China's Path Selection in Global Governance Reform

J. Zhu

Jiejin Zhu – Associate Professor at the School of International Relations and Public Affairs, Fudan University, 220 Handan Road, Shanghai, 200433, China, Email: zhujiejin@fudan.edu.cn

Abstract

With the rise of China, reforming the global governance institutions has become an important part of China's diplomacy. Based on whether to build new international rules or reinterpret or redeploy the existing ones, we can divide the rising power's paths in global governance reform into four types: displacement, layering, conversion and avoidance. Why does China adopt different paths toward reforming the existing international institutions which are dominated by the U.S.? Building on the theory of "gradual institutional change" in historical institutionalism, this article argues that the veto capability of the established power and the flexibility of the existing international institution are two determinants of the rising power's path selection in global governance reform. It applies this theoretical framework to explain China's behaviour in four issue areas: sovereign credit rating, the international monetary system, free trade agreements and multilateral development banks. In sovereign credit rating, the strong veto capability of the U.S. and the low flexibility of the existing international credit rating institution make China adopt the path of avoidance. In the international monetary system, the strong veto capability of the U.S. and the high flexibility of the International Monetary Fund's special drawing rights make China adopt the path of layering. In free trade agreements, the weak veto capability of the U.S. and low flexibility of the Trans-Pacific Partnership make China adopt the path of displacement. In multilateral development banks, the weak veto capability of the U.S. and high flexibility of World Bank rules make China adopt the path of conversion.

Key words: Global Governance Reform; Veto Capability of the Established Power; Flexibility of the Existing International Institution; Gradual Institutional Change; Path Selection

For citation: Zhu J. (2020) China's Path Selection in Global Governance Reform. *International Organisations Research Journal*, vol. 15, no 3, pp. 248–281 (in English). DOI: 10.17323/1996-7845-2020-03-10

Introduction

As a rising power, an important part of China's diplomacy is to promote the institutional reform of global governance, including the goal and path of the reform. In terms of the goal, China should enhance its institutional power to match its growing material power. As the leaders of the BRICS group of Brazil, Russia, India, China and South Africa emphasize in the 2017 Xiamen Declaration, "We resolve to foster a global economic governance architecture that is more effective and reflective of current global economic landscape, increasing the voice and representation of emerging markets and developing economies" [BRICS, 2017].

In terms of the path, China has selected different paths toward reforming the international institutions which are equally dominated by the United States. In the issue area of sovereign credit rating, China has taken measures to reduce the reliance on the international credit rating companies, in response to the criticism of the three major U.S. rating companies in the subprime crisis and the subsequent European sovereign debt crisis [Xiaochun, 2012, pp. 4–7]; this can be called a strategy of avoiding. In the issue area of the international monetary system, China actively promotes the view that the renminbi should join the basket of special drawing rights of the International Monetary Fund (IMF) [People's Bank of China, 2017], which can be called a strategy of layering. In the issue area of free trade agreements, China strongly supported the Regional Comprehensive Economic Partnership (RCEP) as a way to balance the push for the ill-fated Trans-Pacific Partnership (TPP) led by America (from which the U.S. ultimately withdrew). [Hamanaka, 2014], which can be called a strategy of displacement. In the issue area of multilateral development banks, China initiated the establishment of the Asian Infrastructure Investment Bank (AIIB), which is outside the existing system of multilateral development banks. China's strategy here can be called one of conversion. On one hand, the AIIB keeps the same rules as the World Bank (WB) which is dominated by the U.S.; on the other hand, it is redeploying its rules: the World Bank uses the rules for poverty reduction, while the AIIB uses them for infrastructure investment [Lichtenstein, 2018].

Why does China select different paths toward reforming the global governance institutions which are equally dominated by the U.S.? This is the research question addressed in this article. Building on the theory of gradual institutional change in historical institutionalism [Mahoney, Thelen, 2010], this article argues that the veto capability of the established power and the flexibility of the existing international institution are two determinants of a rising power's path selection in global governance reform. This hypothesis is tested empirically through a comparison of the four cases noted above: sovereign credit rating, the international monetary system, free trade agreements and multilateral development banks.

The article proceeds as follows. First, the research question is introduced, followed by a literature review. Then a new theoretical framework developed to explain the rising power's path selection in international institutional change. This is applied to four case studies to test the theoretical hypothesis, followed by concluding observations.

Literature Review

"In a historical and institutional view, politics is structured by persistent incongruities and frictions among institutional orderings" [Skowronek, 1995, p. 95]. In recent years a burgeoning literature has emerged regarding the rising power's strategy and path selection in international institutional change. Generally speaking, there are at least five perspectives to explain China's path selection.

The first is the perspective of the status quo-revisionist debate. Alastair Iain Johnston has developed five indicators – participation rates in international institutions, degree of compliance with international norms, behaviour toward the rules of the game, revisionist preferences and revisionist behaviour – to judge whether China is a status quo power or a revisionist power [Johnston, 2003, pp. 5–56]. John Ikenberry and Darren Lim have identified a spectrum of strategic choices that China faces, ranging from simple status quo-accepting stakeholder membership at one pole to opposition and non-participation at the other. Between these extreme options, there are choices that rising states make to reform and innovate within the existing array of international institutions. Altogether, there are at least five strategies for the rising powers: status quo stakeholder, authority-seeking stakeholder, institutional obstruction, external innovation, and opposition [Ikenberry, Lim, 2017].

Second is the perspective of international institutional competition and balancing. Li Wei and Luo Yifu argue that there are four patterns of international institutional competition between established powers and rising powers: international rule's competition, international regime's competition, international organization's competition and international order's competition [2019, pp. 28–57]. He Kai believes that, similar to the balance of power, major powers have adopted institutional balancing strategies to orient the potential order transition to the direction most beneficial to their own interests. There are three different institutional balancing strategies for the powers: inclusive institutional balancing, exclusive institutional balancing, and inter-institutional balancing [2018, pp. 60–83].

The third perspective is that of voice/exit/threaten to exit. Drawing on Albert Hirchman's voice-exit framework, Phillip Lipscy argues that a rising power has three strategies in international institutional change: to be a voice within the international institution, to exit the international institution, or to threaten to exit the international institution. The strategy of threatening to exit is the best selection under circumstances when the voice strategy is difficult to work and the costs of the exit strategy are high. But the condition for this strategy is that the threat should be credible, which depends on the rising power's outside options [2015, pp. 341–56]. Liu Hongsong also pointed out three factors determining the possibility that a rising power can threaten to exit from the international institution: the degree of the rising power's dependence on the existing international institution, the domestic support in the rising power for an exit from the existing international institution, and the dependence of the established power on the rising power [2019, pp. 74–9].

Fourth is the perspective of accept/hold up/invest. Scott Kastner, Margaret Pearson and Chad Rector argue that as a rising power, China has three paths in global governance reform, including accepting, holding up and investing. Among them, the possibility of China's outside option and the indispensability of China's cooperation within the existing international institution are the two factors that determine China's strategic choice. China will be willing to invest more in supporting a regime when its outside options are relatively poor. When its outside options are good, it will accept the existing international institution if it is not a dispensable player in maintaining regimes, and if it is seen as indispensable it will threaten to hold up regime support as a way to win concessions [2016, pp. 142–5].

Finally there is the perspective of incremental reform. Chen Zhimin and Su Changhe argue that China is pursuing a strategy of incremental reform in global governance. The incremental reform strategy has four aspects: internal reform, external innovation, internal-external complementarity, and external innovation pushing internal reform. Internal reform refers to promoting reform within the existing international institution, gradually realizing the democratization of governance decisions, the fairness of governance rules and the modernization of governance capacity. External innovation refers to initiating the establishment of a new international institution in the areas neglected or unable to be governed by the existing international institutions. Internal-external complementarity refers to ensuring that the new and old international institutions do not conflict with each other and establishing channels for dialogue and communication between them. External innovation pushing internal reform refers to pushing the internal reform from within the existing international institution through the leading by example of the external newly established international institution [2014].

To sum up, the existing five perspectives provide some explanations for China's path selection in global governance reform, but they also have some shortcomings. Although the perspective of the status quo-revisionist debate correctly shows the diversity of the rising power's strategies, it overlooks the influence of the interaction factors between the rising power and the established power in the process of international institutional change. The perspective of international institutional competition and balancing pays attention to the interaction between the rising power and the established power in the process of international institutional change but is focused on the results of the interaction and lacks an analysis of the rising power's path selection.

Comparatively, the perspectives of voice/exit/threatening to exit, accept/hold up/invest, and incremental reform pay attention to the rising power's path selection, emphasizing some contextual factors that affect the selection. However, they still overlook the features of existing international institutions. In fact, features of existing international institutions are important. Some international institutions are flexible, such that a rising power's institutional preference can be accommodated, while others are not. In this respect, the theory of gradual institutional change in historical institutionalism combines the contextual factors and features of institutions in the process of institutional change, which has a strong potential to explain the rising power's path selection in global governance reform. This article will introduce and revise the theory of gradual institutional change and explain the rising power's path selection through two key variables: the great power's veto capability and the international institution's flexibility.

New Theoretical Framework

Among the three new institutionalisms in political science, the study of institutional change occupies a more prominent position in historical institutionalism, which embraces a power-political view of institutions that emphasizes their distributional effects. It is different from the functionalism of rational choice institutionalism, which mainly promotes cooperation through solving collective action problems. It is also different from sociological institutionalism, which highlights the cultural components of institutions. Historical institutionalism views institutions first and foremost as the political legacies of concrete historical struggles. Peter Hall and Rosemary Taylor argue that institutions distribute power unevenly across social groups, giving some groups disproportionate access to the decision-making process and putting others at a disadvantage [1996, pp. 936–57].

Historical institutionalism emphasizes that a dynamic component is built in institutions; while institutions represent compromises or relatively durable, though still contested, settlements based on specific coalitional dynamics, they are always vulnerable to shifts. Those who benefit more from existing institutions may have an objective preference for continuity and become dominant actors. Those who benefit less from the existing institution tend to reform the institution and become reform actors. In the process of institutional change, dominant actors and reform actors with different power resources and preferences usually seek different forms of institutions, and the final institutional result is often the product of political compromise among the actors.

When it comes to institutional change, historical institutionalism has formed two different views: one is the punctuated equilibrium model represented by Stephen Krasner, John Ikenberry and Giovanni Capoccia [2007, pp. 341–4] the other is the gradual institutional change model represented by Kathleen Thelen, James Mahoney and Wolfgang Streeck. The punctuated equilibrium model emphasizes the critical juncture, which is often understood as a period of contingency during which the usual constraints on action are lifted or eased. Explanations of change focusing on such periods are sometimes also linked to arguments about the relative weight of agency versus structure in various phases, as enduring historical pathways are periodically punctuated by moments of agency and choice.

Kathleen Thelen and James Mahoney argue that the problem with the punctuated equilibrium model is that it is both too contingent and too deterministic. It is too contingent in that the initial choice (critical juncture) is seen as rather open and capable of being tipped by small events or chance circumstances. In politics, this kind of blank slate is a rarity and not all options are equally viable. It is too deterministic on the backend of critical junctures, emphasizing, as they often do, the role of "lock in" via increasing returns and positive feedbacks. These views have the drawback of obscuring endogenous sources of change and of conceiving change as involving the breakdown of one set of institutions and its replacement with another [Mahoney, 2017, p. 1117].

The breakthrough solution came with the theory of gradual institutional change of historical institutionalism, which includes independent variables, dependent variables and a theoretical framework. In terms of independent variables, the change of the balance of power between the dominant actors and the reform actors within the institution, in the system, and the reform actors' strategic reinterpretation and redeployment of the existing institutional rules during the implementation process are the causes of gradual institutional changes. In terms of dependent variables, there are four modes of institutional change, namely displacement, layering, conversion and avoiding, which constitute the types of path selection of reform actors. In terms of the theoretical framework, a model containing a causal mechanism is formed between the two independent variables and the four dependent variables to explain under what conditions the reform actor will select which mode of institutional change.

Independent Variables

On the one hand, given the institutional continuity that rests not just on the accumulation but also on the ongoing mobilization of resources, one important source of change will be shifts in the balance of power between the dominant actors and reform actors. It should be noted that the change in the balance of power balance must be contextual and dynamic, rather than static, so it is more accurate to describe the shifts in the balance of power by the concept of veto capabilities of the dominant actor.

George Tsebelis points out that the so-called veto capabilities are held by actors whose consent is necessary to change the status quo of an institution [2002, pp. 19–20]. In the process of institutional change, when the reform actor proposes an initiative of institutional change, if the dominant actor can take various ways to prevent the initiative from becoming reality, it shows that the dominant actor has a strong veto capability. On the contrary, the dominant actor has a weak veto capability.

On the other hand, from the perspective of institutional implementation, reform actors often strategically reinterpret and redeploy the existing institutional rules, which is another source of gradual institutional change. As mentioned above, the institution has a distributional effect on power resources. Dominant actors and reform behaviours will start another political struggle around the implementation of the institution. On this point, there are important differences between the power-distributional perspective of institutions, sociological institutionalism, and rational choice institutionalism. In sociological institutionalism, implementation appears to be a non-issue. If institutions involve cognitive templates that actors unconsciously enact, then actors presumably do not think about not complying. In fact, it is their taken-for-grantedness that makes institutions self-reinforcing. In rational choice institutionalism, sanctions and monitoring do play a role as mechanisms to prevent free-riding and to promote collective action. Implementation is endogenous in the sense that expected costs and extent of noncompliance are factored into the strategic behaviour of the actors in a particular institutional equilibrium [North, 1990].

Unlike sociological institutionalism and rational choice institutionalism, historical institutionalism argues that reform actors will not implement the institutional rule voluntarily; instead, they will implement the institutional rule carrying their own institutional preferences, emanating not just from the politically contested nature of institutional rule but also from a degree of openness in the interpretation and deployment of the rule. Even when institutions are formally codified, their guiding expectations often remain ambiguous and always are subject to interpretation, debate and contestation. It is not just that unambiguous rules are implemented to greater or lesser degrees. Rather, struggles over the meaning, application and enforcement of institutional rules are inextricably intertwined with the resource allocations they entail [Mahoney, Thelen, 2010, pp. 10–1]. Wolfgang Streeck and Kathleen Thelen offer a new approach that conceptualizes formal institutions as social regimes grounded in relations of authority, obligation and enforcement. This vision of institutions not only allows for a new typology of gradual institutional change but also calls new attention to the role of the interpretation of rule meaning, the varied deployment of rules, and the slippage in the enactment of social rules as potential sources of change. In fact, this approach shows that institutions often change not because of shifts in the formal rules of institutions. Rather, institutions often evolve because of changes in their interpretation, meaning, enforcement and functions. We can expect gradual institutional change in the gaps between the rule and its interpretation, or the rule and its deployment [2005, pp. 9–16].

How can a reform actor's strategic reinterpretation and redeployment of the institutional rules in the process of institutional implementation be described? Historical institutionalism puts forward the concept of institutional flexibility, which is the degree of ambiguity and openness in the institutional rules which allow them to be reinterpreted and redeployed [Mahoney, Thelen, 2010, p. 10]. Rational choice institutionalism acknowledges institutional flexibility as a site of conflict but assumes that such flexibility will decline over time or be resolved through the formalization of the rules. However, historical institutionalism sees institutional flexibility as a more permanent feature. Actors with divergent institutional preferences will contest the openings this institutional flexibility provides because matters of interpretation and deployment can have profound consequences for resource allocations and substantive outcomes.

Dependent Variables

What types of path can the reform actors select to promote institutional change? These are the dependent variables of the theory of gradual institutional change. Based on whether to build a new institution or reinterpret or redeploy the existing institution, reform actors' paths in institutional change can be divided into four types: displacement, layering, conversion, and avoiding [Ibid., pp. 15–8].

Displacement means the removal of existing institutional rules and the introduction of new ones. This kind of institutional change may well be abrupt, and it may entail a radical shift. The rapid, sudden breakdown of institutions and their replacement with new ones, as occurs in revolutions, obviously involves displacement. Yet displacement can also be a slow-moving process. This may occur when new institutions are introduced and directly compete with old ones. New institutions are often introduced by reform actors who are the losers under the old institutions.

Layering means the introduction of new rules on top of or alongside existing ones. It occurs when new rules are attached to existing ones, thereby changing the ways in which the original rules structure behaviour. Different from displacement, layering does not introduce new rules to replace the old rules but rather to work along with them. The process of layering often takes place when institutional challengers lack the capacity to actually change the original rules or to set up an explicit alternative institution. While institutional defenders may be able to preserve the original rules, they are unable to prevent the introduction of amendments and modifications.

Conversion means the changed enactment of existing rules due to their strategic redeployment. It occurs when rules remain formally the same but are interpreted and enacted in new ways. The gap between the rules and their implementation is produced by reform actors who actively exploit the inherent flexibility of the institutions. Through redeployment, they convert the institution to new goals, functions and purposes.

Avoiding means the reform actors neither introduce new institutional rules nor reinterpret the existing rules; rather they reduce the reliance on, and use of, existing rules and improve their autonomous power. James Mahoney and Kathleen Thelen use the concept of drift, which means the changed impact of existing rules due to shifts in the environment. However, because drift does not pay attention to the reform actor's path selection in institutional change, avoiding is used in this analysis instead.

Theoretical Framework

Combining the two independent variables (veto capability of the dominant actors and flexibility of the existing institution) with the four dependent variables (displacement, layering, conversion and avoiding) creates a 2×2 theoretical framework to explain the reform actor's path selection in institutional change, as shown in Table 1.

*Table 1. Re*form Actors' Path Selection in Institutional Change

	Low Flexibility of the Existing Institution	**High Flexibility of the Existing Institution**
Strong Veto Capability of the Dominant Actor	Avoiding	Layering
Weak Veto Capability of the Dominant Actor	Displacement	Conversion

In this theoretical framework, the balance of power between dominant actors and reform actors constitutes the political context of institutional change, while institutional flexibility is the main character of the existing institution. Differences in the political context and the character of the existing institutional rules are the two determinants of reform actors' path selection in the institutional change. This raises two broad questions: does the political context afford the dominant actors strong or weak veto capability, and do the existing institutions afford reform actors opportunities for exercising discretion in reinterpretation or redeployment? The answers to these questions produce the analytic space depicted in Table 1. As the Table suggests, differences in veto capability of the dominant actor and the flexibility of the existing institution are associated with reform actors' four types of path selection in institutional change.

When the dominant actor has strong veto capability toward the reform actor's initiatives, it can only choose avoiding or layering rather than displacement or conversion – this is determined by the power structure of the political context. How to choose between avoiding and layering? It depends on the flexibility of the existing institution. If the existing institution is so flexible that new rules can be added alongside, the reform actor will choose layering. If the existing institution is not flexible, the reform actor will choose avoiding.

When the dominant actor has weak veto capability toward the reform actor's initiatives, it can choose displacement or conversion – again, this is determined by the power structure of the political context. The choice between displacement and conversion also depends on the flexibility of the existing institution. If the existing institution is very flexible, the reform actor will choose conversion. After all, the creation of new institutional rules is costly for reform actors. If the existing institution is not flexible, the reform actor can only choose displacement.

This article applies this theoretical framework to analyze China's path selection in global governance reform. Here, the dominant actor is the established power (U.S.), and the reform actor is the rising power (China). The veto capability of the established power and flexibility of the existing international institutions are two determinants of the rising power's path selection in global governance reform. Therefore, this article puts forward the following four theoretical hypotheses: first, when the established power has strong veto capability and the existing international institution has low flexibility, the rising power is more likely to select the avoiding path; second, when the established power has strong veto capability and the existing international institution has high flexibility, the rising power is more likely to select the layering path; third, when the established power has weak veto capability and the existing international institution has low flexibility, the rising power is more likely to select the displacement path; fourth, when the established power has weak veto capability and the existing international institution has high flexibility, the rising power is more likely to select the conversion path. These hypotheses are shown in Fig. 1.

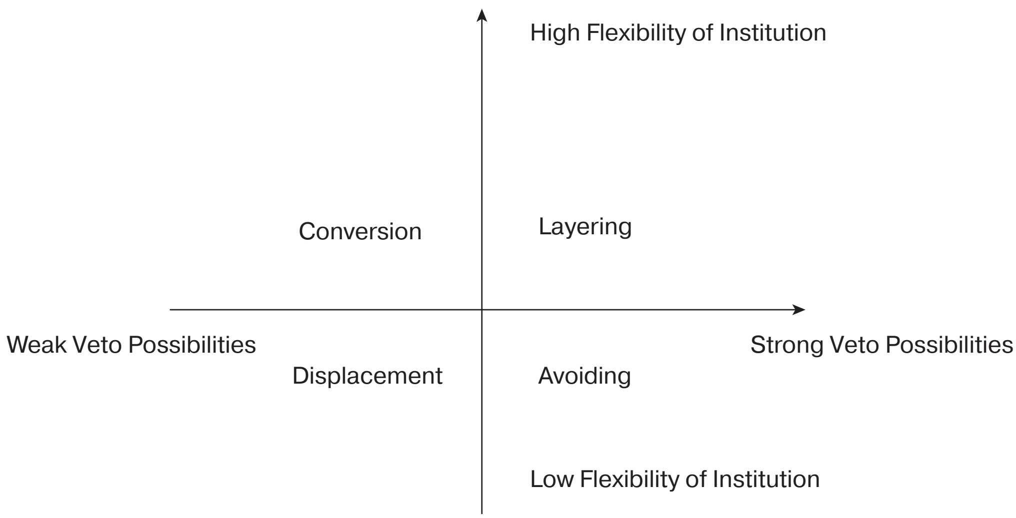

Fig. 1. Rising Power's Path Selection

These theoretical hypotheses are tested in four issue areas of global governance reform, including sovereign credit rating (SCR), the international monetary system (IMS), free trade agreements (FTA) and multilateral development banks (MDB). It should be noted that there are two main reasons for selecting these four cases [Geddes, 1990, pp. 131–50]: first, in terms of actors, the U.S. is the dominant actor in these four cases, and China is the reform actor; second, in terms of issue area, the four cases have distributional implications in that both the dominant actor and the reform actor are struggling to promote its own institutional preferences, as shown in Table 2.

*Table 2. Ca*se Selection

	High Flexibility of Existing International Institution	**Low Flexibility of Existing International Institution**
Strong Veto Capability of the Established Power	Layering (IMS)	Avoiding (SCR)
Weak Veto Capability of the Established Power	Conversion (MDB)	Displacement (FTA)

China's Path Selection

In September 2008, with the outbreak of the American subprime crisis, the shortcomings of the existing international sovereign credit rating institutions were fully exposed, and the three major American rating agencies, Standard & Poor's, Moody's and Fitch (the "Big Three"), suffered international criticism. Critics alleged that the Big Three monopolize the international credit rating market, with low transparency, lack of competitiveness and independence; further, they played a pro-cyclical role in the process of financial crisis and intensified the macroeconomic cyclical fluctuation. In October 2009, sovereign debt crises broke out one after another in Greece, Ireland, Italy, Spain and Portugal, pushing the Big Three into the forefront. Thus, sovereign credit rating reform is regarded as the focus of global governance reform and has become one of the hot topics. In this context, China has actively participated in this reform.

At the first Group of 20 (G20) summit in November 2008, Chinese president Hu Jintao proposed the principle of reforming international rating agencies. "Reform of the international financial system should aim at establishing a new international financial order that is fair, just, inclusive, and orderly and be conducted in a comprehensive, balanced, incremental and result-oriented manner. Reform and improve the international regulatory system and establish the code of conduct for credit rating agencies," Hu said. At the fourth G20 Summit in June 2010, Hu Jintao systematically put forward a specific reform plan of the sovereign credit rating institution. "We should strengthen the supervision of international credit rating agencies, reduce the reliance on international credit rating agencies, improve the code of conduct, and make objective, fair, reasonable and unbiased sovereign credit rating methodology and standards," Hu stressed [Ministry of Foreign Affairs of the People's Republic of China, 2010]. Here, the key of the reform plan is to reduce the reliance on international credit rating agencies.

Zhou Xiaochuan, governor of People's Bank of China, further explained the reform plan. "On one hand, large financial institutions should clean up the regulatory provisions and reduce the reliance on international credit rating agencies. On the other hand, we should support domestic credit rating agencies in China's domestic bond market" [Zhou, 2012]. Zhu Guangyao, the vice finance minister of China, also pointed out that in the current situation of numerous obstacles in the reform of the international credit rating system, China's reform of the rating institution should start at home, support local rating agencies to control the domestic rating market, and reduce the overuse and reliance on international credit rating agencies [Zhu, 2010].

In terms of path selection, the Chinese approach to international credit rating reform can be called avoiding, namely reducing the overuse and reliance on the Big Three and supporting the domestic credit rating agencies' control of the domestic bond market. Why does China select this path rather than other types of institutional change? According to the theoretical framework, it can be analyzed from two aspects: the strong veto capability of the U.S. and the low flexibility of the Big Three.

Strong Veto Capability of the U.S.

In the issue area of sovereign credit rating, the U.S. enjoys structural power and strong veto capability, emanating from the scale and attractiveness of the U.S. bond market, the credibility of the Big Three, and the U.S.' outstanding influence in the G20 and other international institutions in which credit rating reform is being discussed.

First, the scale and attractiveness of the U.S. bond market make the U.S. Securities and Exchange Commission (SEC) the de facto gatekeeper of the international sovereign credit rating industry. The purpose of establishing a sovereign credit rating agency is to provide credit rating services to the issuers of sovereign bonds in the international bond market. Therefore, the international bond market, as the gathering place of sovereign bond issuers and investors, constitutes the power basis of the sovereign credit rating institution. In a sense, "whoever controls the international bond market controls the sovereign credit rating industry" [Soudis, 2015, pp. 813–37]. According to the statistics of the Bank for International Settlements (BIS), in June 2010, the outstanding balance of bonds in the global bond market was $89.28 trillion, of which the U.S. bond market accounted for 24.2%, much more than that of the UK (13.7%) and Germany (7.4%), which ranked second and third, respectively [People's Bank of China, 2010]. It is precisely because of the scale and attractiveness of the U.S. bond market that all of the sovereign credit rating agencies want to operate in the U.S. bond market in order to exert international influence and obtain the qualification of "National Recognized Statistical Rating Organization" (NRSRO) granted by the U.S. SEC. This endows the SEC with a strong institutional veto capability in the reform of the international credit rating institution.

Second, the credibility of the Big Three has established their authority, making it difficult for any newly established rating agencies to compete with them. For example, Standard & Poor's was founded in 1860. In the past 160 years, it has gradually established its leading position in the industry through the independent and rigorous analysis of corporate bonds, sovereign bonds, stocks, mutual funds and other investment varieties. At present, Standard & Poor's has more than 1,500 rating analysts, providing rating services for companies and sovereign credit in 128 countries around the world. The Standard & Poor's 1200 Index and 500 Index have become benchmarks reflecting global stock market performance and the U.S. investment portfolio index, and they have great influence in global financial markets [S&P Global]. According to the SEC's report in 2009, in the rating business of government bonds, local bonds and sovereign bonds around the world, Standard & Poor's accounted for 45.00%, Moody's for 38.63%, Fitch for 15.80%, and the Big Three together accounted for more than 99%, which reflects an absolute monopoly position [Hong, 2011, p. 138].

Last, the U.S. has outstanding influence in the G20 and other international institutions in which credit rating reform is being discussed. Emerging economies led by China have repeatedly called for reform of the international credit rating agencies in the G20, the Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO) [BRIC, 2009]. However, it is worth noting that the United States has the prominent power of agenda setting and decision-making within these institutions. In the end, the reforms endorsed by these institutions have been quite limited. In November 2008, the G20 backed the idea that all credit rating agencies should be registered and thus subject to oversight – a practice the U.S. had already implemented in 2006. The G20 also insisted that rating agencies comply with a revised 2008 IOSCO code of conduct, but this code did not impose significant constraints on the Big Three. It focused on issues such as the disclosure of information rather than direct regulation of their rating methodologies and standards, which are the core concerns of the emerging economies [Helleiner, Wang, 2018, pp. 1–23].

In short, the scale and attraction of the U.S. bond market, the credibility of the Big Three, and the U.S.' outstanding influence in the G20 and other international institutions constitute the strong veto capability of the U.S. in the international credit rating industry. Therefore, it is difficult for China to select a path of displacement or conversion. Under such circumstances, China can only select layering or avoiding. Which one China will select is related to another variable – the low flexibility of the Big Three.

Low Flexibility of the Big Three

The institutional flexibility of the Big Three is relatively low, and the rating methodology and standards adopted are largely based on American domestic political and economic institutions. Therefore, those countries whose political and economic institutions are similar to the U.S. will have a higher sovereign credit rating than those that are not.

For example, Standard & Poor's issued its sovereign credit rating methodology and standards in 2008. These include political, economic, financial, external finance and currency elements. Among them, the political elements are ranked according to the institution model of the U.S., emphasizing balance of power, political participation and open media. The external finance elements mainly examine the external liquidity and external liabilities of sovereign currency in international transactions. The measurement is whether to issue international reserve currency and active trading currency, which in fact emphasizes that reserve currency issuing countries can take the form of over issuance of currency to enhance their sovereign debt repayment ability and take the ability to borrow new debt to repay old debts. The currency elements mainly examine the independence of the central bank and the degree of market-oriented monetary policy and are obviously based on the model of the U.S. [Standard and Poor's, 2008]. See Table 3.

*Table 3. Ra*ting Elements and Measurements of Standard & Poor's, 2008

Rating Elements	Measurement Indicators
Political Elements	Whether there is a mechanism of political checks and balances, the extent to which contracts are executed and laws are observed, the reliability of information and data statistics and the degree of freedom to publish them, whether there is an independent judicial system, a well-developed civil society and free and open news media
Economic Elements	Per capita GDP, economic growth prospects, economic diversification and fluctuation degree
Financial Elements	Government debt-to-GDP ratio, government debt burden
External Finance Elements	Whether to issue international reserve currency/actively traded currency, external liquidity of a country, external debt of a country
Currency Elements	Independence and objectives of the central bank, the market-oriented orientation of monetary policy, the market value of the domestic credit and bond markets denominated in local currency, a large number of local currency bonds issued by the central government

In short, the sovereign credit rating methodology and standards of the Big Three is obviously biased toward the U.S., under the strong influence of neoliberalism and the Washington Consensus. As a result, such an international credit rating system is not flexible enough for rising countries to reinterpret it.

Summary

To sum up, in the issue area of sovereignty credit rating, the U.S. has strong veto capability, which makes it difficult for China to select displacement or conversion paths. Meanwhile, the U.S.-dominated Big Three credit rating agencies lack the openness to embrace different political and economic institutions and stages of development, making it difficult for China to reinterpret the institutional rules. Under these conditions, China selects the path of avoiding.

Therefore, the hypothesis which holds that when the established power has strong veto capability and the existing international institution has low flexibility, the rising power is more likely to select the avoiding path is consistent with the empirical evidence.

International Monetary System Reform and China's Layering Path

China's Path Selection

The outbreak and rapid spread of the international financial crisis in 2008 reflects the inherent weakness and systemic risks of the current international monetary system. After the crisis, the reform of the international monetary system has become a hot topic of global governance. On 23 March 2009, on the eve of the G20 London summit, Zhou Xiaochuan published an influential article entitled "Reform the International Monetary System" and put forward the "China plan" (also known as the "Zhou Xiaochuan plan") for the reform of the international monetary system. "Theoretically, an international reserve should first be anchored to a stable benchmark and issued according to a clear set of rules, therefore to ensure orderly supply; second, its supply should be flexible enough to allow timely adjustment according to the changing demand; third, such adjustments should be disconnected from economic conditions and sovereignty interests of any single country. The acceptance of credit-based national currency as major international reserve currency is a rare special case in history," Zhou stressed. "The establishment of a new and widely accepted reserve currency with a stable valuation benchmark may take a long time. In the short run, special consideration should be given to giving the SDR a greater role. The SDR has the features and potential to act as a super-sovereign reserve currency to further improve the valuation and allocation of the SDR. The basket of currencies forming the basis for SDR valuation should be expanded to include currencies of all major economies, and the GDP may also be included as a weight." According to this plan, as the second-largest economy in the world, China's currency, the renminbi, should be included in the SDR basket, along with the dollar, euro, Japanese yen and others [2009].

In order to turn this plan into reality, China then launched a series of economic diplomacy actions within the G20 and the IMF. In 2011, France assumed the rotating presidency of the G20 and made reform of the international monetary system one of the major topics, establishing the working group on international financial architecture. China actively cooperated with France to jointly hold the High-Level Seminar on the International Monetary System in Nanjing in March 2011, put forward the concept of a shadow SDR, and proposed the participation of emerging economies' currencies in the SDR. Finally, at the G20 Cannes summit in November, China successfully pushed the G20 leaders to reach a consensus that the composition of the SDR basket should continue to reflect the role of currencies in the global trading and financial system [G20, 2011].

In March 2015, the IMF managing director, Christine Lagarde, visited China, and China formally expressed to the IMF its determination that the renminbi should join the SDR. After that, the IMF established the SDR basket review working group to negotiate with the People's Bank of China (PBOC) on a monthly basis. By October 2015, after nine rounds of negotiations, the two sides finally cleared the way for the renminbi to join the SDR. During this period, Chinese president Xi Jinping visited the U.S., and the two countries reached a consensus on the renminbi's inclusion in the SDR. The U.S.' support of this initiative [Xinhuanet, 2015] removed the biggest political obstacle to it. On 30 November 2015, the board of directors of the IMF discussed and unanimously passed the SDR review report and determined that the renminbi met the requirement of being a "freely usable currency." The renminbi was successfully included in the SDR basket on 1 October 2016.

In terms of path selection, the Chinese approach to international monetary system reform was a strategy of layering, by introducing the renminbi along with the dollar into the SDR basket. Why did China select the layering path in the reform of the international monetary system? According to the theoretical framework, it can be explained from two aspects: a strong veto capability of the U.S. and a high flexibility of the SDR.

Strong Veto Capability of the U.S.

In the international monetary system, the U.S. has a strong veto capability, which is reflected in the prominent monopoly position of the dollar in international transaction payments (it is widely used) and major foreign exchange market transactions (it is widely traded). The huge gap of being widely used and widely traded between the renminbi and the dollar makes it almost impossible for China to select displacement or conversion paths toward international monetary system reform.

Indicators are an indirect means of assessing whether a currency is widely used and widely traded. The shares of currencies in official reserve holdings, international banking liabilities (IBL) and international debt securities (IDS) would be important factors for the assessment of wide use, and the volume of transactions (such as turnover) in financial markets can be used to assess wide trade.

For wide use, as for official reserve holdings, data for this indicator is sourced from the IMF's Currency Composition of Official Foreign Exchange Reserves (COFER) survey. In 2015, the dollar's share was 64.1%, while the renminbi was not separately identified in the survey. On official foreign currency assets (OFA), in 2014, the dollar's share was 63.7%, while for the renminbi the share was only 1.1%. On international banking liabilities (IBL), in 2014, the dollar's share was 52.1%, while the share of the renminbi was only 1.9%. On international debt securities (IDS) outstanding, dollar-denominated IDS outstanding accounted for 43.1% in 2015 Q1, while renminbi-denominated IDS outstanding accounted for only 0.6% [IMF, 2015, pp. 23–6].

For wide trade, currency composition of Global Foreign Exchange Market Turnover is the main indicator to assess whether the currency is widely traded. According to the BIS, the share of the dollar was 43.5% in 2014, while the share for the renminbi was only 1.1%. Although the share of the renminbi increased substantially from 0.4% in 2010 to 1.1% in 2014, and great progress has been made, there is still a huge gap between the renminbi and the dollar [Ibid.].

In short, the preliminary data and analysis presented above suggest that the international use and trading of currencies occurs along a relatively wide spectrum. The dollar dominates by far. Although the use and trading of the renminbi has increased substantially since the 2010 review, there is a long way to go for it to catch the dollar in international use and trading. Therefore, China's path in international monetary reform can only be chosen from between layering or avoiding. How to select? This is actually related to another variable – the high flexibility of the SDR.

High Flexibility of the SDR

Although the SDR has emphasized the requirement of being a freely usable currency, the measurement and interpretation of this is ambiguous and flexible, including the measurement standards, measurement indicators and indicator data. From February 2015 to November 2015, the IMF and the PBOC launched nine rounds of negotiations on whether the renminbi is a freely usable currency. In the negotiation process, the SDR's high flexibility paved the way for the renminbi's inclusion in the basket.

First to consider is the measurement standard of a freely usable currency. In the negotiations, the PBOC emphasized that the standard of freely usable currency is not the standard of freely convertible currency. In February 2015, the IMF pointed out that although the convertibility of the capital account is not a necessary condition for the renminbi to join the SDR, a freely usable currency objectively requires the convertibility of capital accounts. In response to this view, the PBOC proposed that, although there is a relationship between the free usability of the renminbi and the free convertibility of the renminbi capital account, the Chinese interpretation of the free convertibility is different from the traditional one which is fully convertible [People's Bank of China, 2017]. In addition, Zhou Xiaochuan pointed out that the IMF did not give a precise definition of freely convertible currency. In the IMF's articles of agreement, freely convertible currency is divided into seven categories and 40 items, which is just an overview for the reference. The importance of each item is not clear and is hard to identify. As for China, it has met 35 items, so the renminbi is not far from meeting the standard of a freely convertible currency [2018, pp. 9–10].

Second, the measurement indicators of a freely usable currency must be considered. Compared with other major reserve currencies, the internationalization of the renminbi has its own uniqueness: the internationalization of the renminbi starts from the field of real economy, and the openness of China's current account is greater than that of the capital account, which means that the renminbi is widely used in the field of trade and services rather than widely traded in the financial market. The previous indicators of freely usable currency standards have paid more attention to the use of currency in financial markets rather than in trade and services; therefore, they cannot accurately measure the internationalization of the renminbi.

In the negotiations, the PBOC repeatedly proposed adding new indicators to measure the real progress of the renminbi's internationalization in trade and services. Finally, the IMF agreed to add two new indicators, namely, "the share of the currency in cross-border payments" and "the share of the currency in trade finance," so as to better reflect the actual situation of the renminbi's internationalization. Zhu Jun, director of the International Department of the PBOC, pointed out that "the IMF has fully considered the special situation of China, because the RMB internationalization is going faster and more reflected in the field of trade and investment, while the original IMF indicators are not enough to reflect the freely usability of the RMB, so it has added the indicators of cross-border payments and trade finance [Hexun 2017].

Finally, the measurement data of freely usable currency should be considered. As for the data, the three-year investigation on foreign exchange transactions by the BIS cannot reflect the latest situation of the renminbi's internationalization because the last round of investigation was conducted in 2013 and the next round of investigation was conducted in 2016, therefore China has argued that the IMF and the BIS should conduct a special data investigation for the renminbi and increase the investigation of incremental data, which is conducive to more accurately reflecting the dynamic change of the renminbi's internationalization. This is because the internationalization of the renminbi has developed rapidly in recent years, whereas the traditional SDR review standard mainly focuses on stock data, which reflects the inertia of a country's currency use, but underestimates the degree of a currency's dynamic adjustment.

In the negotiations, the PBOC proposed the addition of a special investigation of renminbi data. As a result, the IMF and the BIS agreed to carry out a special investigation on the composition of official reserve holdings and international banking liabilities (IBL). Major central banks participated in the special investigation, effectively making up the data gap measuring the degree of free use of the renminbi. At the same time, in the process of evaluating the international debt securities index, the IMF not only investigated stock data but also increased the evaluation of incremental data. Yi Gang, then deputy governor of PBOC, pointed out that the IMF and the BIS have effectively made up the data gap related to the renminbi's internationalization, thus providing strong data support for measuring the degree of the renminbi's free usability [People's Bank of China, 2017].

In short, the SDR system has high flexibility. During the negotiations between the IMF and the PBOC, the SDR's flexibility included the measurement standards, indicators, and data of a freely usable currency, providing a solid basis for the renminbi's inclusion in the SDR.

Summary

To sum up, in the issue area of the international monetary system, the U.S. still occupies a monopoly position and has strong veto capability toward any reform initiatives. Whether in international transaction payments or in global foreign exchange market transactions, the renminbi has a long way to go to catch up with the dollar, which means that China has no opportunity to take the displacement or conversion paths toward the reform of the international monetary system. However, in terms of international institutional flexibility, the U.S.-dominated IMF SDR system has high flexibility, which provides opportunities for China to reinterpret the standards that define a freely usable currency. Under these two conditions, China has chosen the layering path, putting the renminbi along with the dollar in the SDR basket. Therefore, it is consistent with the theoretical hypothesis that when the established power has strong veto capability and the existing international institution has high flexibility, the rising power is more likely to select layering.

Free Trade Agreement Reform and China's Displacement Path

China's Path Selection

The Trans-Pacific Partnership (TPP) was originally a free trade agreement between Singapore, Brunei, Chile and New Zealand (P4), which took effect on 28 May 2006. Due to the P4's small economic size and limited political influence, the TPP did not attract much attention for a long time. But when the U.S. showed interest in the TPP, it became the most popular free trade agreement in the Asia-Pacific region. On 14 November 2009, U.S. President Barack Obama announced that the U.S. would work with TPP countries to develop a 21st century free trade agreement with broad membership and high standards, which indicated that the U.S. would use the TPP to promote its own trade rules [Elms, 2009].

On 8 November 2011, on the eve of the Asia-Pacific Economic Cooperation (APEC) meeting held in Hawaii, the U.S. convened the TPP members to negotiate a new P4 agreement. In a speech at the 2011 Annual Meeting of the American Society of International Law, Ron Kirk, the U.S. trade representative, proposed that the U.S. government would negotiate a new agreement with other TPP partners to be approved by the U.S. Congress rather than take on the original P4 agreement [Hamanaka, 2014, p. 170]. Subsequently, Vietnam, Peru, Mexico, Japan, Canada, Australia and Malaysia announced accession one after the other to what would have been a strong regional trade agreement composed of 12 Asia Pacific countries. On 5 October 2015, the five-year TPP negotiation was completed in the United States – and the largest regional trade agreement other than the World Trade Organization (WTO) was formally formed. The 12 members accounted for about 40% of global GDP and one third of global trade. The U.S. eventually withdrew its signature from the TPP agreement (and the remaining countries negotiated a new agreement, which maintained many of the original provisions and came into force on 30 December 2018). Nevertheless, the case study provides a useful way to test one of the hypotheses of this article given the dominance of the U.S. in the original agreement.

The TPP, covered not only the liberalization of trade in goods and services, but also investment and competition policies, especially on state-owned enterprises, and transparency in government procurement and other sensitive issues that developing countries are reluctant to address in WTO negotiations. Moreover, the TPP also involved strict intellectual property rights protection, binding environmental and labour standards, and the introduction of a neutral and transparent investor-state dispute settlement mechanism. These characteristics made the TPP extremely different from the former free trade agreements based on WTO rules. It was regarded as a balancing institution to China's growing economic influence in the Asia-Pacific region [Perlez, 2015].

To address the U.S.-dominated TPP challenges, China strongly supported Asia-only free trade agreements rather than Asia Pacific agreements. In fact, China launched a feasibility study for the East Asia Free Trade Area Agreement (EAFTA) in 2004. However, due to competition with Japan for economic leadership in East Asia, the progress of EAFTA has been very limited. In 2006, Japan put forward the Comprehensive Economic Partnership in East Asia (CEPEA). There are some important differences between the EAFTA and CEPEA. First, the membership of the EAFTA is 10+3, while that of the CEPEA is 10+6, reflecting Japan's intention to dilute China's influence with a larger group. Second, the main agenda discussed by the EAFTA is the liberalization of trade in goods and service, while the CEPEA covers the liberalization of trade in goods and service, investment and intellectual property protection (called comprehensive economic partnership). For a long time, the competition between China and Japan made it difficult for the Association of Southeast Asian Nations (ASEAN) to play a leadership role in free trade agreements in Asia.

With the growing pressure of the TPP, China began to accept the scope of members and comprehensive agenda of the CEPEA. In August 2011, China and Japan worked hand in hand at the 10+6 Economic Ministerial Meeting, proposing the establishment of a working group on trade and investment liberalization. Based on this, ASEAN proposed the establishment of the Regional Comprehensive Economic Partnership (RCEP) at the East Asia Summit in November 2011. On 30 August 2012, the 10+6 economic ministers' meeting adopted the guiding principles and objectives for Negotiating the Regional Comprehensive Economic Partnership [ASEAN, 2012]. On 20 November, 10+6 leaders jointly issued a statement on launching negotiations on the Regional Comprehensive Economic Partnership.

It is worth noting that the RCEP, supported and promoted by China, is fundamentally different from the U.S-dominated TPP: the RCEP belongs to the first generation of trade rules under the WTO framework, while the TPP belonged to the second generation of trade rules beyond the WTO framework. The RCEP includes trade goods, trade services, investment, economic and technical cooperation, intellectual property rights, competition and dispute settlement. Most of these issues are related to cutting first-generation trade policy rules "at the border." However, the TPP not only included market access clauses such as trade in goods and service and investment, but also included expanded intellectual property rights protection, government procurement, state-owned enterprises, labour and environment, and regulatory harmonization. Its depth and breadth far exceeded WTO rules, and most of its content was related to the reduction of the second-generation "within the border" trade rules [Horn, Mavroidis, Sapir, 2010, pp. 1565–88].

In terms of path selection, the Chinese approach to the reform of free trade agreements followed the strategy of displacement, introducing very different rules to directly compete with, and hopefully to take the place of, the existing institutional rules. Why did China select the path of displacement rather than others? According to the theoretical framework, this can be analyzed from two aspects: the veto capability of the established power and the flexibility of existing institutional rules.

Weak Veto Capability of the U.S.

In the issue area of free trade agreements, the veto capability of the U.S. is weak. As for the U.S.-dominated TPP, China had the power to promote an alternative free trade agreement, the RCEP, which was difficult for the United States to veto.

First, after the global financial crisis, the trade dependence of most Asia-Pacific countries on the U. S. market declined and that of China increased, which constitutes China's market power. A prominent feature of the economic development of Asia-Pacific countries is their high dependence on the external market. With its rapid economic growth and deepening opening up to the world, China provided its Asia-Pacific neighbours with expanding export markets and prospects for economic growth, and as a result most Asia-Pacific economies are much more dependent on the Chinese market than on the U.S. market [Park, Shin, 2009]. Therefore, it was difficult for them to reject the China-supported RCEP agreement.

*Table 4. As*ia-Pacific Economies' Trade With China and the United States as a Proportion of Their Total Trade Volume, 2011

Asia-Pacific Economies	Trade With China, %	Trade With the U.S., %
Brunei	7.43	1.27
Malaysia	13.02	7.24
Singapore	10.42	7.98
Thailand	12.68	7.72
Vietnam	17.78	10.68
Japan	20.62	12.16
Korea	20.41	9.37
India	9.71	7.27
Australia	23.25	7.31
New Zealand	14.17	9.32

Source: [IMF, Direction of Trade Statistics Yearbook, 2012].

Second, most Asia-Pacific countries had already signed a free trade agreement (FTA) with China, so the signing of the new RCEP agreement did not have a big impact on these countries, pointing to China's institutional power. The China-ASEAN FTA was the first free trade agreement for China to negotiate with the outside world and was concluded in 2010. In November 2004, China-New Zealand FTA negotiations were launched, which was the first time China negotiated an FTA with a developed country; it was concluded in 2008. In May 2005, China and Australia launched FTA negotiations, the first time China negotiated an FTA with a developed economy with a large economic aggregate. In May 2005, China and Australia launched free trade zone negotiations; this was an FTA with a high level of trade and investment liberalization and was agreed in November 2014. In May 2012, the China-Korea FTA negotiations were launched. This was the FTA with the widest coverage and the largest trade volume involving countries in China's foreign negotiations at that time. It was concluded in June 2015.

Finally, the inclusiveness and diversity of the RCEP itself has more attractiveness than the high standard TPP. There is a large gap in the development stage and level of the Asia-Pacific countries. Most Asia-Pacific countries, especially those less-developed countries, preferred the inclusive and flexible regional economic integration model advocated by the RCEP. In terms of institutional rules, the RCEP belongs to the first generation of trade policy under the framework of WTO rules, and focused on market access issues such as trade and investment liberalization and facilitation; it also stressed a wide range of economic and technical cooperation among members, in contrast to the TPP as the 21st century high standard free trade agreement [ASEAN, 2012].

In short, the U.S. had weak veto capability in the issue area of free trade agreements in the Asia-Pacific region. This is a result of China's strong market and institutional power in the Asia-Pacific. Under these conditions, China had the opportunity to select either the path of displacement or conversion. Why did China finally choose displacement rather than conversion? This is related to another variable – the flexibility of the TPP.

Low Flexibility of the TPP

The institutional flexibility of the TPP was low and its high standards mainly reflected the preferences of the U.S, lacking inclusiveness toward China's institutional interests. Therefore, it was difficult for China to reinterpret the TPP's rules and thus it could only choose the displacement strategy toward free trade agreement reform.

First, the TPP's text reflects other U.S.-style agreements in the region. Comparing the TPP's text with other regional trade agreements, Todd Allee and Andrew Lugg found that about 45% of the TPP's text was similar to other regional trade agreements that the United States had previously signed. The free trade agreements signed by the U.S. with Bahrain, Oman and Korea had a particularly prominent impact on the TPP's text – the intellectual property rights clauses in the U.S.-Bahrain trade agreement and the investment clauses in the U.S.-Oman trade agreement had been almost directly copied into the TPP's text. Investment is one of the most controversial clauses in the TPP's text, and 80% of the content of the investment clause can be found in the text of free trade agreements signed by the United States with Korea, Peru, Australia, Singapore, Chile and other countries [Allee, Lugg, 2016, pp. 1–9].

Second, the high standards of the TPP reflected the values and standards of the United States. On intellectual property rights, the TPP standard was obviously higher than that of the WTO and beyond the development stage and level of China and other developing countries. For example, the TPP's intellectual property rights agreement proposed a safe harbour framework for the Internet, which is derived from the domestic intellectual property law of the U.S. If implemented, it would have further strengthened the global monopoly position of U.S. Internet giants. On labour and environmental standards, the TPP agreement specifically added labour and environmental clauses, which were linked to trade. By imposing other countries' higher labour and environmental standards, the U.S. could have used this as an excuse to impose trade sanctions on the products of developing countries. The basis of the TPP's labour provisions, including freedom of association and collective bargaining, were the 2007 Bipartisan Trade Agreements reached in the U.S. On state-owned enterprise, the TPP agreement had an obvious "U.S.-style": the scope of the provisions of the TPP on state-owned enterprises was limited to state-owned enterprises at the level of the federal government and did not involve state-owned enterprises of local governments. The U.S. has no state-owned enterprises at the level of the federal government, while state-owned enterprises in China and other developing countries are mainly concentrated at that level.

Finally, the TPP also reflected the U.S.' geopolitical "pivot to Asia" strategy. As the economic tool of the pivot, the TPP was not only an agreement to promote trade liberalization in the Asia-Pacific region, but also had political and diplomatic purposes in light of the struggle between the U.S. and China for leadership in the Asia-Pacific region. The Obama administration delegated major trade power to the National Security Council rather than the U.S. trade representative and emphasized that the U.S. should take a political and strategic approach toward foreign trade policy [Barfield, 2016]. As President Obama wrote in the Washington post, "China wants to set the rules in the world's fastest-growing region, which will put our workers and businesses at a disadvantage. Why do we let this happen? We should make the rules. TPP is to ensure that the U.S rather than China write the rules of trade in the Asia-Pacific region" [Obama, 2016].

In short, the flexibility of the TPP was low, with the distinctive features of U.S.-style trade agreements, reflecting the values and interests of the U.S., and undertaking the political mission of the U.S. strategy of pivot to Asia. Under such conditions, it was difficult for China to reinterpret the institutional rules and integrate its own institutional preferences into the TPP.

Summary

To sum up, in the issue area of free trade agreements, the veto capability of the U.S. is weak, which provided the opportunity for China to select the path of displacement or conversion. However, the flexibility of the TPP was low, which made the conversion path impossible for China. So China chose the path of displacement.[1] This is consistent with the theoretical hypothesis that when the established power has weak veto capability and the existing international institution has low flexibility, the rising power is more likely to select the displacement path.

Multilateral Development Bank Reform and China's Conversion Path

China's Path Selection

After the end of the cold war, the U.S. injected the Washington Consensus and neoliberalism into the World Bank. At the same time, the emerging economies represented by China were not able to increase their own voices in keeping with their growing economic strength. Therefore, there is an obvious mismatch between the distribution of economic power and the distribution of institutional power in the World Bank. In addition, the World Bank is widely criticized by developing countries for its bureaucracy and inefficiency of operations [Chinese Ministry of Finance, 2006, pp. 4–5].

In order to promote reform of the World Bank and meet the infrastructure financing needs of developing countries in Asia, China initiated the establishment of the AIIB. On 7 October 2013, Chinese president Xi Jinping put forward the institutional initiative of establishing the AIIB when he attended the APEC leaders' meeting [Ministry of Foreign Affairs of the People's Republic of China, 2013]. On 24 October 2014, China and 21 Asian countries signed a memorandum of understanding (MOU) on the establishment of the bank, which officially launched the multilateral negotiation process on the establishment of the AIIB. As of 31 March 2015, 57 countries have announced themselves as founding members of the AIIB, including 37 in Asia and 20 non-regional and including both developed and developing countries. On 22 May 2015,

[1] On 23 January 2017, the Trump administration declared that the U.S. would withdraw from the TPP. Under these circumstances, China still chooses to push the RCEP. There are two reasons for this: first, the spirit of the TPP is still alive in the form of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, signed by the remaining TPP countries after the U.S. withdrawal. It is very likely that the U.S. will return to the renewed TPP with a new administration; second, the RCEP can provide strategic support to China in the context of the deepening U.S.-China trade war.

the founding members of the AIIB established the articles of agreement of the AIIB and on 16 January 2016, the AIIB officially started operations in Beijing.

It should be emphasized that although the AIIB is a new multilateral development bank initiated by China and is also outside of the World Bank, China is not taking a displacement path in multilateral development bank reform. This is because the difference between the AIIB and the World Bank is not in the institutional rules but in the deployment of the institutional rules. This means that China is taking the same institutional rules to pursue different institutional goals.

On 5 March 2015, the multilateral interim secretariat of the AIIB held a seminar on institution building of the AIIB in Beijing, focusing on the governance structure, environmental and social security policies, procurement policies and other core institutional rules of the AIIB. The AIIB invited the World Bank and other multilateral development banks' officials to offer advice on the AIIB's institution-building. Several experienced World Bank experts, such as Natalie Lichtenstein, Stephen Lintner, Matthew Dalzell, and Mara Warwick have contributed to the AIIB's adoption of the WB's institutional rules. Among them, Lichtenstein helped draft the articles of agreement of the AIIB, and Lintner made an important contribution to the formulation of its environmental and social framework [Ifeng, 2015].

In terms of path selection, the Chinese approach to multilateral development bank reform follows the strategy of conversion, which occurs when rules remain formally the same but are interpreted and redeployed in new ways. "AIIB founding members were seeking to mobilize additional finance for infrastructure in Asia, the establishment of a new financing mechanism was not the primary objective. In setting up the AIIB, the parties sought to differentiate AIIB from others by its specialized focus and its operation in practice. Existing MDBs already amply demonstrate that the same legal text and same structures can lead to very different institutions and ways of operation," noted Natalie Lichtenstein [2018, p. 12]. Why did China choose the conversion path? According to the theoretical framework, this can be analyzed from two aspects: the weak veto capability of the established power and the high flexibility of the existing international institutions.

Weak Veto Capability of the U.S.

In the issue area of multilateral development banks, the veto capability of the U.S. is weak. Comparing the BRICS Contingent Reserve Arrangement (CRA) and the BRICS New Development Bank (NDB), Eric Helleiner and Hongying Wang point out that the CRA has a 70% link with the IMF while the NDB is independent of the World Bank, mainly because the U.S. has strong veto capability in crisis finance but has weak veto capability in development finance. For emerging economies, the creation of a new international crisis finance institution requires resources: first, money for crisis assistance, mainly in dollars; second, a credible mechanism to ensure that loans in crisis can be paid back. Despite criticizing the IMF's harsh conditionality, emerging economies are not sure that the loans can be paid back without it. In contrast, in the field of development finance, the establishment of a new multilateral development bank also requires two resources: first, money for development finance, mainly dollars; second, knowledge about investing money in other countries' infrastructure and raising money from the financial market. In these two aspects, BRICS, especially China, has accumulated considerable knowledge on investment in infrastructure and raising money in financial markets [Helleiner, Wang, 2018, pp. 573–95].

In practice, in the process of establishing the AIIB, the U.S. did try to veto China's AIIB proposal many times. After the AIIB initiative was put forward, U.S. Secretary of State John Kerry, Treasury Secretary Jack Lew and President Barack Obama accused the AIIB of reducing international best standards [Kelly, 2014]. Despite this, the U.S. alliance in Europe and Asia decided to join the AIIB.

As for its European allies, the United Kingdom took the lead in applying for AIIB membership. "The UK will play a key role in ensuring that the AIIB adopts the international best standards in terms of accountability, transparency and governance," UK Chancellor George Osborne said in a statement [Gov.UK, 2015]. This made the U.S. unhappy with the UK. "We are concerned that the UK is continuing to accommodate China, which is not a good way of dealing with emerging powers," it said [The Guardian, 2015]. The UK's application triggered a domino effect, with Germany, France and Italy subsequently announcing their applications. Germany, France and Italy said in a statement that they are keen to work with the founding members of the AIIB to establish the institution with the highest standards and best practices in regulation, safeguards, debt and procurement [The Guardian, 2015].

As for its Asian allies, Australia and Korea have joined the AIIB despite resistance from the U.S. On 20 October 2014, U.S. Secretary of State John Kerry tried to dissuade Australia from joining the AIIB while attending the inauguration ceremony of the new Indonesian president in Jakarta [China Daily, 2014]. But in Australian domestic politics, cabinet economic officials, including Joe Hockey, the treasurer, and Andrew Robb, the commerce secretary, have stressed the importance of participating in the China-proposed bank to maintain Australia's economic relationship with China. In 2013, trade with China accounted for 23.3% of Australia's total trade, compared with 8.4% with the U.S. In terms of exports, Australia's exports to China accounted for 32.5% of its total exports, while its exports to the U.S. and Japan combined accounted for only 20.5% [Bates, Switzer, 2015]. With this domestic political pressure, Prime Minister Tony Abbott announced that Australia would apply to join the AIIB as a prospective founding member on 29 March 2015. Similarly, Korea applied to join the AIIB on 26 March 2015, and said its decision to join the AIIB was based on its national interests [Guangzhou Daily, 2015].

In short, the U.S. has weak veto capacity toward the Chinese reform imitative in the issue area of multilateral development banks, both in terms of China's resources to create a new multilateral development bank and in terms of its political difficulty in preventing its allies from joining the AIIB proposed by China. Therefore, under this condition China could choose the path of displacement or conversion. Why did China finally choose conversion rather than displacement? This is related to another variable – the high flexibility of the World Bank's institutional rules.

High Flexibility of the World Bank's Institutional Rules

In terms of flexibility, the institutional rules of the World Bank are relatively open and inclusive, and they can be deployed to both poverty reduction and infrastructure investment. On the one hand, the AIIB has adopted almost the same institutional rules as the World Bank; on the other hand, the AIIB has redeployed the World Bank's institutional rules.

In terms of the institutional rules, although the AIIB has some innovations, such as nonresident board of directors and global procurement, it is generally built on the model of the World Bank in terms of capital allocation, environmental and social safeguards, procurement policy, and so on. On quota allocation, the AIIB articles of agreement stipulates that "the basic parameter of allocation of capital stock to members would be the relative share of the global economy of members. Members' shares of the global economy would be measured by reference to Gross Domestic Product (GDP)" [AIIB, Art. 5, Para. 4], which is consistent with the quota allocation rules of the World Bank. On environmental and social safeguards and procurement policies, the AIIB agreement states that "the operational and financial policies of the AIIB would be subject to approval by the board of directors and should be based on international best practices. These policies would include environmental and social frameworks, disclosure, procurement and debt sustainability" [Ibid., Art. 13, Para. 4]. Here, international best practices actually means the practices of the World Bank.

In terms of the deployment of the institutional rules, the World Bank rules can be deployed in both the area of poverty reduction and the area of infrastructure investment. Despite the indication in the World Bank's articles of agreement that the mission of the Bank is to develop the production facilities and resources of less-developed countries, the interpretation and deployment of the mission often changes with the mainstreaming of developing ideas. Since the late 1950s, the mainstreaming of developing ideas in the World Bank worked to promote economic growth, so the main business of the World Bank was infrastructure investment. However, since the early 1990s, the mainstreaming of developing ideas shifted the focus toward reducing poverty, such that social investment, including education, environment, health, anti-corruption and public management, became the new focus of the World Bank. Overall, the shift in the businesses of the World Bank shows that its institutional rules are inclusive and open and can be deployed in different areas of operations.

In short, the flexibility of the World Bank's institutional rules is high, allowing it to meet the United States' institutional preference – poverty reduction – and China's institutional preference – infrastructure investment.

Summary

To sum up, in the issue area of multilateral development banks, the veto capability of the U.S. is weak, which gives China the opportunity to select the path of displacement or conversion. Meanwhile, the institutional rules of the U.S.-dominated World Bank are flexible and inclusive, so that China can choose conversion rather than displacement. After all, the cost of the establishment of a brand new international institution is much higher than starting with something workable and known [Lichtenstein, 2018, p. 12]. This is consistent with the theoretical hypothesis that when the established power has weak veto capability and the existing international institution has high flexibility, the rising power is more likely to select the conversion path.

Conclusion

Building on the theory of gradual institutional change in historical institutionalism, this article develops a new theoretical framework to explain China's path selection in global governance reform.[2] The veto capability of the established power and the flexibility of the existing international institutions are two determinants of the rising power's path selection. When the established power has strong veto capability and the existing international institution has low flexibility, the rising power is more likely to select the avoiding path. When the established power has strong veto capability and the existing international institution has high flexibility, the rising power is more likely to select the layering path. When the established power has weak veto capability and the existing international institution has low flexibility, the rising power is more likely to select the displacement path. When the established power has weak veto capabil-

[2] It should be noted that the gradual institutional change theory is a mid-range theory rather than a grand theory. Generally, historical institutionalists scour the historical record for evidence of why the historical actors behaved as they did and depend heavily on induction. However, this emphasis on induction has been a weakness as well as a strength: historical institutionalists have been slower than others to aggregate their findings into systematic theories about the general processes involved in institutional change.

ity and the existing international institution has high flexibility, the rising power is more likely to select the conversion path.

In sovereign credit rating, the strong veto capability of the U.S. and the low flexibility of the existing international credit rating institution made China adopt the path of avoiding. In the international monetary system, the strong veto capability of the U.S. and the high flexibility of the special drawing rights of the IMF made China adopt the path of layering. In free trade agreements, the weak veto capability of the U.S. and low flexibility of the Trans-Pacific Partnership made China adopt the path of displacement. In multilateral development banks, the weak veto capability of the U.S. and high flexibility of the Work Bank rules made China adopt the path of conversion.

Based on whether to build new international rules or reinterpret or redeploy the existing ones, this article proposed a new typology of China's path selection (avoiding, layering, displacement and conversion), which is different from the traditional status quo-revisionist typology.

According to the traditional typology, if China selects the path of status quo, it is very likely that China will be criticized as a free rider. If China selects the path of revisionist, it is very likely that China will be seen as a challenger of the existing international order. The new typology shows that China's path selection has something to do with the veto capability of the U.S. and the flexibility and inclusiveness of the U.S.-dominated existing international institutions. This means that scholars and practitioners of global governance should pay more attention to the interaction between the rising power and established power, rather than simply ask what kind of state the rising power is.

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