONAL INSTITUTIONAL BYPASS

### NEW DEVELOPMENT BANKS AS HORIZONTAL INTERNATIONAL BYPASSES: TOWARDS A PARALLEL ORDER?

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Over the past years, the Chinese government (along with other rising powers) has engaged in unprecedented international institution-building, leading to the establishment of, among others, the Asian Infrastructure Investment Bank (AIIB) and the BRICS-led New Development Bank (NDB). Providing services similar to existing institutions such as the World Bank, these new institutions profoundly alter the landscape of global governance. The existing literature has mostly debated whether such activism shows that China and others are embracing or confronting today's Western-led order. This discussion fails to capture a more complex reality, and the concept of international institutional bypasses (IIB) may help us gain a better understanding of China's complex institutional entrepreneurship. As will be explained, decisions by China and other countries to simultaneously support reform processes in existing institutions and also create new ones suggests that they seek alternative ways to overcome perceived dysfunctions in the dominant institutions by creating IIBs. Considering the initiatives in these terms allows for a more nuanced picture that transcends the simplistic dichotomy of integration versus rupture.

#### *Integrate Versus Overthrow*

Will China and other emerging powers such as India seek to oppose and overturn the existing order, or will they integrate? Princeton's [John Ikenberry](#), a prominent liberal internationalist, has asked this question relatively recently.<sup>1</sup> Many policy-minded scholars have followed his lead, asking whether China, as it turns into the world's leading economy, will try to end three centuries of Western global dominance. Ikenberry argues that it may be easier for China to integrate into today's order, which he famously describes as "easy to join and hard to overturn." [He writes:](#)

Even if China and Russia do attempt to contest the basic terms of the current global order, the adventure will be daunting and self-defeating. These powers aren't just up against the United States; they would also have to contend with the most globally organized and deeply entrenched order the world has ever seen, one that is dominated by states that are liberal, capitalist, and democratic. This order is backed by a U.S.-led network of alliances, institutions, geopolitical bargains, client states, and democratic partnerships.<sup>2</sup>

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<sup>1</sup> G. JOHN IKENBERRY, [LIBERAL LEVIATHAN](#) 343 (2011).

<sup>2</sup> G. John Ikenberry, [The Illusion of Geopolitics: The Enduring Power of the Liberal Order](#), 93 FOREIGN AFF. 80 (May/June 2014).

<sup>†</sup> Funding information has been added since original publication. See 10.1017/aju.2017.78

By contrast, [John Mearsheimer](#), a leading realist scholar at the University of Chicago, predicts that China's rise will be disruptive and that China will show little inclination towards maintaining the structures set up by the United States.<sup>3</sup> Rising powers like China could create a [parallel system](#) with, as Barma, Ratner, and Weber put it, "its own distinctive set of rules, institutions, and currencies of power, rejecting key tenets of liberal internationalism and particularly any notion of global civil society justifying political or military intervention."<sup>4</sup>

The hope that China (and, to varying degree, the other BRICS) will integrate into the Western-led order has long informed Western policy. Attempts to engage countries like China or Russia shrewdly sought to increase interdependence, generate mutual wealth, and turn them into stakeholders and thus parties interested in upholding the U. S.-led order. This hope was based on the conviction that the existing institutions were successful in providing public goods, and that they were flexible enough to adapt to a historic shift of power away from the West towards Asia and the Global South. Put differently, from a Western point of view, no new institutions were needed.

Eluding the simplistic extremes of either confronting or joining the existing order, policy makers in Beijing, Delhi, and elsewhere opted for a different approach. They began creating new institutions while continuing to support, and seeking to expand their influence in, existing structures. The creation of several China- or BRICS-centric institutions can be expected to allow these states to embrace their own type of competitive multilateralism, picking and choosing among flexible frameworks, in accordance with their national interests. By doing so, China and the other BRICS countries pursue a strategy that defies the assumption that there is an all-or-nothing choice between rejecting the liberal international order and upholding it. The declarations signed at the yearly BRICS summits, for example, show how committed member states are to maintaining and strengthening the UN framework and many other multilateral institutions like the World Trade Organization. At the same time, these emerging powers have engaged in unprecedented institutional entrepreneurship, as the creation of the NDB and China's AIIB attest.

Why did emerging powers decide to engage in this type of behavior? In the eyes of emerging powers, the dominant institutions were no longer fulfilling their purposes in an adequate way, and little suggested that reforming them would be possible. While policymakers from Beijing, Delhi, and elsewhere in the Global South sought and continue to seek a larger role within the existing framework, they did not feel that established powers were willing to provide them with the adequate power and responsibility. Reforms at the World Bank and the IMF have been too slow, and not far-reaching enough. Seen from Delhi, Beijing, and Brasília, the World Bank remains, despite its name, essentially a Western-dominated institution, and there is little prospect that this will change any time soon. The institutional reform agenda of the first decade of the Twenty-First Century has failed, largely due to the resistance to reform of global structures, and this has strongly contributed to the rise of the incipient parallel order described below.

It is precisely in this dimension that the activities of emerging powers—and especially Beijing's—can be best understood as international institutional bypasses, as they not only keep the preexisting institution in place, but also seek to offer benefits that existing institutions do not generate—namely, greater financial support for infrastructure in Asia and other developing countries. Yet rather than reinventing development finance from scratch, these institutions operate based on existing knowledge, and in many cases even use human resources with ample experience in existing institutions. Indeed, the first projects of the AIIB support work jointly with existing institutions, such as the Asian Development Bank and the World Bank.

The strategy used by China and the other BRICS countries is thus not openly aggressive vis-à-vis the existing order. Most of the structures they set up are complementary or parallel to existing ones, rarely challenging them

<sup>3</sup> John J. Mearsheimer, [China's Unpeaceful Rise](#), 105 CURRENT HIST. 160 (April 2006).

<sup>4</sup> Nikolas K. Gvosdev, [World Without the West Watch](#), NAT'L INT. (Nov. 21, 2007).

head-on or disrupting them—another element of an IIB. What is often overlooked in the debate about these institutions is that they are mostly open for Western powers to join them—as is the case of the AIIB, which has several European founding members. This reinforces the idea that they are operating as an IIB by offering a broad range of actors a choice between the new institution, or the dominant one.

There is also, of course, a political dimension to these initiatives. Chinese activities are not only about providing better global public goods. Creating, leading, and controlling international institutions is a means to influence others, and one of the main goals of establishing parallel structures is to slowly enhance strategic autonomy and reduce China's dependence on Western-controlled structures and institutions. Just like the West has used international institutions like the World Bank and the IMF to project its power and draw countries into its sphere of influence, China and other non-Western powers will use their new institutions to cement their newly won centrality, tighten economic ties to other countries, and eventually generate stronger political influence. In addition, they will enhance non-Western powers' capacity to navigate the international system according to their own interests, picking and choosing institutions on a case-by-case basis. Rather than creating their own distinctive set of rules and institutions, China and other emerging powers are likely to construct these institutions according to broadly similar paradigms and interests as Western powers have done in the past—with both the benefits and incoherence those structures entail.

Still, risk-averse and conscious of its limitations, China continues to actively support existing structures, making it harder for the West to accuse China of actively undermining current order. Nevertheless, the political dimension of this institutional entrepreneurship is still very clear. Indeed, the United States actively sought to undermine the AIIB, transforming the question of many of its allies' potential membership into a diplomatic contest. In contrast, the vast majority of observers even within the World Bank have welcomed the rise of new development banks.

### *Emergence of Parallel Structures*

The development of these banks will help allow countries that are home to the majority of humanity to play a more important role when it comes to dealing with global challenges. As a [Financial Times editorial](#) rightly argued after the Sixth BRICS Summit:

Shifts in global economic power suggest that changes in institutional power may be logical—or even inevitable. Why should the US set the rules for the internet, when most internet traffic no longer involves Americans? Why should the dollar be the global reserve currency, when the US is no longer the unchallenged core of the global economy?<sup>5</sup>

This raises interesting questions about the inherent tensions in international institutions. On the one hand, they are providers of public goods. On the other, they are vehicles for projecting influence, and the Obama administration clearly identified the Chinese leadership of new institutions as an attempt to reduce Western control of global development finance—despite the consensus that there is a large unmet need for it in many developing countries around world.<sup>6</sup> This raises a question about the concept of institutional bypass: can it be strictly

<sup>5</sup> [The World Calls Time on Western Rules](#), FIN. TIMES (Aug. 1, 2014).

<sup>6</sup> This shows that, at least for now, new institutions are unlikely to fundamentally challenge the logic that undergirds current international development finance. Rather, the new structures are created as a parallel hedge—serving not only China, but also actors like Brazil, India, South Africa, and Russia, which can reduce their dependency on existing structures without openly reducing their support for them. As power is shifting towards emerging powers, these structures are an attempt to institutionalize their growing weight, project their power, and enhance their soft power by assuming greater international responsibility. For the West, the major question is to what extent it wants to become a stakeholder in Chinese-led projects, or whether to undermine the new institutions.

functional, even if there is an underlying political dimension to the delivery of these public goods? The case of Chinese-led institutional entrepreneurship suggests that it is difficult to separate the two, and that the IIB concept should take this ambiguity into account, particularly since the leadership of institutions like development banks inevitably confers significant political power. To some extent, the concept indirectly captures the political dimension by indicating that there may be some institutional competition in the way the bypass interacts with the dominant institution—and, if it works better, even threaten its existence at some point.

While this analysis focuses on development banks, Chinese efforts are broader, including initiatives in the realms of finance, currency, infrastructure, diplomatic dialogue, trade and investment, and security—all these can be seen as examples of institutional bypasses (even though the dynamics of development finance and security are profoundly different, and each would have to be analyzed separately).

Table 1 lists the international institutions led by non-Western powers in the areas of finance.<sup>7</sup> In the right column of the graph appears the existing institution that is most comparable to a particular new institution.

Provided that China and other developing countries (predominantly in Asia) can continue their above-average growth trajectory, we should see the emergence of several other new structures in the coming years. The BRICS are discussing the possibility of setting up their own credit rating agency, increasing bilateral currency swaps, and establishing mechanisms for enabling and settling BRICS cross-border trade in local currencies. The China International Payments System (CIPS) will be Beijing's equivalent to SWIFT, dramatically reducing the West's capacity to isolate wrongdoers financially. Western analysts routinely warn their Indian or Brazilian counterparts that they are about to be “trapped in a Chinese-dominated order.”<sup>8</sup> That fails to take into account that countries like Brazil and India remain firmly integrated (or perhaps “trapped”) in existing institutions such as the World Bank, the IMF, SWIFT, and all the other structures led or controlled by Western powers. Being part of both U.S.- and Chinese-led institutions is likely to provide Brasilia, Delhi, and others with flexibility and room to maneuver and may help them increase their bargaining power within existing structures.

Most importantly, perhaps, the emergence of parallel structures will provide additional platforms for cooperation (among both non-Western and between non-Western and Western powers), and spread the burden of contributing global public goods more evenly. A post-Western international architecture is still a long way off, and it is far from certain whether it will ever become a reality. And yet, it is undeniable that China's institutional activism, which may be understood as a case of IIB, will profoundly influence both regional and global dynamics in the coming years. Whether China-led institutions will succeed does not depend on the United States or Europe, but on Beijing's capacity to convince its neighbors that China's rise is good (and not dangerous) for the entire region. While the outcome of China's bid to regional hegemony is far from clear, the West's active opposition to projects that could benefit the region are likely to play into China's hands.

### *Competitive Multilateralism*

There is no inherent revolutionary element or rupture in the creation of these new institutions. Emerging powers accept the global order's liberal characteristics and are likely to maintain them, but they will change the hierarchy that is a key characteristic of the system. Aside from the new institutions created by emerging powers, several existing international institutions may not look that different several decades down the line, and neither will the norms and rules they are based on. Yet while today it is the United States that can break the rules and go

<sup>7</sup> The third is analyzed in Medhora's essay in this AJIL Unbound Symposium. See Rohinton P. Medhora, *Monetary Unions, Regional Financial Arrangements, and Central Bank Swap Lines: Bypasses to the International Monetary Fund*, 111 AJIL UNBOUND 241 (2017).

<sup>8</sup> Cynthia Roberts, *Are the BRICS Building a Non-Western Concert of Powers?*, NAT'L INT. (July 8, 2015).

**Table 1:** The Parallel Order – Finance

| Non-Western institutions                           | Traditional institutions      |
|--|-------------------------------|
| The Asian Infrastructure Investment Bank (AIIB)    | Asian Development Bank        |
| The BRICS-led New Development Bank (NDB)           | World Bank                    |
| BRICS Contingency Reserve Agreement (CRA)          | IMF                           |
| Global infrastructure to internationalize the Yuan | US-dollar                     |
| China International Payment System (CIPS)          | CHIPS                         |
| China Union Pay                                    | VISA and MasterCard           |
| Shanghai Global Financial Center (GFC)             | Traditional financial centers |
| Universal Credit Rating Group                      | Moody's, Standard & Poor's    |

unpunished, this privilege will soon be China's, and possibly one day that of other emerging powers. There is no evidence that they will use it any differently than the United States has done over the past decades.

Still, the new wave of competitive multilateralism will seem unfamiliar to Western powers because they involve a plethora of new institutions created by non-Western powers. Playing on China's turf will make agenda setting far more difficult for policymakers from Washington and London. Decisive negotiations about global challenges—say, geopolitical tensions in Central Asia, or a necessary bailout for a developing country in trouble—will thus first focus on where such issues will be discussed in the first place.

Pointing to the potentially negative consequences, most observers will associate creating international bypasses with excessive competitive multilateralism, and an erosion of universal norms that will likely result in a “race to the bottom” when it comes to global standards. It is certainly true that the multiplication of standards in some fields (such as development finance) forces governments to understand more than just one system. Yet, there is little evidence that the growing number of development banks has negatively affected lending practices. Quite the contrary, the proliferation of institutions may also have important positive consequences, as they may propose new ideas regarding activities like lending practices, project evaluation, and knowledge sharing. This does not imply that they have a revolutionary approach or cause any kind of rupture—rather, any changes are more likely to be mostly technical in nature. After all, a lack of competition can undermine the agility and effectiveness of any institution, while competition can help generate new ideas and develop new best practices.

More importantly, as pointed out above, great powers will always be careful to balance their exceptionalism with the provision of global public goods and the stability they need to protect their vital interests. Beijing is fully aware of the fact that its hard power sources can only translate into political influence when they are bound by agreed-upon rules and norms. China cannot afford to be regarded as a global rule-breaker that cares little about the rest of the world. It was this very understanding that Chinese power must be embedded in a network of rules and norms to be considered legitimate that made policymakers in Beijing create the many institutions described earlier.

### *Conclusion*

The concept of international institutional bypass (IIB) may be helpful when thinking about emerging powers' entrepreneurship in a more sophisticated way, avoiding the simplistic approach that merely offers the more radical options of integration versus rupture. While power shifts require great powers to bargain constantly and renegotiate agreements with the rest of the world, this debate shows that they are not necessarily bad news for the future of global rules and norms. The case of the creation of the AIIB and the BRICS-led NDB show that the transition, for now, may involve far less systemic rupture than many had initially expected.