Institutional Adaptation
How China Adjusts the International Order

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Abstract
The international order is being confronted by a global power shift. As emerging states grow more powerful, they are set to demand more authority within the order. The same holds true for China, today’s most notable emerging state. Because the distribution of power within some of the order’s major institutions no longer reflect China’s economic and geopolitical weight, it aims to make adjustments to the system. For example by introducing new, parallel institutions, or by making sure existing ones adapt. This thesis aims to understand how China uses its increasing power to pressure existing international institutions to adapt. The analysis focusses on the International Monetary Fund (IMF), which was pressured to recognize China’s demands for change in the aftermath of the global financial crisis. The findings of this research show that an exogenous shock was necessary to exacerbate the power differences which prompted institutional adaptation. This shock: the global financial crisis, triggered a critical juncture in the IMF’s development by providing China with enough hard and soft power to effectively challenge the institutional status quo. Because China was only briefly able to undermine the IMF before the institutional balance of power re-equilibrated, this research proposes to include critical junctures as a key concept in institutional power shift (IPS) theory.

Keywords
International order ∙ Institutional adaptation ∙ Power shift ∙ Rational choice institutionalism ∙ Critical junctures ∙ International Monetary Fund (IMF)
1 Introduction

China’s economy has experienced the fastest sustained expansion for its size in history (World Bank, 2019). Today, China has grown to become the world’s largest economy by many measures and it is expected to overtake the United States in terms of GDP before the year 2030 (Morrison, 2018). Its economic rise has been a source of increasing power for China’s regime, which seems to be slowly departing from its low-profile policy and moving towards a role at the center of the international system (Clover, 2017). During its latest party congress in October 2017, the Chinese Communist Party (CCP) presented its vision for the first half of the twenty-first century. Its president, Xi Jinping, stated that the party’s current mission is to “rejuvenate the nation”. Xi wants China to become prosperous and strong again, so that it can recover from a “century of humiliation” and reclaim its rightful place in the international order (Xinhua, 2017). According to Dr Yu Jie, head of the China Foresight program at the London School of Economics, there is a clear dissatisfaction amongst CCP elites with the distribution of power in some of the major institutions of global governance (Yu, 2018).

This dissatisfaction is however, not limited to China. For years emerging states have demanded to be more equally represented in the post-WW2 international order, but this has not always paid off (Buira, 2003; Daßler, Kruck, & Zangl, 2018). Ironically, by providing a strong foundation for China’s economic rise, it has been the international order itself which has enhanced China’s ability to successfully challenge some of its underpinning rules and institutions. Over time, China’s economic weight has translated into more bargaining strength in international organizations (IO’s) such as the WTO, World Bank and the IMF. This allows China to more effectively pressure IO’s to adapt to shifting power distributions (Ikenberry, 2008; Rittberger, Zangl, & Kruck, 2012, p. 271). As the following paragraphs will illustrate, these developments have received much devoted attention in the field of International Relations. However, while most studies focus on the consequences of China’s rise by asking whether or not it is challenging the international order, or to what extent, this research aims to explain how China has already used its increased power to adjust international institutions. It analyzes the causal mechanisms behind institutional adaptation by adopting the lens of institutional power shift theory to ask the following question:

How was China able to bring about the IMF’s adaptation of 2012?
2 Literature review

The rise of powers has been at the heart of international relations literature since Thucydides described the rise of Athens in comparison to Sparta. In his historical account of the fifth century BCE, Thucydides argued that the uneven growth in power and the fear it inspired made war between the two leagues inevitable (Strassler, 1998). Throughout history much scholarly attention has gone to the correlation between power transitions and international conflict. Especially in the last decades, when China’s economic rise began to inspire fear about an American decline (Allison, 2017; Kennedy, 1989; Tammen, 2008).1 As China’s power grows in comparison to the United States, some scholars believe that war between the two is also inevitable (Kagan, 1997; Mearsheimer, 2014). This realist perspective has been criticized by opposing scholars for overlooking the differences between China’s rise and the power transitions of the past. According to them, the rise of Athens, Germany, Japan and the Soviet Union all occurred in a vastly different world from today (Ikenberry, 2008; Nye, 2011a). In the decades following World War II, China committed itself to many key institutions of a Western-led, liberal international order. It co-founded the UN, the IMF, the World Bank, and further integrated into the international economic system when it joined the WTO in 2001 (De Wijk, 2019). Therefore, China now finds itself in a dense global web of governance that did not exist previously. In this new, multilateral world, rising states are more incentivized to cooperate than ever before (Ikenberry, 2008; Snyder, 2013).

Proponents of power transition theory argue that as long as these incentives are provided, China will remain satisfied with the existing international order and rise peacefully (Tammen, 2008). While some scholars believe that China is already dissatisfied and wants to replace the order’s institutional system (De Wijk, 2019; Kagan, 1997), more convincing evidence is presented by the opposing camp. They argue that China is acting as a “responsible stakeholder” of the current system because it finds its interests sufficiently represented (Chan, Hu, & He, 2018, p. 23). Therefore, they would like to see further integration of China in the current international order (Hachigian & Sutphen, 2008; Ikenberry, 2008). As this research will show, international institutions are adaptable enough to accommodate a rising China. However, whether this is also the long term wish of the Chinese government remains to be seen. Regardless of what China’s rise might entail for the international order, both sides of this debate agree that shifting distributions of power create difficulties for the orders’ institutional system (Keohane & Martin, 1995; Mearsheimer, 1994). Several scholars recognize that even if the

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1 Graham Allison (2017) concludes that out of the sixteen power transitions of the past, twelve have ended in war.
order is to survive by co-opting China, its institutions will inevitably change to some degree (Ikenberry, 2008; Nye, 2017, p. 13).

In fact, several studies have shown that China has already been a force for change (Hopewell, 2015; Zangl et al., 2016; Lipsy, 2017; Okano-Heijmans & Van der Putten, 2018). As researchers at the Mercator Institute for China Studies have pointed out, China has recently introduced many new structures of governance. While some of these structures are multilateral by design, such as the Asian Infrastructure and Investment Bank (AIIB), others may seem multilateral, but often work in conjunction with bilateral strategies, such as the 16+1 Framework and the Belt and Road Initiative (Heilmann et al., 2014). Although these new structures do not necessarily serve a counter-hegemonic purpose (Ikenberry & Lim, 2017), they do contest the rules, institutionalized practices and missions of existing institutions (Morse & Keohane, 2014). Besides introducing these new, competitive institutions, China also has been shown to expand its influence in existing ones. After all, new institutions are only beneficial when old ones can no longer be conformed to serve China’s interests. When they can, adjusting existing institutions might be the preferred way for China to increase its voice (Chan et al., 2018; Sohn, 2007). To this extent, prior research has shown China’s ability to increase its share of power in the UN, World Bank, IMF and Asian Development Bank (ADB) (Hopewell, 2015; Lipsy, 2017). Such research often assumes institutional adaptation to occur due to China’s use of hard power, such as financial payment or military threats. For example, China has been shown to significantly change the UN’s functioning by shifting the focus of its financial contributions to a small selection of the organization’s bodies (Okano-Heijmans & Van der Putten, 2018). More recently however, scholars began to question whether hard power resources are the only causal factors behind institutional adaptation to power shifts by looking more closely into the role of soft power (Daßler et al., 2018).

The current field of academic literature on institutional adaptation largely overlooks soft power. However, according to Daßler et al. (2018), it is of importance because states have to use soft power to justify their use of hard power in institutional bargaining processes. Institutional adaptations to power shifts are therefore also partly the result of the soft power states are able to mobilize. Until now, this theory has only been tested in two cases: the adaption of the Trade-Related Aspects of International Property Rights (TRIPS) agreement in the WTO and the adaption of the Convention on Biological Diversity (CBD). Therefore, the authors state:
“Of course, we must not generalize from the TRIPS and CBD cases too easily. The cases merely provide plausibility probes of our theory. Additional case studies on the relevance of soft power for institutional adaptation to power shifts are warranted. These should include cases of institutional adaptation in different issue-areas (not merely intellectual property protection), in different time periods (not merely in the early 21st century) and involving different emerging powers (not merely Brazil and India)” (Daßler et al., 2018, p. 18).

This research aims to address this gap in the literature by conducting an additional case study involving a different issue-area and a different emerging state. Namely, by examining the relevance of China’s hard and soft power for the IMF’s adaptation. Although this case study analyzes a similar time period, there is good reason to do so. The early 21st century represents a period of extreme volatility for the international order. As a part of ongoing global power shifts, China’s rise has been unprecedented in human history and its repercussions will undoubtedly affect international politics for decades to come. While it remains to be seen to what extent China will change the international order and its institutions, the processes that allows it to do so certainly deserve more attention. Especially now that China is assuming a more active and assertive role in the multilateral system.

3 Theoretical Framework

This research discusses institutional change as a result of a power shift. In what follows I will thus elaborate on theories of institutional change that focus on adaptation to changing power distributions. Moreover, this research accepts the main tenets of rational choice institutionalism, as will be further explained below.

3.1 Main theory

The theoretical assumptions of this research are that states can cooperate even when they are constrained by the anarchical structure of the international system. States are inclined to cooperate because of high alternative costs and ‘interdependence’ as an outcome of international institutions (Axelrod & Keohane, 1985; Keohane, 1984; Keohane & Nye, 1989). States are rational and deliberatively choose when to cooperate in these international institutions. Nonetheless, cooperation can still be an unequal affair due to issues of power (Nye, 1990).
In order to study the phenomenon of institutional adaptation to power shifts, this research will adopt the lens of institutionalist power shift (IPS) theory as proposed by Zangl et al. (2016). The theory claims that international institutions can adapt to shifting power distributions among their members. It hypothesizes that institutions only adapt when they become sufficiently pressured by their member states. The more that challengers of the status-quo are able to issue credible threats to undermine the institution, the more likely it is that defenders of the status-quo will accept the institution’s adaptation. This all depends on the relative bargaining strength of states (Zangl et al., 2016). Similarly to most power transition literature, this theory assumes hard power to be the main source of bargaining strength. New scholarship has expanded IPS theory by including sources of soft power when determining a states’ bargaining strength (Daßler et al. 2018). Although Daßler et al. (2018) agree that hard power is needed to make credible threats to undermine an institution, they argue that these threats also need to be backed up by soft power. This argument mainly rests on the importance of civil society resonance for a states’ arguments in the bargaining process. In other words, they argue soft power matters because it can justify a states’ use of hard power in the first place.

Before delving into the relation between power and institutional adaptation, these concepts must be accurately defined. Firstly, this research slightly deviates Daßler et al.’s (2018) conceptualization of power by emphasizing the views of Nye, who coined the terms hard and soft power in 1990. Accordingly, it considers power to be the ability to achieve one’s goals by affecting the behavior of others (Nye, 2004, p. 2). Hard and soft power are both aspects of this ability. Where a states’ hard power relies on coercion – often by threatening military force or economic sanctions – soft power relies on co-optation (Nye, 2004). More concretely, “soft power is the ability to affect others through the co-optive means of framing the agenda, persuading, and eliciting positive attraction in order to obtain preferred outcomes” (Nye, 2011, p. 21). One might imagine soft power as pulling and hard power as pushing. By effectively combining both aspects of power, actors become both feared and loved, allowing them to most successfully achieve their goals in international politics (Machiavelli, 1532; Nye, 2011a).

Power plays a role in institutional change during the bargaining processes between states about the terms of cooperation. The relationship between power and institutional adaptation is that states need power in order to make credible threats to undermine an institution (Zangl et al., 2016). The strength of a states’ bargaining position relies on both its hard and soft power relative to other states. Firstly, states need enough sources of hard power relevant to the institution that is being contested. For example, military capabilities in the case of the UNSC,
or financial assets in the case of the IMF. This provides them with the “power to undermine” an institution. Secondly, states need to have the “power to make credible threats” (Daßler et al., 2018, p. 4). For threats to be credible, they need to be not only backed up by sufficient muscles in the form of hard power, they also require soft power support. According to Daßler et al. (2018), threats are part of an argumentative exercise that relies on a states’ rhetorical capability and persuasiveness. They argue that a state with sufficient sources of soft power, can more easily attract support for its arguments from other states and civil society. This support provides the state with legitimacy for its cause and justification for its threats that undermine the institution. Therefore, states need soft power in order to set the agenda and mobilize coalitions.

When states have sufficient hard and soft power resources, they can undermine an institution in three different ways. Firstly, they can *sabotage*, by blocking a organization’s decision-making process. Secondly, they can *disengage*, by withdrawing or shifting their support. Third and lastly, they can *hedge* by introducing alternative governance structures (Morse and Keohane, 2014). While IPS theory goes a long way in explaining institutional adaptation, other schools of institutionalism offer insight.

### 3.2 Theoretical additions

IPS theory focusses on the endogenous causes of institutional adaptation. Namely, the bargaining process between states that may disrupt an institutions’ equilibrium. Interestingly, it became evident during the course of this research that exogenous shocks can affect this bargaining process. Most importantly, shocks such as war and crisis can exacerbate the power differences between states. Especially in the case of institutions that follow a path-dependent logic, a shock can be a significant force for change (Capoccia, 2015). Shocks can trigger so called ‘critical junctures’ in the development of institutions. Critical junctures refer to “relatively short periods of time during which there is a substantially heightened probability that agent’s choices will affect the outcome of interest” (Capoccia & Kelemen, 2007, p. 348). Therefore, critical junctures can allow adaptations to occur in institutions that were once resilient to change. Therefore, this research adds the following assumption in order to supplement the main, IPS theory.

Although this research maintains that institutional adaptation is the result of an internal bargaining process, it presents the argument that exogenous shocks can affect this internal process by altering the bargaining power of states. It therefore borrows insights from historical

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2 Page 4 and pages 18-19 illustrate how China has used the latter two of these strategies: hedging and disengaging.
institutionalism (HI). Specifically, this research draws from Kathleen Thelen’s dynamic constraints model by focusing on the actions of states within an institution in response to an external event (Thelen & Steinmo, 1992). According to Thelen’s model, this research assumes that state actors “are not merely spectators as conditions change to favor or penalize them in the political balance of power, but rather strategic actors capable of acting on “openings” provided by such shifting contextual conditions in order to defend or enhance their own positions” (Thelen & Steinmo, 1992, p. 17). By incorporating this assumption, this research provides a complete framework to study relatively rare moments of political openness in the history of path-dependent institutions (Capoccia, 2005).

3.3 Expectations and hypothesis

This research expects, according to IPS theory, that China’s ability to bring about the IMF’s adaptation of 2012 stemmed from both its hard and soft power. Because it had enough power relative to other states during the bargaining process, it was able to undermine the IMF with credible threats, which caused it to adapt. Additionally, this research hypothesizes that in the case of path-dependent institutions such as the IMF, adaptation only occurs when exogenous shocks exacerbate the power differences among states, therefore suddenly allowing (or denying) states the ability to challenge (or defend) the institutional status quo.

4 Research design

This research aims to test the hypothesis derived from the theory with a process-tracing method. The analysis therefore consists of careful empirical observations of China’s behavior in regards to the IMF. These methodological choices are explained below.

4.1 Methodology

This research uses process-tracing as its method of analysis. Through process-tracing it aims to find out how initial conditions turn into outcomes. This can be achieved by building a detailed historical narrative that ‘traces the processes’ in a specific case (Vennesson, 2008). In this research, process-tracing is used to examine the (potential) relationship between China’s use of power and the IMF’s adaptation of 2012. By performing this in-depth case study analysis, it aims to find out whether the causal mechanisms identified by IPS theory are generalizable to
the extent that they also count for the IMF’s adaptation of 2012. Process-tracing is the suggested method to analyze the role of power on the one hand (Nye 2011) and critical junctures on the other hand (Capoccia, 2015).

4.2 Case selection

This research takes a qualitative causes-of-effects approach. It firstly selects a case that exhibits ‘the effect’, which is an institution adapting to accommodate China’s rise. Secondly, it examines ‘the causes’ by questioning the role of China’s hard and soft power in bringing about these institutional changes. I select the case of the IMF because it displays the effect (institutional adaptation) and therefore expect to observe credible threats to undermine the institution, backed up by both hard and soft power. This assumption has been based on two case studies in earlier research: Brazil and India (Daßler et al., 2018). However, because soft power might be more pronounced in the foreign policy of democracies, these states both represent ‘likely cases’ (Nye, 2004). Although the theory has been able to explain these cases adequately, its strength relies on its ability to also explain the least likely cases. For this reason the case study of this research focusses on China. Because China is authoritarian, it is less likely that soft power matters (Nye, 2004). However, because the IMF still adapted to China’s rise, both hard- and soft power (the theory’s causal phenomena) should still be observed. Whether the theory holds depends on the congruence of this prediction with the empirical observations of this research. For example, if the observations show that institutional adaptations occurred when the causal phenomena were scarce, the theory should be amended. Additionally, when antecedent conditions matter, such as exogenous shocks, the theory should account for them. However, if the observations match the predictions of IPS theory perfectly, the theory as it stands is strengthened (Van Evera, 2015).

4.3 Data collection

Even though it is part of everyday life, ‘power’ remains a concept that is vague, elusive and difficult to measure precisely. Power depends upon human relationships that vary in different contexts, which is why previous attempts to capture the concept in a single formula have often failed (Nye, 2011). Hard power is relatively quantifiable, for example by measuring GDP, military expenditures, or other material assets. However, it is more difficult to measure soft power in numbers only. For this reason, a qualitative approach is required to effectively study
the full spectrum of power. Moreover, many causal factors can be involved in bringing about institutional change. Therefore, judging the causal relationship between power and institutional adaptation requires an in-depth analysis of the processes at play.

This research will analyze China’s behavior towards IMF and determine the degree to which it used hard and soft power to achieve its goal of institutional adaptation. Before conducting this analysis however, a statement is needed on what counts as evidence. In other words, what constitutes the use of either hard or soft power? Evidence for the use of power in an institutional setting can be found in the actions of a states. It can be concluded that a state uses soft power when it frames the agenda, when it persuades others, or when it elicits positive attraction in order to obtain its goal. Alternatively, the use of hard power can be identified when a state uses material capabilities, or threatens to do so (Nye, 2011). The evidence is gathered from observations of China’s behavior and the responses to that behavior by other state actors. Although the bulk of evidence comes from state representatives in the IMF, additional evidence is gathered from state representatives outside of the IMF’s institutional setting. Their actions, consisting of policy positions and official statements, have been carefully documented in primary sources and published by the IMF or other related bodies. Unfortunately, these documents are the only type of primary sources available for this research. This is mainly due to the limited transparency of the IMF. Although it is an international public institution, it does not allow citizens to appeal to find out exactly what is going on within its walls (Stiglitz, 2002). Therefore, this research also relies on secondary sources from actors with inside access to the IMF. Consequently, this puts additional emphasis on earlier findings such as those of Blustein (2013). Mindful of this constraint, this research aims to triangulate sources as much as possible. The time frame of the analysis will focus on the years leading up to the IMF’s adaptation, which occurred in 2012.

5 Empirics

Cooperation can be an unequal affair. Although states act rationally, their choice sets can be limited when they are constrained by actors who exercise power. Therefore, interdependence can be unevenly balanced (Nye, 1990). The international economic system institutionalized such imbalances amongst states. Its construction began at the end of World War II and was spearheaded by the United States, the world’s sole superpower at the time. Due to its hegemonic power status, the US was able to construct an asymmetrical economic system in its favor
(Blustein, 2013). However, this system was not only beneficial to the United States. Other states could also benefit greatly from integrating (Keohane, 1984; Ikenberry, 2008). Although China was fundamentally at odds with the architects of the international economic system when it came to topics such as sovereignty and human rights, it ultimately choose to integrate for the purpose of accelerating its economic development (Liang, 2002). Nowadays, it actively participates in multilateral economic institutions such as the WTO, the IMF and the World Bank. Through effective cooperation, China has been able to generate massive economic returns (Owen, 2019). However, now that China is growing relatively more powerful, it deliberately seeks to get rid of the asymmetrical structure of the system (Kaplan, 2017). Contrary to earlier work, which argued that a major conflict is necessary to achieve this (Gilpin, 1981; Mearsheimer, 2014), rational choice institutionalists argue that interdependence and high alternative costs make such conflicts unlikely. However, China is still able to contest the structure and institutional framework of the international economic system (Nye, 2010). Similarly to Kaplan (2017), this research therefore expects China to act as a rational actor that aims to endogenously change the existing international order (without overturning it) by achieving institutional change. According to IPS theory, China needs sufficient power to bring about the adaptation of existing institutions. While gradual global power shifts are underway, exogenous shocks such as war and crisis can exacerbate the power imbalances between states. This chapter examines one occasion of institutional adaptation following such a sudden power shift. It analyzes the IMF, which after decades of demands from a rising China, reformed its surveillance model in the wake of the global financial crisis. The table below presents a chronology of the bargaining process which led to the IMF’s adaptation. The subsequent paragraphs explain this process in further detail.

Table 1. A chronology of China’s bargaining process

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>China joins the IMF to become an active member.</td>
</tr>
<tr>
<td>1982</td>
<td>China first voices its discontent with the IMF’s biased surveillance model, to no avail.</td>
</tr>
<tr>
<td>2007</td>
<td>The global financial crisis redistributes power in the IMF, triggering a critical juncture.</td>
</tr>
<tr>
<td>2008</td>
<td>China gains the upper hand in the bargaining process for institutional adaptation.</td>
</tr>
<tr>
<td>2009</td>
<td>IMF staff changes the Surveillance Decision.</td>
</tr>
<tr>
<td>2012</td>
<td>The new ‘Integrated Surveillance Decision’ is ratified.</td>
</tr>
<tr>
<td>2016</td>
<td>The IMF’s balance of power returns to the pre-critical juncture status quo.</td>
</tr>
</tbody>
</table>
5.1 The case of the IMF

The International Monetary Fund is a key institution in the current international order. It governs international financial relations and serves as a venue for multilateral financial cooperation. The IMF’s main mission is to ensure the stability of the international monetary system. It aims to achieve this by closely monitoring the economic policies of its member states, also known as ‘surveillance’, and by providing technical assistance or loans if necessary. Since its creation in 1945, the IMF’s membership has quickly expanded to a total of 189 countries (IMF, 2019). However, the Fund’s expansion did not occur for a lack of criticism. For years, the organization has been scrutinized and shown to have made mistakes in all the areas it has been involved in (Stiglitz, 2002). In spite of the Funds’ efforts, deep economic crises have frequently reoccurred (Valencia & Laeven, 2012). It is therefore that the Nobel Prize-winning economist Joseph Stiglitz (2002) concluded that the IMF had failed its mission. Discontent with the Fund especially grew in the developing world, in which many of the economic crises originated. Not only was the IMF’s approach to crisis prevention and resolution controversial, its governance structure was and is to this day, widely perceived to be fundamentally flawed (Buira, 2003; Stiglitz, 2002).

Criticism is mainly directed towards the Fund’s voting arrangement, which is heavily skewed to favor major industrialized countries. Initially, the voting arrangement was designed to partially reflect the economic power of member states. However, the discrepancies between states have increased over time and nowadays, a states’ voting power is almost entirely determined by the size of its financial contribution to the Fund.3 Essentially, this means that the wealthiest countries run the show. The voting system especially favors the United States. With its share of the vote being over 15%, the US has obtained veto power over decisions that require a qualified majority (85%), which includes decisions on institutional reform (Buira, 2003). Therefore, the IMF can only adapt when reforms are supported by the US and a number of other wealthy states.4 Because these powerful stakeholders have few incentives to support changes that go against their interests, institutional adaptations have been quite rare in the case of the IMF. Although the Fund’s biased governance structure and its inability to prevent crises have led to a loss of legitimacy, it has remained resistant to any fundamental change. When change

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3 The two reasons for this are the IMF’s expanding membership and inflation. As the total amount of contribution by IMF members increased, so did the total amount of quota based votes (one vote per 100,000 US dollar). However the number of basic votes, which are divided equally amongst all members, has remained constant. Therefore, basic votes have become almost worthless over time. Because developing countries rely largely on basic votes, their share of influence has declined dramatically (Buira, 2003).

4 Other large shareholders have traditionally included Japan, Germany, France and the UK (IMF, 2008).
did occur, it has been incremental and almost always in the interests of the IMF’s largest shareholders. The institutional privileges they have enjoyed since the institutions’ creation, have therefore had a ‘lock-in effect’, causing the institution to follow a path-dependent logic (Capoccia, 2015). This begs the question: how was China, a marginal shareholder with only 2.9% of the vote at the time, able to bring about adaptation of the IMF? The following paragraphs will answer this question by examining China’s engagement with the IMF and its role in the institutions’ adaptation of 2012.

5.3 China in the IMF (1980-2007)

China’s dramatic economic transformation started with the reforms of opening up in 1978. According to its former president Deng Xiaoping, China needed to re-engage with the rest of the world in order to save its economic development (Liang, 2002). China’s integration into the international economic system was an essential part of this effort. Although it did not partake in designing today’s major economic institutions, China quickly became fully integrated. This includes the IMF, where China is considered to be an active member (Wang, 2017). Although some scholars expected this integration to further ‘socialize’ China to the extent where it would accept most norms and rules of established international organizations (Johnston, 2008; Kent, 2007), the many disagreements between China and the IMF indicate otherwise. From the very beginning, China has voiced its opinion on IMF practices it disagreed with. Since it joined the IMF in 1980, it has supported protests against the organizations’ Western-dominated governance structure (G-24, 1980). It did so specifically in the G-24, a coalition of emerging and developing states that grew out of a broader coalition representing the developing world: the G-77. As a chapter of the G-77, the G-24 focusses specifically on issues concerning the international monetary system and its governing institutions (G-24, 2018). Together, the G-24 claim that Western states should let go of their inherited authority in the IMF. For decades, the group has advocated for an overhaul of the voting system and equal opportunities to claim the Funds’ top position (Keating, 2011). 5 These two most important demands for structural change have gathered wide support from civil society organizations (Wood, 2001). However, besides the structure of the IMF, China also demanded changes to some of the Fund’s approaches. In particular, its approach to surveillance.

5 The selection procedure for the Fund’s managing director takes place behind closed doors and due to their large voting shares, major industrialized countries have more say in it. According to tradition or an unspoken agreement, they have always supported a European to be the head of the Fund, to the dissatisfaction of the G-24 (Keating, 2011).
Surveillance refers to the act of monitoring the economic policies of member states and is one of the IMF’s main activities. According to China, the Funds’ surveillance practices were biased because they were mainly directed towards developing and emerging economies. Instead, Chinese officials argued that the IMF’s surveillance efforts should be ‘symmetrical’, by also focussing on the economies of industrialised countries. Their argument rested on the assumption that advanced economies could just as well become sources of financial instability (G-24, 1982; Walter, 2010; Wang, 2017). Although China had received occasional support from the G-24 on the issue ever since 1982, their argument remained relatively weak due to the empirical regularity of financial crises originating in the developing world (Valencia & Laeven, 2012). In the years prior to the global financial crisis, demands for even-handed surveillance were continuously ignored by the IMF’s largest shareholders.

To make matters worse for China, its own policies were becoming increasingly criticized. China’s economy had become increasingly export focused since it joined the WTO in 2001. Besides the elimination of barriers to international trade, China’s undervalued currency was a main reason for the success of this economic model. By keeping the exchange rate of China’s currency (the Renminbi) artificially low, the Chinese government could provide domestic companies a competitive advantage overseas, whilst facilitating growing employment opportunities for the Chinese people (Mussa, 2008, p. 293). Therefore, several countries and the US in particular, became highly critical of China’s exchange rate policy. Besides creating a competitive trade advantage, the cheapness of China’s currency also allowed it to build up a large trade surplus and foreign currency reserves (James, 2009, p. 163). According to the US, this created global imbalances which threatened the stability of the international monetary system (Geithner, 2010). Because it is the IMF’s duty to protect this system by conducting surveillance over economic policies, including a members’ exchange rate policies, the US demanded that the institution took a firm stance against China’s behavior. However, to their discontent, the Fund did not pressure Chinese authorities on the matter straight away (Mussa, 2008, p. 328). Outrage from American representatives followed, proclaiming that the IMF was “asleep at the wheel” (cited in Blustein, 2014, p. 68). Wishing to pacify the US, the IMF started to consider reforming its surveillance rules. Many of the Fund’s staff members were opposed to the proposed changes. According to them, the new rules would not be objective and target some countries disproportionately. Developing and emerging states were opposed to the changes for the same reason and instead, demanded the new surveillance rules to be symmetrical (Blustein, 2014, p. 69-73). Nonetheless, the US dominated the bargaining process.
It threatened to undermine the IMF by disengaging and supported this threat with an extensive lobbying campaign. Although the American lobby did not obtain a consensus among IMF members, the threat from the US was powerful enough to force the IMF’s adaptation. In accordance with its demands, the Fund introduced the 2007 Surveillance Decision (IMF, 2007; Blustein, 2014). Once again the IMF’s largest shareholder, the US, had proven to be its rule-maker.

To China, the 2007 Decision was a thorn in the eye. It directed the IMF’s surveillance efforts towards exchange rate policies in particular. As a result, the IMF concluded the following year that China’s exchange rate policy significantly contributed to the instability of the international monetary system (Blustein, 2014). In response, Vice Finance Minister Li Yong stated China’s disapproval:

“We regret that the Fund adopted in June the Decision on Bilateral Surveillance over Members’ Policies (the 2007 Decision) in the absence of consensus among its members. […] Moreover, the Fund should appropriately determine the priorities in its exchange rate surveillance, and enhance its surveillance of countries issuing major reserve currencies” (Li, 2007, pp. 5–6).

From this point forward, China would avoid further scrutiny by postponing meetings with the IMF’s surveillance staff (Blustein, 2013). By withdrawing from the Fund with limited bargaining power, China’s longstanding wish for even-handed surveillance seemed far from attainable. In order for China to bring about institutional adaptation of the IMF, the balance of power had to shift dramatically.

5.3 Critical juncture

In 2007, a crisis that originated in the American housing and mortgage market destabilized the US financial system. Because this system accounted for 31 percent of all global financial assets, the crisis rapidly spilled over to markets around the world, disrupting the global economy for several years to come. What is now known as the global financial crisis, represents a critical juncture in the IMF’s development. Following the height of the crisis, constraints on institutional adaptation were temporarily loosened and new opportunities appeared for reform-oriented states such as China. The crisis represented a stark shift from the past. For the first time in the history of the international economic system had the US become a source of financial instability. As a result, American soft power weakened, with its dominant ‘Washington
Consensus’ losing significant credibility around the world (Blustein, 2013). In the following years, many observers would interpret the crisis as a sign of America’s decline. According to them, it ushered in a new, non- or multi-polar world (Nye, 2010). “People are now looking down on the West, from leadership circles, to academia, to everyday folks,” proclaimed Professor Kan Xiaoguang of Renmin University (Nye, 2011b). Like many others, he hailed the crisis as the beginning of a hegemonic power transition between China and the US (Nye, 2010). By the end of 2007, China had already become the world’s third largest economy and was expected to overtake Japan sometime in the next three years. Especially when China came out of the crisis in relatively good shape due to its large reserve-holdings, optimism about China’s future grew exponentially (Chwieroth, 2010). Besides affecting the perceived geopolitical stature of the both China and the US, the crisis caused major shifts in hard and soft power. The following paragraphs will therefore examine the significance of this sudden power shift in terms of China’s ability to inspire the IMF’s adaptation of 2012.

5.3.1 Hard power

The global financial crisis signified once again, the IMF’s inability to preserve the stability of the international monetary system. Making matters worse, the Fund had not even foreseen the crisis, highlighting the inadequacies of its surveillance model. It had been blindsided by a fact that the Chinese had stressed for years. Namely, that advanced economies could also become sources of financial instability. China’s representative to the IMF even warned about the American economy just prior to the crisis taking shape. “With its influence on the global economy, US economic developments must be closely monitored and prompt, appropriate measures taken when warranted”, stated Hu Xiaolian (2007, p. 1). The financial crisis that followed allowed China to seize the initiative. Within the same year, it successfully put even-handed surveillance back on the agenda of the G-24. Their October communiqué clearly reflected China’s longstanding demands:

“Ministers noted the vulnerability of the U.S. sub-prime mortgage market and its financial and real spillover effects. They underscored the need to improve the Fund’s surveillance of advanced economies, putting as much focus in evaluating their vulnerabilities as it does in

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6 The Washington Consensus is the belief that prioritizes liberalization and self-regulation. The global financial crisis gave many new reasons to challenge these beliefs. Nye (2010) argues that the so-called “Beijing Consensus”, the belief in the effectiveness of authoritarian rule with a successful market economy, has become more popular as a result of the crisis, therefore enhancing China’s soft power.
emerging market economies. Ministers called for evenhanded implementation of the 2007 Surveillance Decision” (G-24, 2007, p. 1).

The push for institutional adaptation was met with fierce resistance from the US. Although it acknowledged that the crisis had originated within its borders, it maintained that the IMF’s surveillance should focus on exchange rate issues by upholding the 2007 Surveillance Decision (Geithner, 2009). It explicitly threatened the Fund would be “dead” if it did not act accordingly (cited in Blustein, 2014, p. 86). Because the IMF relied heavily on financial support from the US, the threat was backed up by significant hard power. However, the crisis continued to undermine its position. On the 15th of September 2008, Lehman Brothers, America’s fourth largest investment bank, declared its bankruptcy. Broadcasted images of its office-supplies-carrying employees triggered a global panic. According to Blustein (2013), the event “shifted the balance of power again away from the United States and towards China – this time seismically, by several orders of magnitude greater than anything that had come earlier in the crisis” (p. 87). By the end of 2008, as the US was scrambling for financial resources, its dependence on Chinese purchases of its Treasury debt became painfully clear (Foot & Walter, 2010). As a result of its loss in hard power resources, the US could no longer maintain an aggressive stance towards China in the IMF (Blustein, 2014). Simultaneously, on the other side of the equation, China’s share of hard power was increasing. With its financial assets largely intact, China was one of the few states that could still provide the IMF with much needed lending resources (Nye, 2010). This provided China with a significant leverage over the other member states of the IMF. Ultimately, the escalating global financial crisis had therefore opened a window of opportunity for China in the bargaining process for institutional adaptation.

5.3.2 Soft power

While Chinese officials continued to press for reforms towards even-handed surveillance (Yi, 2008; Zhou, 2008), their statements were now systematically echoed by the G-24 (G-24, 2008, 2009). Furthermore, the ongoing crisis had prompted Brazil, Russia, India and China to intensify their cooperation (Stuenkel, 2015). The so called ‘BRICs’ united behind a common position on IMF surveillance in yet another forum of global governance: the G-20. In accordance with earlier Chinese statements, they declared a need for:

“better-focused even-handed surveillance across all IMF members, especially […] advanced economies with major financial centers and large cross-border capital flows”
(cited in Roberts, Armijo, & Katada, 2018, p. 86).
At the time of this joint statement, only two months after the collapse of Lehman Brothers, the BRICs seemed relatively resistant to the effects of the crisis (The Economist, 2009). Because the G-20 included these important emerging powers, it gained prominence and eventually became the leading forum for international economic cooperation (Fioretos, 2016). The US did not have as much influence in the G-20, which came to overshadow smaller fora, such as the G-7 (Stuenkel, 2015). Additionally, the US had been losing support from both emerging and developed states on the issue of surveillance. Once committed backers of the 2007 Surveillance Decision, such as Brazil, Germany and Japan, joined China’s cause when the US devalued its own currency during the crisis in an attempt to prevent its economy from deteriorating further. Although all three states opposed China’s exchange rate policy for similar reasons, they now had an incentive to support its demand for even-handed surveillance (Schirm, 2013). By manipulating its exchange rate, the US opted to use its remaining economic hard power. However, with insufficient soft power it could no longer maintain support for such actions. While the US quickly lost support for its argument, China used its increasing soft power to form strong coalitions and set the agenda in both the G-24 and G-20.

5.3.3 Threatening to undermine the IMF

China’s contributions to the IMF had become essential, both for the Fund itself and for member states in need of IMF loans. Therefore, China possessed enough hard power to undermine the institution. Simultaneously, its soft power efforts were piling pressure on the Fund. The IMF’s independent evaluator concluded that the shared sentiments from emerging states were undermining the Fund’s legitimacy (IEO, 2009). However, in order to bring about institutional adaptation, China also needed to make credible threats indicating that it not only could, but would undermine the IMF.

First, China threatened to disengage, by withdrawing its support from the Fund. Since the 2007 Surveillance Decision was announced, China had postponed any cooperation with the Fund’s surveillance staff and kept ambiguous whether it would continue contributing to the IMF’s lending resources (Blustein, 2013). For example, it implicitly threatened to scale down its contribution to the Fund when one of China’s representatives to the IMF stated that: “any reduction in the medium-term budget [of the Fund] should not undermine its ability to carry out its functions” (Zhou, 2008, p. 4). Second, China threatened to hedge, by creating alternative governance structures parallel to the IMF. This threat actually materialized in 2009 when China spearheaded the multilateralization of the Chiang Mai Initiative (CMI) by contributing to 32%
of its funds. The CMI represents a regional alternative to the IMF by providing a group of Asian states with a financial safety net in the case of a new crisis (West, 2017). Although the CMI was built to compliment the IMF, it effectively undermined its dominant position by increasing the complexity of the regime that governs the international monetary system (Heilmann et al., 2014; Morse & Keohane, 2014). Backed up by its increased hard and soft power, China’s threats exerted enough pressure to bring about the IMF’s adaptation.

5.4 Institutional adaptation

Two years after the initial 2007 Surveillance Decision was announced, the IMF revised it according to China’s wishes (Blustein, 2013). Its staff sided with the Chinese by officially recognizing that advanced economies and especially their financial sectors could be sources of financial instability. Furthermore, they called for expanding the regulatory perimeter to encompass all financial institutions in all countries (IMF, 2009). According to Chwieroth (2010), the institutional adaptation represented the most significant change in the Fund’s approach since the global financial crisis. In 2012, these changes were incorporated into the IMF’s Articles of Agreement. The ‘Integrated Surveillance Decision’ would put increasing emphasis on advanced economies. This expanded the IMF’s surveillance focus to encompass all economies, rather than focusing primarily on emerging markets (IMF, 2012). The table on the following page summarizes the causal mechanisms that led to the IMF’s adaptation.
Table 2. Overview of causal mechanisms

<table>
<thead>
<tr>
<th>Cause</th>
<th>Description</th>
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<tr>
<td>Critical juncture</td>
<td>- The global financial crisis opens a window of opportunity by abruptly redistributing power within the IMF.</td>
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<tr>
<td>Hard power (increase)</td>
<td>- China’s financial assets remain relatively intact due to its large reserve holdings.</td>
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<td></td>
<td>- The US becomes dependent on China’s purchases of its Treasury debt.</td>
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<td></td>
<td>- Other states rely on China’s contribution to the IMF to receive loans.</td>
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<tr>
<td>Soft power (increase)</td>
<td>- China puts even-handed surveillance back on the agenda in the G-24.</td>
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<td></td>
<td>- The BRIC coalition takes a common stance in the G-20.</td>
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<td></td>
<td>- The US loses support from important allies: Brazil, Germany and Japan.</td>
</tr>
<tr>
<td>Credible threats</td>
<td>- China disengages by implicitly threatening to withdraw its support from the IMF.</td>
</tr>
<tr>
<td></td>
<td>- China hedges by introducing a regional institutional alternative to the IMF.</td>
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6 Discussion

The findings suggest that current IPS theory goes a long way in explaining the process of institutional adaptation. As expected, China successfully employed a mix of hard and soft power to pressure the IMF. Subsequently, institutional adaptation occurred because China credibly threatened to undermine the IMF. However, this ability was largely shaped by something IPS theory currently still overlooks: an exogenous shock. The theoretical framework presented in this research addresses this shortcoming by supplementing IPS theory with insights from historical institutionalism. This allows for new concepts to be incorporated that can adequately explain the significance of exogenous shocks. In this case, a shock in the form of a crisis triggered a critical juncture in the IMF’s development. By exacerbating the power differences between the challengers and defenders of the institutional status quo, the critical juncture opened a window of opportunity for China and other reform-oriented states. With its bargaining power temporarily increased, China seized the opportunity to bring about its desired
institutional changes in the wake of the crisis. The stable path the IMF had followed for decades was therefore suddenly redirected.

Interestingly, the reform of the IMF’s surveillance model has not been the only institutional adaptation since the global financial crisis. Instead, several institutional adaptations occurred in a short sequence following the height of the crisis in 2008. The reforms that were introduced addressed key issues such as the Fund’s controversial voting arrangement (IMF, 2008). After years of protracted negotiations, the demands from developing and emerging states were finally being accommodated. Only when the global financial crisis escalated, did the scales tip enough in the favor of China and other emerging states to force concessions from the largest shareholders in the IMF. Ever since the ratification of these historic reforms in 2015, the IMF has shown to re-equilibrate to the pre-critical juncture status quo, a scenario which is not excluded by historical institutionalism (Capoccia & Kelemen, 2007). With their economies recovered and growing again, it does not come as a surprise that Western states have regained their bargaining power in the IMF. Although the recent reforms have reduced their voting shares slightly, the major industrialized states have successfully re-established their control over the Fund. To this day, the US retains its veto power and actively prevents further adjustments to the IMF (Lawder & Milliken, 2019). Consequently, China’s ability to adjust the rules of the institution has returned to being limited. The years following the crisis (2008-2015) therefore represent an extraordinary time period during which change was suddenly possible in a historically rigid and ‘sticky’ institution.

7 Conclusion

This research questioned how China was able to bring about the IMF’s adaptation of 2012. It set out to provide the answer by adopting the lens of IPS theory combined with insights from historical institutionalism. Guided by a process-tracing method, it presents an in-depth case study of China’s engagement with the IMF leading up to 2012. First and foremost, the findings show that China’s ability to dominate the institutional bargaining process stemmed from both its hard and soft power resources. Whilst China’s hard power allowed it to credibly threaten that it would undermine the IMF, its soft power enabled it to attract support for its cause by

7 For this reason, China may shift its focus further away from the IMF and towards alternative institutions. The recent establishment of the BRICS’ led Contingent Reserve Arrangement (CRA) is an early indication of such hedging behavior (The Economist, 2014).
setting the agenda in important fora of global governance, thereby legitimizing its threats to the institution. To this extent, the findings support the theoretical expectations of IPS theory, which argues that states need both aspects of power in order to successfully pressure for institutional adaptation. However, current IPS theory overlooks that China’s bargaining power increased significantly due to the effects of the global financial crisis. This research identifies the crisis as the initial cause which set in motion the endogenous processes described by IPS theory. By exacerbating the power differences between states, the global financial crisis opened a window of opportunity for China to challenge the institutional status quo. Therefore, this research argues that the crisis represents a critical juncture in the bargaining process between states over the rules of cooperation. Ultimately, China could only successfully contest the rules of the IMF during a brief moment in time following the crisis. Currently, it seems far from being able to mount another successful challenge to the re-equilibrated status quo of the IMF.

The findings of this research have two important implications. Firstly, they suggest that there is room to improve Daßler et al.’s IPS theory (2018). Because the theory does not recognize the significance of exogenous shocks such as wars and crises, this research argues that the theory should be supplemented with insights from historical institutionalism. By incorporating Thelen’s dynamic constraints model, this research has presented a possible first step in innovating current IPS theory (Thelen & Steinmo, 1992). This new theoretical framework could account for the exogenous shock which completely altered the balance of power in the IMF. However, this research only provides enough evidence to conclude that one shock, the global financial crisis, mattered in one case. Although additional adaptations of the IMF in the same time period suggest that the crisis mattered in more cases of institutional adaptation, there might be exceptions. In order to address the questions that remain, subsequent studies could further test the significance of the global financial crisis or other shocks in shaping the processes of institutional adaptation. Whether these studies focus on China or different states, they should in any case include the concept of critical junctures when examining how or why institutions adapt.

Secondly, the findings of this research contribute to the ongoing academic debate about the rise of China. The evidence shows that even the most resilient institutions are capable of accommodating rising states by adapting to shifting power distributions. Although a significant number of forces have to come together in order to bring about institutional adaptation, the case of the IMF illustrates the flexibility of the international order and its capacity for change, albeit limited. While China may occasionally be able to adjust the norms and rules of the international
order, its challenge also shows a degree of commitment to the order’s development. Unfortunately, the same cannot be said of all great powers. Scholars looking for existential threats to the international order may therefore want to redirect their attention elsewhere, at least for the time being.
Reference list


York: Longman.


Institutional Adaptation


