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Research Report

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China's Belt and Road investment governance: building a hybrid model*

by

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China's Belt and Road Initiative (BRI) will give rise to an unprecedented hybrid model of investment governance. Transnational governance under the BRI will combine elements of a traditional state-driven model, in which states shape rulemaking either directly or through agents, with elements of transnational policy networks, in which non-state actors play significant roles in rulemaking. If designed and implemented as an effective and sustainable hybrid model, investment governance, understood as rulemaking throughout the investment life cycle, from authorizations through disputes, could contribute greatly to the BRI's ultimate success.

Transnational policy networks will significantly shape BRI investment governance. Although existing and future treaties will support the BRI, the initiative itself is not treaty-based; rather, it has been established as a framework that allows considerable flexibility in implementation. The entity that is perhaps most closely associated with BRI implementation, the Asian Infrastructure Investment Bank (AIIB), identifies "openness, transparency, independence, and accountability" as its "core principles";¹ it has established an International Advisory Panel, composed of former government officials, private sector executives and academics to support AIIB senior management in decision-making. The AIIB also has joined two recent initiatives that are assembling a range of public and private stakeholders to advance opportunities for collaboration and knowledge exchange: the Global Infrastructure Facility and the Global Infrastructure Connectivity Alliance. With respect to BRI financing, President Xi Jinping, at the opening of the Belt and Road Forum for International Cooperation, held in Beijing in 2017, called for the development of a "diversified financing system" and for "greater cooperation between government and private capital."²

At the same time, however, state entities advancing state policy will play a key role in the development of BRI investment governance. Chinese investors seeking to invest in BRI projects abroad will need to obtain approvals from one or more state entities, depending on the particular characteristics of a contemplated investment (including sector, location and amount, as well as the

state-owned or privately-owned status of the investor). Many BRI investments will be funded by Chinese policy banks, state-owned commercial banks and/or state-owned investment funds. These state-driven aspects of BRI governance will contribute to the BRI's ambition and reach, but also will be closely scrutinized abroad by a range of actors, including governments, businesses, non-governmental organizations, and academics, with a particular focus on debt sustainability, terms of financing and competition for securing work on BRI projects.

A US\$1 billion transaction in Sri Lanka in 2017 illustrates how the state-driven aspects of BRI projects can lead to controversy. Specifically, in exchange for a reduced debt burden, Sri Lanka agreed to transfer control over a strategic port to a Chinese corporation. More recently, Malaysia suspended three major China-backed infrastructure projects and has called for renegotiating or cancelling infrastructure deals with China that are considered by Malaysia to be one-sided. With respect to competition for Chinese-funded BRI projects, recent reports by the Center for Strategic and International Studies and the National Bureau of Asian Research have raised questions concerning the extent to which companies outside of China can secure such work.

The ultimate success of the BRI will depend in significant part on whether issues of debt sustainability, terms of financing and competition for projects are clarified and resolved. Notably, the AIIB has directly addressed all three issues, committing to (i) fiscal sustainability as a condition of financing, (ii) disclosure of project documents and (iii) transparent procurement processes. The issues should also be addressed on the state-driven side of the hybrid governance model.

More generally, to build an effective and sustainable hybrid model of investment governance, a number of strategies can be pursued:

- One central institution could advance transparency, clarity and predictability by coordinating China's BRI-related decision-making. The IMF Managing Director, Christine Lagarde, has suggested that China's recently-created International Development Cooperation Agency, which will oversee China's foreign aid, could play such a role.
- State entities in China could increase their level of engagement with non-state entities on BRI-related issues. One example is the China-IMF Capacity Development Center; it will be based in Beijing and will strengthen collaboration between China and the IMF on capacity development, with a focus on BRI jurisdictions. A second example would be the recently-established International Energy Charter-China Electricity Council Joint Research Centre in Beijing; it will focus on a range of energy-related issues, i.e., trade, transit, efficiency, investment, and dispute settlement.
- Decision-making in connection with BRI-related investment disputes could be undertaken primarily by non-state actors, specifically private individuals sitting as arbitrators in BRI-related disputes that are submitted by private entities to international commercial

arbitration or investment treaty arbitration and administered by either Chinese or foreign arbitral institutions. The recently established China International Commercial Court can complement, rather than displace, China's existing international arbitration regime, similar to the role played by other international commercial courts launched in Singapore, Abu Dhabi and Dubai.

Striking an appropriate balance between the ambition of a state-driven model and the inclusiveness of a transnational policy network model will be of central importance for BRI investment governance.

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¹ AIIB, "Introduction: our founding principles," <https://www.aiib.org/en/about-aiib/>.

² "Full text of President Xi's speech at opening of Belt and Road Forum," *Xinhua*, May 14, 2017.

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