

## STRATEGIC STUDIES QUARTERLY

# China's Institutional Challenges to the International Order

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## Abstract

This article examines one critical but understudied question: *how* does China challenge the international order through multilateral institutions? By integrating institutional balancing theory in international relations (IR) and prospect theory in behavioral psychology, this article introduces a “prospect-institutional balancing” model to explain how China has utilized two types of institutional balancing strategies to challenge the US-led international order. We argue that China is more likely to use inclusive institutional balancing to challenge the United States in an area where it has a relatively advantageous status, such as the economic and trade arena. When China faces a security challenge with disadvantageous prospects, it is more likely to take risks to conduct exclusive institutional balancing against the United States. Using China's policy choices in the Asian-Pacific Economic Cooperation (APEC) and the Conference on Interaction and Confidence-Building Measures in Asia (CICA) as two case studies, the project tests the validity of the “prospect-institutional balancing” model.<sup>1</sup> It concludes that China's institutional challenge to the international order will be more peaceful than widely predicted.

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The rise of China is one of the most dynamic political events in world politics in the twenty-first century. Scholars and policy analysts have debated China's challenges to the international order as well as the implications for world politics. One critical but understudied question is *how* China challenges the international order. If China uses military means to overthrow the system (as power transition theory might expect) as Germany and Japan did in WWII, then military conflicts between China and the United States will be unavoidable. However, if China relies on multilateral institutions and institutional balancing strategies to challenge the international order, a peaceful power transition in the international system will become probable.

Borrowing insights from institutional balancing theory and prospect theory helps examine China's two institutional balancing approaches in challenging the US-led international order. This suggests that China is more likely to use *inclusive* institutional balancing—that is, to join and reform the rules and norms of existing institutions to maximize its economic gains in the liberal economic order. When facing security pressures and threats from US alliance-based bilateralism—the major feature of the security order—China is more likely to adopt *exclusive* institutional balancing, for example establishing and strengthening non-US-involved multilateralism, to minimize its potential losses in the security arena.

This article proceeds in four parts. First, by critically examining the “China debate” it argues that the current debate oversimplifies the dynamics of the international order and overemphasizes China's threats. How China challenges the international order is the key to examining the consequences of the rise of China. Second, integrating prospect theory with institutional balancing theory creates a “prospect-institutional balancing” model to explain how China copes with challenges and threats in the two components of the international order: the economic sub-order and the security sub-order. Third, the article provides case studies to examine China's inclusive institutional balancing through advocating the Free Trade Area of the Asia-Pacific (FTAAP) at the APEC as well as its exclusive institutional balancing through promoting the “New Asian Security” concept at the CICA. The conclusion suggests that although China's challenges to the international order will be inevitable, the outcome of the institutional balancing may be more peaceful than widely predicted.

## **China's Rise and the Dynamics of the International Order**

Scholars have debated China's rise and its implications for the international order since the 1990s. Most realists, especially offensive realists and power transition theorists, are pessimistic about China's rise in the international order because a rising power, by definition, is revisionist in nature, which aims to overthrow the existing international order. On the contrary, liberals optimistically argue that China will be a status quo power because China has benefited significantly from the current international order, which it should sustain rather than overturn. The uncertain constructivist school focuses on the role of ideas and norms of the existing international order in shaping China's foreign policy. It suggests that China's future is still unwritten, because ideas and norms in the international order are easy to interpret but hard to predict. While all three schools of thought have valid arguments in certain aspects, they suffer two analytical weaknesses: a static and holistic view of the international order and insufficient attention to China's different strategies in challenging the international order.<sup>2</sup>

### **Realism: China Is a Revisionist Power**

To a certain extent, different stripes of realism share a common argument about threats or potential threats of a rising China to the existing international order, although they disagree on the level of China's challenges as well as how to deal with China. For example, John Mearsheimer's offensive realism suggests that as a rising power, China will do what the United States did in the nineteenth century: pursue regional hegemony in its own hemisphere.<sup>3</sup> This revisionist behavior will be inevitably at odds with US hegemony—the essence of the existing international order. Therefore, Mearsheimer concludes that the rise of China will be “unpeaceful” and the United States will do anything to constrain, contain, and slow down China's rise.<sup>4</sup> Mearsheimer's argument is shared by power-transition theorists who suggest that the power transition in the international system is likely to end up with military conflicts and war between a rising power and the hegemon.<sup>5</sup>

Although defensive realists believe states are pursuing security instead of power in the international system, they are also pessimistic about the consequence of China's rise, US decline, and the transformation of the international system.<sup>6</sup> For example, as Christopher Layne points out, the emerging multipolarity caused by China's rise will be a nightmare for

US policymakers who still live in the unipolar illusion.<sup>7</sup> However, some defensive realists believe China will rise eventually, but its challenges and threats to the United States will still be limited over a relatively long time, especially in the military domain.<sup>8</sup> The policy recommendation of defensive realists is an offshore balancing strategy.<sup>9</sup> It means that the United States should gradually withdraw its security commitments and avoid a direct power competition with China in the Asia Pacific. Moreover, the United States should encourage other Asian countries, such as Japan, South Korea, and India, to balance rising threats from China.

Most realists label China as a revisionist state regarding the existing international order. China's "assertive diplomacy" since 2009 and the US "pivot toward Asia" during Obama's second term can be seen as an inevitable power struggle and competition between a revisionist power and the status-quo hegemon, as many realists have predicted.<sup>10</sup>

### **Liberalism: China Is a Beneficiary of the Existing Order**

Most liberals have an optimistic view of China's rise for two reasons. First, economic liberalism suggests that economic interdependence can make war costly for all countries and therefore will alleviate the intensity of strategic competition between the United States and China.<sup>11</sup> Next, institutional liberalism argues that China has benefited tremendously from the current international order after the Cold War, and therefore the stakes are too high for China to overthrow the system. In IR theorist G. John Ikenberry's words, the Western liberal order is easy to join but hard to overturn.<sup>12</sup> Although the United States might lose its hegemon status in the future multipolar world, it can still play a leadership role in the Western order.<sup>13</sup> In other words, the Western order built by the United States after World War II may not be able to stop China's rise, but it will shape and constrain its behavior. Therefore, most liberals advocate an engagement policy toward China so that China will be further integrated, enmeshed, and entangled by international rules and institutions.<sup>14</sup>

China's "charm offensive" in the 1990s and "peaceful rise" pledge in the early 2000s seem to support the "status quo" foreign policy suggested by liberals.<sup>15</sup> China strengthened its economic ties with the United States and joined the World Trade Organization in 2001.<sup>16</sup> China also alleviated regional suspicions toward its economic and military ascent by actively participating in regional multilateral institutions and strengthening confidence-building measures.<sup>17</sup> However, as mentioned above,

China's assertive turn in diplomacy after 2009 has cast a deep-seated doubt about the liberal optimism regarding China's rise. One remaining question is whether liberals are totally wrong. In other words, has China really decided to give up all the benefits from economic interdependence and the existing international order?

### **Constructivism: Socialize China into the Existing Order**

Constructivists highlight the role of norms, culture, and ideas in constituting state behavior.<sup>18</sup> Although they agree that China's rise is a challenge to the international order, they suggest that the prevailing norms, culture, and ideas can socialize China's behavior to make it fit with the existing international order. For example, East Asia international relations expert Alastair Iain Johnston suggests that Chinese foreign policy elites have been socialized by cooperative security norms and rules through participating in multilateral institutions since the Cold War.<sup>19</sup> This socialization effect in turn allowed Chinese foreign policy elites to educate their leaders about what China should do in the international system and directly contributed to the cooperative direction of China's foreign policy in the post-Cold War era.

Like Johnston, political scientist Jeffrey Legro suggests that Chinese political leaders are experiencing a clash of ideas and intentions regarding China's future role in the international system.<sup>20</sup> Other powers, especially the United States, should keep their ideational engagement with China so Chinese political elites can be further socialized by Western ideas, especially democracy and liberalism. The rise of the Soviet-like "new thinking" in China will eventually lead China to embrace democracy and the existing international order. In a similar vein, Like Legro, Johnston's policy suggestion is to further engage China through multilateral institutions so that Chinese leaders and policy elites can be continuously socialized by cooperative norms in security and foreign policy decision making. The US call for China to become a "responsible stakeholder" in the early 2000s can be seen as an engagement effort to socialize China into the existing international order.<sup>21</sup>

Like liberals, constructivists also face difficulties in explaining China's "assertiveness turn" in foreign policy after 2009. One possible explanation may lie in the contingent nature of ideas and intentions as well as the nonlinear socialization process. For example, Johnston might

argue that the socialization process of cooperative security norms is interrupted by other norms, such as nationalism or *realpolitik*.

While all three schools of thought contain some elements of truth, they suffer two analytical weaknesses: a static and holistic view of the international order and insufficient attention given to China's different strategies in challenging the international order. First, they hold a static and holistic view of the international order. In a realist world, the international order equals the international system, in which a rising power like China will inevitably challenge the status quo. When liberals argue that China is a beneficiary of the existing order, they also assume that there is only one Western order or liberal order in the world. Constructivists assume that some universal norms in one ideational system, such as cooperative security or democracy, may constitute and socialize Chinese elites' ideas in making policies.

Yet, "order" is a contested concept in international relations. Order can be just descriptive in nature in that scholars treat *order* as a synonym of *system*. International affairs scholar James Rosenau suggested that an analytic concept of order, or an empirical order, can "be located on a continuum which differentiates between those founded on cooperation and cohesion at one extreme and those sustained by conflict and disarray—i.e., disorder—at the other."<sup>22</sup> On the other hand, scholars can claim normative meanings to *order*, that is, a desirable outcome of states' interactions. Hedley Bull defined order as "a pattern that leads to a particular result, an arrangement of social life such that it promotes certain goals or values."<sup>23</sup> Similarly, Muthiah Alagappa conceptualizes order as "a formal or informal arrangement that sustains rule-governed interaction among sovereign states in their pursuit of individual and collection goals."<sup>24</sup> Generally, realists treat order more as a fact, while liberals and constructivists view order more as a rule or a value. However, as mentioned before, all of these three schools of thought to a certain extent hold a static and holistic conceptualization of order.<sup>25</sup>

In fact, the so-called international order has many components or sub-orders, which makes the transformation of the international order more dynamic than widely believed. According to Alagappa, order is built on the interaction among states. Different types of state interactions, therefore, can create different sub-international-orders, such as an economic order, a political order, and a security order in the world. Moreover, the change of the international order will not happen at one

time or overnight. Instead, one component of the international order, such as the economic order, may transform first while others may stay the same. In other words, the transformation of the whole international order will take time and happen gradually.

China might challenge the security order as realists predict, but it is not rational to overthrow the economic order, because, as liberals argue, China has been a “winner” by joining the liberal economic order after the Cold War. In addition, China’s communist ideology might be at odds with the democracy-based political order, but it will not lead to war as long as China does not export communism or revolution to the outside world. Therefore, the holistic and static view of the “international order” oversimplifies the complex nature of the international order and thereby overemphasizes the potential dangers or threats from the rise of China.

Second, there is no doubt that China will challenge some components of the international order. However, how China will challenge the international order is still an unanswered question and deserves serious scholarly inquiry and scrutiny. On the one hand, if China uses military means to overthrow the existing order just like Japan and Germany did in World War II, then a hegemonic war or a power-transition conflict between a rising China and the existing hegemon as well as other regional powers, such as Japan, seems unavoidable. On the other hand, if China uses other means, such as institutions, to challenge some parts of the existing international order, then the outcome of China’s challenges might not be conflictual. China can become a rule-maker or rule-reformer to transform the international order from within. As political scientists Randall Schweller and Xiaoyu Pu point out, China’s “rightful resistance” toward US-led international order might not lead to war or conflict in the post-US-hegemony era.<sup>26</sup>

### **Prospect-Institutional Balancing Model: How Will China Challenge?**

Built on prospect theory from behavioral economics and institutional balancing theory from IR, a “prospect-institutional balancing” model emerges to explain how China will challenge the different components of the international order or the sub-international orders. To simplify the model’s application, we only focus on two parts of the international order in world politics: the liberal economic order and the US bilateralism-based security order in the Asia Pacific.

Institutional balancing theory is realism-based, which suggests that the high level of economic interdependence among states in the context of deepening globalization encourages states to choose multilateral institutions instead of traditional military means to pursue security and interests under the anarchic international system. It is applied to explain the proliferation of multilateral institutions in the Asia Pacific, such as the ASEAN Regional Forum (ARF), the ASEAN Plus Three (APT), and the East Asia Summit (EAS), after the Cold War.<sup>27</sup>

According to institutional balancing theory, there are two types of institutional balancing: inclusive and exclusive. Inclusive institutional balancing means to invite a target state into an institution and use the rules and norms of the institution to constrain the behavior of the target state. The establishment of the ARF is seen as an inclusive institutional balancing of ASEAN states in constraining China's behavior in the 1990s. Exclusive institutional balancing intends to exclude a target state from an institution and utilize the unity and cohesion of the institution to exert pressures toward or countervail threats from the target state. The APT is an example of exclusive institutional balancing conducted by ASEAN states and three major powers in East Asia to enhance cooperation among them as well as deal with pressures from the United States after the 1997 Asian economic crisis.<sup>28</sup>

China's institutional challenges to the international order are remarkable after the 2000s. On the one hand, China has adopted inclusive institutional balancing against the United States through actively engaging existing institutions, such as the APT, the EAS, and APEC. On the other hand, it has also chosen exclusive institutional balancing targeting the United States through non-US institutions, such as the Shanghai Cooperation Organization (SCO) and the CICA. After the 2008 financial crisis, China became even more proactive in proposing new multilateral institutions, such as the Asian Infrastructure Investment Bank, the Community of Common Destiny, as well as the "One Belt, One Road" (OBOR)—an ambitious investment initiative across Europe and Southeast Asia. It might still be debatable whether the OBOR is a multilateral institution or not. However, to streamline the implementation of the OBOR, some types of multilateral institutions around the OBOR might be inevitable in the future.

One puzzle about China's institutional behavior is its different strategies toward different institutions.<sup>29</sup> As mentioned before, China has used



both inclusive and exclusive balancing in different institutions. To better understand the consequences of China's institutional challenges to the international order, it is imperative to know under what conditions or *when* China will adopt inclusive institutional balancing and under what conditions and *when* exclusive institutional balancing. The existing institutional balancing theory is inadequate to answer this question.

This article borrows insights from prospect theory, a behavioral economics/psychology theory, to address this *when* question. From laboratory experiments, Daniel Kahneman and Amos Tversky, the originators of prospect theory, found that the way people interpret their situation for making choices—as a domain of either gains or losses— influences how they behave in terms of their risk orientation.<sup>30</sup> People tend to evaluate choices with respect to a reference point; they choose risk-averse behavior in a domain of gains but risk-acceptant behavior in a domain of losses. In other words, if people are in an advantageous situation (a domain of gains), they are more likely to behave cautiously (be risk averse) to protect their gains. However, when people are in a disadvantageous situation (a domain of losses), they are more likely to choose risky behavior (be risk acceptant) that may either reverse or worsen their losses.<sup>31</sup> In other words, they choose irrationally by going “against the odds” of expected utility calculations, as in the case of the debt-ridden lottery player in the domain of losses whose odds (probability) of winning the lottery (achieving gains) are much worse than losing the purchase price (incurring losses) of the lottery ticket.<sup>32</sup>

Integrating prospect theory and institutional balancing suggests three outcomes: (1) inclusive institutional balancing is less risky than exclusive institutional balancing, because the latter is more oriented toward alienation, antagonism, and rivalry than the former; (2) a state is more likely to choose inclusive institutional balancing in an arena where it has clear advantages (i.e., when its decisions are framed in a domain of gains); and (3) a state is more likely to adopt exclusive institutional balancing in an arena where it has clear disadvantages (i.e., when its decisions are framed in a domain of losses). Applying this “prospect-institutional balancing” model to China's different institutional strategies suggests two hypotheses:

1. When facing pressures in a sub-international order where China has a comparative advantage, Chinese leaders are more likely to

be framed in a domain of gains and thereby to adopt a risk-averse policy of inclusive institutional balancing.

2. When facing pressures in a sub-international order where China does not enjoy a comparative advantage, Chinese leaders are more likely to be framed in a domain of losses and thereby to adopt a risk-acceptant policy of exclusive institutional balancing.

To test this prospect-institutional balancing model, two brief case studies will be used to examine China's institutional strategies in APEC and CICA.<sup>33</sup> Each case examines Chinese leaders' domain of actions when facing challenges to see whether Chinese leaders behave in a domain of gains or a domain of losses. The prospect-institutional balancing model is used to predict what Chinese leaders will do. The results are compared to China's actual policy choices.

## **China's Institutional Strategies in APEC and CICA**

China has adopted inclusive institutional balancing and exclusive institutional balancing strategies through the APEC and CICA respectively to deal with economic and security pressures from the United States. At the 2014 APEC meeting in Beijing, China actively promoted the Free Trade Area of the Asia-Pacific (FTAAP) for offsetting negative influences and the impact of the US-led Trans-Pacific Partnership (TPP). In 2014, China reinvigorated the CICA, a less-known security institution across Asia, to countervail security pressures from the "US pivot" policy by the Obama administration.

### **The TPP and China's Inclusive Institutional Balancing through the FTAAP**

The APEC is an important multilateral institution aiming to promote free trade and economic liberalization in the Asia Pacific. It was established in 1989 and has 21 members from the Asia Pacific now, including the United States and China. However, due to the stalled Doha Round of trade negotiations in the World Trade Organization (WTO), states have started some bilateral and unilateral free trade negotiations at the beginning of the 2000s. Although the 21 APEC leaders still gather annually, the APEC's role in promoting free trade at the regional level has gradually marginalized and diminished.

The TPP, a smaller free trade pact than the APEC, is a product of widespread dissatisfaction over the stalled Doha Round in the WTO as well as the slow development of APEC. It originated from the Trans-Pacific Strategic Economic Partnership (TPSEP) agreement, a four-country trade agreement among Brunei, Chile, Singapore, and New Zealand in 2005. Starting in early 2008, the United States joined negotiations to establish a broad and high standard trading bloc—the TPP—on the basis of TPSEP with support from other US allies in the Asia Pacific, such as Australia, Canada, and Japan. In February 2016, 12 countries signed the TPP agreement.<sup>34</sup> Because of its relatively high admission standards, especially on protection for intellectual property, high labor and environmental codes, and restriction on state-owned enterprises, China is intentionally excluded from the TPP. The Obama administration was clear that the purpose of the TPP is to prevent China from writing the trading rules in the Asia Pacific.<sup>35</sup> In the eyes of Chinese elites, the TPP is nothing but a balancing strategy of the United States aiming to undermine China's economic power and influence in the Asia Pacific region.<sup>36</sup>

Facing US challenges through the TPP, China can adopt either exclusive or inclusive institutional balancing. For exclusive institutional balancing, China will need to form a new trading bloc to purposefully exclude the United States so the China-led new trading bloc can counter-vail pressures from the TPP. For inclusive institutional balancing, China will need to create and dominate a larger trading bloc including the United States so China can use this bigger trading bloc to dilute the negative influence of the TPP. It is worth noting that the Chinese government publicly stated that it would examine the possibility to join the TPP after the 12 countries signed the TPP agreement in February 2016. However, it is still not clear whether the statement is genuine or rhetorical in nature due to the mounting difficulties for the Chinese economy to meet the TPP standards in a short period.

According to the “prospect-institutional balancing” model, China's policy choices are shaped by the nature of the challenge. In the economics and trading arena, China has enjoyed a relatively advantageous position since the 2008 global financial crisis. That crisis started in the United States and spread to the whole world quickly. Although China's economic growth was also dragged down to 9 percent in 2008, it was still the most dynamic economy in the world. In addition, the Chinese government announced a two-year, four-trillion Chinese Yuan (\$586

billion) stimulus plan to beef up its economy. It was the largest economic stimulus plan ever undertaken by the central government. As Dominique Strauss-Kahn, then the managing director of the International Monetary Fund, pointed out, “It’s a huge package. . . . It will have an influence not only on the world economy in supporting demand but also a lot of influence on the Chinese economy itself, and I think it is good news for correcting imbalances.”<sup>37</sup> To a certain extent, China was regarded as the hope of economic recovery in the world after the 2008 global financial crisis.<sup>38</sup>

In 2010, China passed Japan to become the second-largest economy in the world after the United States.<sup>39</sup> In 2013, China overtook the United States as the largest trading nation in the world.<sup>40</sup> In 2014, the IMF announced that according to purchasing power parity, China’s economy has passed the United States as the largest economy in the world. Although the Chinese government seems reluctant to celebrate its economic success publicly, it is difficult to deny that its economic performance is relatively better than that of the rest of the world, especially compared to the West, when measured in terms of economic growth. It is also an underlying reason why the United States became so active in forming the TPP after 2008 to countervail China’s economic influence in the Asia Pacific.

This relative economic advantage has placed Chinese leaders in a domain of gains when facing the TPP pressures from the United States. Therefore, according to the prospect-institutional balancing model, China is more likely to adopt an inclusive institutional balancing strategy. In fact, China has chosen inclusive institutional balancing to promote the FTAAP through the APEC. The strategic purpose of the FTAAP is to dilute the potential negative impacts from the TPP.

Establishing a regional free-trade agreement was not a new idea in the Asia Pacific. Japanese economist Kiyoshi Kojima is usually credited for first advancing such a Pacific free trade agreement concept in 1966. In the late 1980s, the Pacific Economic Cooperation Council and the later APEC were formed to encourage economic cooperation and trade liberalization in the region. In more recent times, US economist C. Fred Bergsten has been at the forefront as an advocate of an FTAAP. In 2006, Bergsten published an article in *Financial Times* suggesting that a regional trading bloc in the Asia Pacific can be a “plan B” to respond to the stalled trade negotiation in the Doha Round in the WTO.<sup>41</sup> The

APEC, therefore, has become a logical platform to promote the FTAAP. For example, the APEC officially announced that it would examine the long-term prospect of an FTAAP in 2006.

China has been an active member of APEC since it joined. Chinese leaders took the APEC summit meeting seriously because it is an important diplomatic platform to engage other countries, especially the United States. For example, it is reported that China and the United States utilized the APEC meeting to restore bilateral relations after the 1995–1996 Taiwan crisis.<sup>42</sup> However, China normally played a participant or a follower role in the APEC. There are two reasons for this. First, China is a latecomer to the liberal trade regime because it officially joined the WTO in December 2001. Although it has become the largest trading nation, until now China has not been granted a “market economy” status in the WTO. Therefore, as a beneficiary of the world trade regime, its contribution to the APEC is limited.

Second and more important, APEC is a loosely organized forum without enforcement mechanisms. The decision making of APEC is based on consensus and voluntarism. In other words, despite the fact that APEC leaders like to gather annually, APEC itself is just a place to propose ideas—not to implement them. Therefore, some critics suggest that APEC, like other multilateral institutions in Asia, is just a “talk shop” without teeth. For China, it can actively participate in the APEC, but there is no tangible benefit for it to lead the APEC. As for the proposal of establishing the FTAAP, China’s original attitude was lukewarm at best just because of the “talk shop” nature of the APEC.

However, China’s policy toward the APEC and the FTAAP changed dramatically in 2014 when the TPP challenges from the United States were approaching China’s economy. In 2014, China was the host nation of the APEC summit in Beijing. Using its hosting role, China proactively advocated the establishment of the FTAAP. More importantly, China encouraged other APEC members to endorse a roadmap to form the FTAAP. If the FTAAP was just an idea or a proposal without any implementation plan before, it had a clear blueprint after the 2014 APEC meeting. President Xi hailed this new development as “a historic step we took in the direction toward realizing the FTAAP, marking the official launch of the FTAAP process and demonstrating the confidence and determination of the APEC in advancing regional economic integration.”<sup>43</sup>

Although the final establishment of the FTAAP is still uncertain, China's changing policy toward the FTAAP serves two strategic purposes for China. First, since Xi Jinping came to power in 2013, China has gradually abandoned the traditional "keeping-a-low-profile" principle and started a foreign policy of striving for achievement. Hosting APEC in Beijing provided an opportunity for Xi to implement his new principle of striving for achievement.<sup>44</sup> Therefore, the FTAAP can be seen as a product of China's new proactive foreign policy under Xi. Additionally, the FTAAP can serve as an inclusive institutional balancing against the United States and its TPP. Differing from the TPP with only 12 members, the FTAAP includes all APEC nations.

While the United States stated that it would write the trading rules in the TPP, the FTAAP, if established under Chinese leadership, will become a rule-making arena for China. Moreover, it is clear that China intends to use the FTAAP to subsume the TPP in the future. For example, Xi clearly stated at the 2014 APEC meeting that the FTAAP can be the "aggregation" of existing free-trade arrangements, including the TPP and the Regional Comprehensive Economic Partnership (RCEP). In other words, the FTAAP will eventually take over both TPP and RCEP in leading regional trade and cooperation.

It is worth noting that China also actively engages in the negotiations of the RCEP, which is widely seen as a counterinstitution of the TPP. However, there are two reasons why the RCEP is not an exclusive institutional balancing of China against the United States. First, the RCEP is not led by China but by ASEAN. Actually, China has different views than ASEAN on the framework of the RCEP. While China preferred to develop the RCEP on the basis of ASEAN Plus Three, some ASEAN countries and Japan supported a broader structure of the RCEP (i.e., ASEAN Plus Six). Eventually, ASEAN and Japan won the "battle" and the current RCEP is based on the ASEAN Plus Six. Therefore, it is hard to argue that the RCEP is *China's* exclusive institutional balancing strategy against the United States or the TPP—although it might help China countervail pressures from the TPP to a certain extent.

Second, the principle of the RCEP is an open or inclusive free-trade agreement. It means that the United States can join the RCEP anytime it wants. The problem is not that ASEAN or China wanted to exclude the United States from the RCEP but that the United States did not want to join in the first place, because the free-trade and investment

standards of the RCEP are too low compared to the TPP. Therefore, it is the United States that excluded itself from the RCEP, not China or ASEAN per se. This is why China has to choose APEC/FTAAP as a new inclusive institutional balancing strategy to further balance or dilute the potential negative impacts of TPP.

Still, China's high-profile effort in advocating the FTAAP does not mean that the FTAAP will be a success in promoting regional economic cooperation or trade liberalization. However, it serves China's institutional balancing purpose. On the one hand, the FTAAP offers a rule-making opportunity for China to compete with the United States in constructing the future trading regime in the Asia Pacific. On the other hand, it will reduce the negative economic impacts of the TPP on China's economy because all TPP members are included in the FTAAP. If both TPP and FTAAP are established, China will enjoy the same trading privileges with the TPP nations even though it is excluded from the TPP.

President Donald Trump's withdrawal from the TPP in early 2017 has brought uncertainties for the regional free-trade regime and China's foreign policy. It is hard to foresee what China will do without the TPP, because many domestic and international factors might influence its foreign and economic policies. However, institutional balancing theory suggests two preliminary predictions. First, without the TPP pressure, China's incentive to push the FTAAP will be reduced. Although it might still publicly support a region-wide free-trade agreement or the FTAAP, the lack of balancing pressure from the TPP will limit its substantial efforts in the FTAAP. Second, China might focus on the development of the RCEP since it has the potential to replace ASEAN's leadership in the RCEP. However, it will not be easy, because ASEAN and Japan will conduct inclusive institutional balancing against China inside the RCEP.

Thus, in facing US challenges in the economic arena, especially through the TPP, China has adopted an inclusive institutional balancing strategy through promoting FTAAP in APEC. Because of China's relatively strong economic performance after the 2008 financial crisis, Chinese leaders acted against the TPP challenge in a domain of gains. The inclusive institutional balancing is a risk-averse behavior because the FTAAP does not directly antagonize either the United States or the TPP. It is still a balancing strategy because the FTAAP has the potential to dilute the influence and impact of the TPP and the United States in the region. Therefore, China's FTAAP policy basically supports the first

hypothesis of the prospect-institutional balancing model, which suggests that China is more likely to adopt an inclusive institutional balancing strategy in an issue area where it has relative advantages compared to others.

### **US Pivot and China's Exclusive Institutional Balancing in CICA**

The Obama administration adopted the “pivot toward Asia” after the 2008 financial crisis.<sup>45</sup> In 2011, Secretary of State Hillary Clinton published an article in *Foreign Policy* titled “America's Pacific Century,” which emphasized US renewed interests in the Asia Pacific.<sup>46</sup> In late 2011, Obama paid a 10-day visit to the Asia Pacific to attend the East Asia Summit (EAS) in Bali, Indonesia. It was the first time the United States participated in the summit as a full member. Obama raised the South China Sea issue with Chinese Premier Wen Jiabao at the meeting. Moreover, in his speech in Australia, Obama reconfirmed the US pivot or rebalancing strategy in the Asia Pacific, because “the United States will play a larger and long-term role in shaping this region and its future.”<sup>47</sup>

In June 2012, US defense secretary Leon Panetta announced the United States would reconfigure US forces to deploy 60 percent of its naval power to the Asia Pacific. The adjustments included “six aircraft carriers, and a majority of the Navy's cruisers, destroyers, littoral combat ships and submarines.”<sup>48</sup> Moreover, Secretary Panetta ensured the coming budget cut would not affect US security commitments to the region. Given the fact that the United States already had 50 percent of its warships in the Pacific, the 10 percent increase of naval power seemed not very significant from a pure military perspective. However, considering US budget constraints at home as well as the unstable situation in the Middle East, it may have stretched thin what the United States could possibly do in the Pacific.

More importantly, the US pivot strategy aims at increasing the flexibility of US military deployments in the region. Instead of maintaining expensive permanent bases in Asia, the United States promoted a more flexible deployment approach in which its troop presence “will be smaller, more agile, expeditionary, self-sustaining, and self-contained.”<sup>49</sup> More specifically, the United States will move or rotate its troops through different ports in the region. Although it is a less expensive deployment option, it will require greater cooperation from its Asian allies who will host US troops on their soil. In addition, it will also require upgrading



the military capabilities of its Asian allies or partners to facilitate military coordination with US troops.<sup>50</sup>

Multilaterally, the United States actively participated in regional institutions, such as the ARF and EAS. It is a sea change in US foreign policy compared with the George W. Bush administration, when Secretary of State Condoleezza Rice would consistently skip ARF meetings. Strategically, the United States started to strengthen traditional ties with allies, such as Japan, the Philippines, and Australia in the Asia Pacific. During his visit to Australia, Obama announced deploying 2,500 Marines in Darwin.<sup>51</sup> The United States also reached an agreement with Singapore to base several combat ships in its ports. In November 2011, Secretary Clinton visited Manila and signed the “Manila Declaration” to strengthen the Philippines’ surveillance capabilities in the South China Sea.<sup>52</sup>

The US pivot is a clear containment effort in the eyes of Chinese leaders, although US officials publicly denied that it targeted China.<sup>53</sup> Facing US pivot pressures in the security arena, China has two strategic options. The first one is to form a military-based alliance to deal with military pressure from the strengthened US alliances in the region. It is a traditional realist policy rooted in either balance of power or balance of threat theories. Another option is institutional balancing, which means to use multilateral institutions to countervail US pressures. It is a policy option advocated by institutional balancing theory and soft balancing theory, which suggest that economic interdependence increases the potential costs of military-based balancing or hard balancing. Therefore, multilateral institutions become a useful diplomatic tool for states to balance against outside pressures.<sup>54</sup>

In fact, China has adopted both balancing strategies in dealing with the US “pivot” pressure. Militarily, China has strengthened its own capabilities (internal balancing) and tightened strategic ties with Russia (external balancing). Although neither China nor Russia admitted that their close military cooperation targeted the United States, their upgraded “strategic partnership” is widely seen as a “soft alliance” against the United States, the common threat for both China and Russia.<sup>55</sup> China’s military-based balancing strategy against the United States deserves a serious inquiry, which is beyond the scope of this article. Here the main focus is on China’s institutional balancing strategies through multilateral institutions, not internal or external balancing as Kenneth Waltz suggested.<sup>56</sup>

As mentioned before, the US pivot is multifaceted in nature. Strengthening military ties with traditional allies is only one part of the story. The United States has also used multilateral security institutions (such as the ARF) to pressure China on the South China Sea issues. Facing US pressures through multilateral institutions, China can choose either inclusive institutional balancing or exclusive institutional balancing. However, which policy China will choose depends on the domain of action that Chinese leaders are framed in according to the prospect-institutional balancing model.

Militarily, China is still far away from catching up with the United States. There are many military indicators that show the capability distance between China and the United States in technology, weaponry, and strategy. One simple way to gauge military power is to compare the military budgets of the two countries. China's defense spending is always a myth for analysts because of its less transparent political system.<sup>57</sup> In 2015, the Chinese government officially announced its defense budget of \$146 billion, an increase of 11 percent from the budget of \$131 billion in 2014. In comparison, the US defense budget is around \$597 billion in 2015—four times the Chinese budget. Even with the most aggressive estimate from the Stockholm International Peace Research Institute, China's actual military spending was \$214 billion, still only a third of the US budget.<sup>58</sup>

The huge military power gap between the United States and China has put the Chinese decision makers in a domain of losses in dealing with US challenges in the military arena. This disadvantageous situation encourages Chinese leaders to choose a risk-acceptant behavior in choosing institutional balancing means. According to the prospect-institutional balancing model, China is more likely to adopt exclusive institutional balancing when Chinese leaders are framed in a domain of losses. Through excluding the United States from a multilateral institution that China leads, China can utilize the cohesion and unity of the institutions to offset the pressures from the United States, although it is a risky institutional choice due to its potential antagonism toward the United States.

In 2014, China actively reinvigorated the CICA, an old security institution initiated by small central Asian countries, to exercise its exclusive institutional balancing against the United States. The CICA was first proposed by Kazakhstan President Nursultan Nazarbayev on 5 October

1992. It is a loosely organized, security-oriented multilateral institution in Asia. Originally, it had 15 members, including China, Russia, and some Central Asian and West Asian countries. It was not well known in the world because of its relatively slow institutionalization and development. The first foreign minister meeting of the CICA took place in 1999, and the first CICA summit meeting was in 2002. Due to the proliferation of the multilateral institutions in the Asia Pacific, the CICA did not attract much attention until 2014 when China chaired it. China hosted the fourth CICA summit in Shanghai, which became the largest ever participation by the heads of state and governments. The UN secretary general also attended the summit.

Through the “host” diplomacy by the Chinese, President Xi advocated a new “Asian security concept” at the CICA summit. According to Xi, “it is necessary to advocate common, comprehensive, cooperative, and sustainable security in Asia. We need to innovate our security concept, establish a new regional security cooperation architecture, and jointly build a road for security of Asia that is shared by and win-win to all.”<sup>59</sup> It is worth noting that this was not the first time China promoted this type of cooperative security ideas. China advocated a similar “new security concept” at the ARF meeting in the 1990s.

However, there are two distinctions in Xi’s speech at the CICA. First, China proposes a new security architecture targeting the US-led regional security order. It is still not clear what a security architecture based on “common, comprehensive, cooperative, and sustainable security” looks like and how Asian countries can achieve it. However, the real message between the lines of Xi’s speech is that it is time to abandon the US-led, post–World War II regional security order. Moreover, Xi directly challenged the presence of the United States in the Asia Pacific. In his speech, Xi stated “it is for the people of Asia to run the affairs of Asia, solve the problems of Asia and uphold the security of Asia. The people of Asia have the capability and wisdom to achieve peace and stability in the region through enhanced cooperation.”<sup>60</sup> Although Xi did not mention the United States in name, the implication is clear that Asia is for Asians and the United States should go home.

The United States is not a formal member of CICA; neither is Japan—both countries have an observer status. As one reporter mentioned, more than half of the CICA members are authoritarian regimes according to the Western standard.<sup>61</sup> Therefore, the CICA became a useful diplomatic

tool for China to gather support from states with similar ideologies and political systems. The unity and coherence of the CICA became a valuable form of soft power for China to countervail pressures from the United States. While the United States actively advocated its pivot to Asia through strengthening bilateral alliances, China (with the endorsement of the other CICA members) strongly promoted a multilateral security order based on cooperative security ideas. The competition between US bilateralism and Chinese multilateralism in regional security signifies the inevitable clash of ideas between the hegemon and a rising power during the power transition period. Although it is still too early to say whose version of regional security will win out, China's policy through the CICA is a clear exclusive institutional balancing strategy against the United States.

It is worth noting that the CICA is by no means the only institutional platform for China to challenge the United States. The Shanghai Cooperation Organization (SCO) is also a non-US security institution led by China and Russia. Like CICA, the SCO has become an important diplomatic arena for China to conduct its exclusive institutional balancing against the United States. The close military cooperation among the SCO members, such as joint military exercises, might not directly challenge US security and interests in the short run. In the long run, however, the cohesion of the SCO will be a valuable institutional asset for China to pool resources against the United States if necessary.

In short, China has adopted an exclusive institutional balancing strategy against the US pivot-to-Asia challenge in the security arena. Due to the huge power gap between the United States and China, Chinese leaders, especially Xi Jinping, are placed in a domain of losses, which encourages risk-acceptant behavior. Exclusive institutional balancing is more risky than inclusive institutional balancing due to its alienating and antagonistic nature. Just because no country likes to be excluded by others, this exclusive design of multilateral institutions becomes an important diplomatic weapon to address external threats and challenges from an outside target state.

Finally, it should be noted that prospect-institutional balancing is only partially supported in this case study. Facing the security challenges and threats from the United States, China indeed chose both traditional military-based balancing and exclusive institutional balancing strategies. But China's military-based balancing is beyond the explanatory domain

of the prospect-institutional balancing model, which reveals the theoretical limitation of the model. However, the prospect-institutional balancing model can still serve as an analytical tool to explain a state's institutional strategy in dealing with institutional pressures and challenges.

## **Conclusion**

It is too pessimistic to predict or prescribe a conflictual and inevitable clash between China and the existing international order. Although China will challenge the existing order, how China will do it or which strategy it will use is still an understudied question. Moreover, which part of the international order China will take on is still uncertain. Therefore, it is too early to predict a coming conflict with China without carefully examining its various strategies in different sub-international orders.

Integrating prospect theory and institutional balancing theory introduces a prospect-institutional balancing model to explain how China deals with pressures from the United States in different issue areas. Facing US economic pressures through the TPP, Chinese leaders responded in a domain of gains because the Chinese economy was in much better shape than the rest of the world after the 2008 financial crisis. Therefore, China has adopted a risk-averse policy to conduct an inclusive institutional balancing strategy against the US TPP through promoting the FTAAP, because the FTAAP could reduce US influence and offset trading pressure from the TPP.

When the United States challenged China in the security arena through the pivot-toward-Asia policy in 2011, Chinese leaders were framed in a domain of losses due to the huge military power gap between the two nations. Consequently, Chinese leaders have conducted a risk-acceptant policy, that is, exclusive institutional balancing, against the US pressures in the CICA. Since the CICA is a non-US security institution, it provides the opportunity and platform for China to gather support and pool resources from other CICA members against the United States. In the 2014 CICA meeting in Shanghai, Xi advocated a new Asian security concept based on multilateralism as well as an "Asia-is-for-Asians" philosophy. Although it is unclear whether Xi's new Asian security concept can actually succeed beyond the CICA, the balancing goal of this new concept has been fulfilled. On the one hand, China has implied that the US-pivot policy was an outdated strategy, which should be replaced by multilateralism and cooperative security. On the other hand, China's

message is clear toward the outside world that the Chinese vision of the new security architecture will be more peaceful than widely predicted. In other words, what Xi really suggests is that it is time for other Asian countries to abandon the old US-led security order and embrace the new Chinese one.

China's rise will inevitably challenge the existing international order as we have seen from China's "assertiveness turn" in diplomatic strategy after the global financial crisis. However, we suggest that institution-based balancing and counterbalancing between China and the United States might not lead to war or conflict as realists predict. China intends to write new rules and develop new norms differing from the ones in the existing international order. However, China will also be constrained by these new norms and rules. This "lock-in" effect of multilateral institutions will ensure that a new type of power transition based on institutional balancing rather than traditional military means might be more peaceful than widely predicted. However, our case study on the CICA in the security arena also indicates that both the United States and China have also pursued military balancing besides institutional balancing against one another. As Winston Churchill used to say, "To jaw-jaw is always better than to war-war." The future of the international order depends on the wisdom of policy makers in selecting the right institutional tool to solve traditional problems. **ISSQ**

## Notes

1. Members of APEC include Australia, Brunei Darussalam, Canada, Chile, China, Hong Kong, Indonesia, Japan, Republic of Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, the Philippines, Russia, Singapore, Chinese Taipei, Thailand, the United States, and Vietnam. Members of CICA include Afghanistan, Azerbaijan, Bahrain, Bangladesh, Cambodia, China, Egypt, India, Iran, Iraq, Israel, Jordan, Kazakhstan, the Republic of Korea, Kyrgyzstan, Mongolia, Pakistan, Palestine, Qatar, Russia, Tajikistan, Thailand, Turkey, United Arab Emirates, Uzbekistan, and Vietnam.

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30. Daniel Kahneman and Amos Tversky, "Prospect Theory: An Analysis of Decision under Risk," *Econometrica* 47 (March 1979), 263–91, <http://www.jstor.org/stable/1914185>. Tversky died in 1996, and Kahneman was awarded the 2002 Nobel Prize in economics for his work in prospect theory.

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44. Yan Xuetong, “From Keeping a Low Profile to Striving for Achievement,” *Chinese Journal of International Politics* 7, no. 2 (1 June 2014): 153–84, <http://doi.org/cb3z>.

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