Research on FDI Regulation Framework at the Background of "BRI" Implementation

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Abstract: Alongside "Belt and Road Initiative" (BRI) are mostly developing countries, with complicated geopolitical relationships and poor business environments. Therefore, how to promote Foreign Direct Investment (FDI) cooperation prudently is a critical issue faced by Chinese government and enterprises. On one hand "BRI" is an initiative and cannot establish new organization to coordinate investment disputes, and on the other hand FDI regulations are at crossroad: lacking multilateral mechanism, restructuring regional rules and requiring upgrade of Bilateral Investment Treaties (BITs). In order to protect Chinese overseas investment and prevent potential "BRI" risks, it's indispensable for China to take actions in FDI regulations: in multilateral level to propose global FDI rules and long-term mechanism, in regional level to innovate rules by methods of Regional Comprehensive Economic Partnership (RCEP) and Asian Infrastructure Investment Bank (AIIB), in bilateral level to upgrade BITs and promote liberalization and facilitation, and in unilateral level to deepen domestic reform and pilot new rules.

Keywords: FDI, "BRI", Risk Prevention, FDI Regulations

Since it was proposed, the Belt and Road Initiative has witnessed increasing Chinese investment cooperation with the countries along the Belt and Road,① and has made certain achievements. However, the Belt and Road is a proposal, an initiative that is not entitled to establish an organization to facilitate

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① Being open, the Belt and Road Initiative includes but is not limited to the scope of the ancient Silk Road. However, this paper only includes 64 Belt and Road countries (excluding China) as research samples. For a complete list, please see http://beltandroad.hktdc.com/tc/country-profiles/country-profiles.aspx, May 22, 2016.

investment. Meanwhile, in FDI area we are faced with many problems, such as lacking multilateral mechanism, restructuring regional rules. In order to pragmatically and effectively boost investment cooperation alongside BRI, we have to take full advantage of current FDI regulations and make constant innovations in FDI new rules.

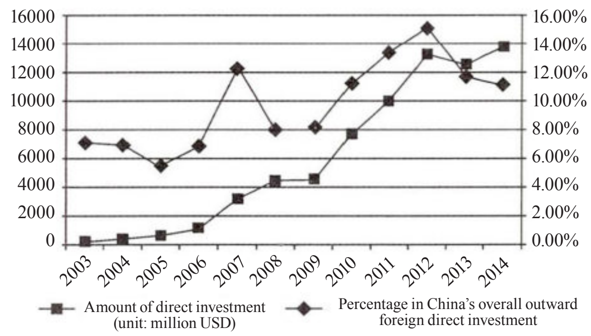
1. Attributes and disadvantages of China's foreign direct investment in the countries along the Belt and Road

Nowadays the world economy is depressed and China is also under pressure. Under the circumstance, China's move to advance investment in the countries along the Belt and Road is beneficial and indispensable. However, opportunities and challenges co-exist in the process. Despite fast growth, several problems still exist in China's outward foreign direct investment, for example, it is disproportionately concentrated on certain countries and industries.

1.1 Rapid growth with great potential

According to statistics released by China's Ministry of Commerce, from 2003 to 2014, China's outward foreign direct investment flowed into 58 countries along the Belt and Road and amounted to USD 72.03 billion. This was a booming increase, from USD 200 million in 2003 to USD 13.66 billion in 2014, with an average annual increase of 46.7%. Despite the fast growth, China's direct investment in the countries along the Belt and Road only accounts for a small proportion of China's overall outward foreign direct investment, merely 11.1% in 2014, which means great potential for increasing Chinese direct investment in the countries along the Belt and Road. As the Belt and Road Initiative is further advanced and more investment projects break ground, Chinese direct investment in the countries along the Belt and Road will increase faster and on a broader scale.

Chart 1 Chinese direct investment in the countries along the Belt and Road from 2003 to 2014



Source: Statistical Bulletin of China's Outward Foreign Direct Investment

1.2 Destination concentration with vulnerability to disturbance

Statistics from the Ministry of Commerce of China reveals that Singapore, Russia, Indonesia and Kazakhstan top the list of destinations for Chinese direct investment to the countries along the Belt and Road, claiming 43.1% of the total; the percentage rises to 71.4% if we calculate the top 10 destinations. In terms of risk diversification, excessive geographic concentration is not a good choice. Data also shows China has no direct investment in any of these six countries; Bhutan, Armenia, Moldova, Estonia, Montenegro and Slovenia, and moreover China has negative investment figures in Latvia, Bahrain and Syria, which means divestment or capital withdrawal.

Table 1 China's Direct Investments in the Countries along the Belt and Road from 2003 to 2014 (unit: million USD)

Country	Stock of direct investment	Country	Stock of direct investment
Singapore	14312.69	Croatia	5.14
Russia	5708.39	Bosnia and Herzegovina	3.13

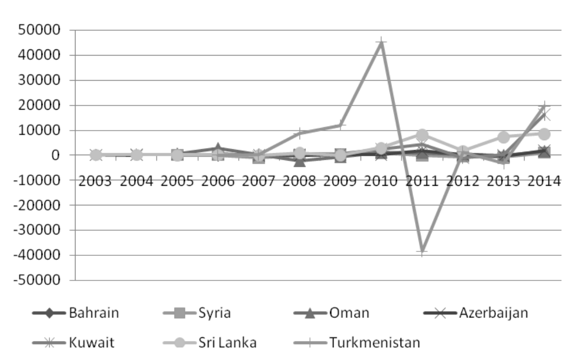
Country	Stock of direct investment	Country	Stock of direct investment
Indonesia	5646.85	The Maldives	2.27
Kazakhstan	5374.41	Lebanon	1.21
Laos	3906.84	Albania	0.65
Myanmar	3390.66	Macedonia	0.06
Iran	3371.30	Palestine	0.04
Mongolia	3331.07	Latvia	−0.19
Thailand	3276.23	Bahrain	−1.94
Pakistan	3137.46	Syria	−7.20

Notes: The left column lists the top ten destinations for investment, while the right column lists the bottom ten.

Source: Statistical Bulletin of China's Outward Foreign Direct Investment

Meanwhile, due to the complicated geopolitical relations among the countries along the Belt and Road and the frequent occurrence of emergencies, Chinese direct investment could not be kept at a stable level. For example, Syria, Bahrain, Oman, Azerbaijan, Kuwait, Sri Lanka, and Turkmenistan have seen drastic fluctuations of direct investments from China.

Chart 2 Fluctuation of China's direct investment in certain countries along the Belt and Road from 2003 to 2014 (unit: million USD)



Source: Statistical Bulletin of China's Outward Foreign Direct Investment

2. The existing rules and regulations concerning China's investment cooperation with countries along the Belt and Road

Considering the possible problems and risks in investment cooperation during the advancement of the Belt and Road Initiative, China is in need of institutional guarantees and binding regulations. As an initiative, the Belt and Road is not entitled to set up a new mechanism for investment cooperation. Instead, it can only utilize the existing investment rules and try to coordinate investments at the multilateral, regional and bilateral levels. In real practice, however, it is still challenged by several problems.

2.1 Lacking multilateral mechanism

There is not yet an international regulator for international investments, nor a comprehensive international agreement, which means that direct investments in countries along the Belt and Road lack effective coordinating mechanisms and multilateral regulations. This makes international investments in an embarrassed position compared with international trade, which has permanent multilateral organization (WTO, World Trade Organization) and its agreements, such as the General Agreement on Tariffs and Trade (GATT), the General Agreement on Trade in Services (GATS), and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). WTO and its rules can be used to regulate and facilitate trade cooperation among countries along the Belt and Road.

While in FDI area, there are only a few multilateral agreements in effect, which include Convention Establishing the Multilateral Investment Guarantee Agency (MIGA), Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID) and related agreements within the WTO framework (mainly referring to Agreement on Trade-Related Investment Measures, or TRIMs for short). Among them, MIGA aims to reduce political risks posed to investments in developing countries, ICSID is meant to settle investment disputes through mediation and conciliation, while TRIMs only covers investment measures that relate to trade in goods and limit or distort trade (Li & Sang; 2014).

To all these treaties China is a signatory country, which entitles China to directly use them to strengthen investment cooperation with countries along the Belt and Road, but only in a very limited way. First, the initial purpose of these treaties is to protect international investments involving investment risks and barriers, but not mentioning how to promote and encourage direct investment. They are somehow at a lower stage, while current multilateral trade rules have evolved from trade protection and trade liberalization to a higher-level of promotion and facilitation of trade, which is well demonstrated by the Trade Facilitation Agreement. Second, these treaties, incomplete and unsystematic, only cover a small range of investment topics. A large number of basic problems (such as national treatment and most favored-nation treatment) and other sensitive issues (such as national security review, capital transfer and supervision) are yet to be given standard solutions. Last, the binding effectiveness and authority of the treaties are taken with a pinch of salt. Take ICSID for example, according to WB and ICSID statistics, from 1972 to 2015, only 549 cases were handed over to ICSID for mediation or arbitration. That is a relatively tiny number compared with large quantities of investment disputes occurring each year, and of those 549 cases there are only five cases in which China as an investor turned to ICSID for help. The fact that these established mechanisms turn out to be underused indicates that there might be weaknesses in these mechanisms, whose binding force and effectiveness need to be further enhanced. To be sure though, ICSID has its own influence, and 51 countries along the Belt and Road are its contracting parties.① To some extent, it helps to guard against FDI political risks.

Establishment of comprehensive multilateral mechanisms has indeed been tried yet but ended in failure. Whether it was the Multilateral Agreement on Investment (MAI) of by the Organization for Economic Co-operation and Development (OECD), or WTO's Multilateral Investment Framework (MFI), these attempts proved to be a wild goose chase (Xing, 2013). The United Nations Conference on Trade and Development (UNCTAD) also made efforts, for example, in its "World Investment Report" to propose establishing a new-generation of investment policies and investing in the SDGs: an action plan, but these were all merely initiatives that have no substantive binding enforcement. There are other international treaties, which have been passed but lack a binding power, such as the International Code of Fair Treatment for Foreign Investments by the International Chamber of Commerce (ICC), and OECD's Declaration on International Investment and Multinational Enterprises; some treaties are not ratified, such as the UN Code of Conduct on Transnational Corporations (Draft).

It is an embarrassed situation because of lack of multilateral mechanisms, with only a few loosely-binding treaties, yet limited in effect. The investment cooperation among the Belt and Road requires a comprehensive multilateral investment mechanism, to provide guarantee by fundamental, universally

① There are ten non–contracting countries, including Bhutan, India, Iran, Laos, Maldives, Myanmar, Palestine, Poland, Tajikistan and Vietnam. Three countries, i.e. Russia, Kyrgyzstan and Thailand have signed the treaty but not brought it into force.

binding and authentic rules.

2.2 Restructuring regional rules

Regional investment treaties fall into two categories. The first type targets direct investment, such as the Asia-Pacific Trade Agreement on Investment (APTA Investment, cosigned by the countries along the Belt and Road including China, Bangladesh, Laos and Sri Lanka), and the China-ASEAN Free Trade Area (CAFTA) Investment Agreement. The second type refers to trade treaties with investment provisions, which is common in nowadays trade negotiations (Lu & Sun, 2014).

Regional treaties along the Belt and Road are scarce in quantity and limited in effect. First, regional treaties do not hold enough binding power in settling investment issues, especially in solving investment disputes. For example, APTA Investment, although passed in 2009, never came into effect. Second, whether there are specific agreements concentrating on direct investment or not, all regional treaties tend to focus on trade and cover a very limited range of contents on investment. Third, the existing regional treaties cannot cover all countries along the Belt and Road, which makes regional treaties less applicable. Finally, the investment issues covered by the treaties are at a low level and lag behind the new international rules. The Trans-Pacific Partnership (TPP) features several investment topics that are leading the path of building new investment rules, such as competitive neutrality, investor-state dispute settlement mechanisms, and labor and environmental standards (Wen, 2016). As for treaties signed by the countries along the Belt and Road, RCEP might be the only one that is up to date, but still in negotiation. The high standards of the TPP is not feasible for RCEP due to the diversification of the RCEP countries. For example, the investor-state dispute settlement mechanism is in fact not suitable for the countries along the Belt and Road, or rather, too high to achieve. Foreign investors are permitted to sue the government of the host country, and it is obviously favorable for multinational companies from developed countries, but not in any way helpful for the governments of the developing countries. It is not in accordance with the mutual benefit and win-win philosophy pursued by the Belt and Road Initiative. Therefore, it is inevitable that the new investment rules should be customized, designed and adopted based on the cooperative ideas and practical needs of the Belt and Road Initiative in order to fit specific local conditions.

Some beneficial attempts have been made by the countries along the Belt and Road. For example, the AIIB, compared with the WB and the Asian Development Bank (ADB), is lean, clean and green. What's more, it adheres to the principle of achieving mutual benefit and a win-win outcome, and never imposes harsh political clauses upon investment projects or the host countries of investment. In some sense many AIIB principles and measures are advancing the reform of financial development agencies, causing pressure upon original financial investment cooperation mechanisms and adding impetus to the investment cooperation. Given that it was established years before, the AIIB is yet to be tested by practice.

There are two challenges facing the regional investment treaties or mechanisms. The first is the reconstruction of rules, namely figuring out how to integrate the practical needs with the new international rules and achieve high-standard investment treaties. The second challenge is to implement concrete measures to make the AIIB work more effectively and push the investment projects that could yield mutual benefits and a win-win outcome to break ground.

2.3 Requiring upgrade of BITs

Bilateral cooperative mechanisms include BIT and the Avoidance of Double Taxation Treaty (DTT). BIT is currently the most important and effective mechanism for investment cooperation. China has already signed BITs with 56 countries along the Belt and Road.① DTT, on the other hand, helps to reduce the tax burdens of those enterprises that invest in foreign countries. So far China has signed DTTs with 53 countries along the Belt and Road.②

Backdropped by the lack of multilateral mechanisms and the reconstruction of regional rules, BIT becomes the most effective investment rule that China can rely on when advancing the Belt and Road Initiative. However, problems still exist in the BITs signed by China and the countries along the Belt and Road. First, the low outdated of those BITs, mostly signed in the 1990s, cannot satisfy nowadays requirements. China began to engage in BIT negotiation long time ago, but at that point China had just begun its undertaking of outward foreign direct investment and did not have urgent demand for BIT. Worse still, some BITs, such as those China signed with Brunei and Jordan, never come into effect. Currently the latest version of BIT in the world is the 2012 US BIT template, which has high-standard investment protection and high-level openness to investment, characterized by the management model of pre-establishment national treatment and negative list (Nie, 2014). In contrast, the BITs signed between China and countries along the Belt and Road countries mainly focus on protecting foreign investments in China, at a low level of protection, with little liberalization and facilitation, and with no pre-establishment national treatment and negative list. Second, these BITs only apply to a narrow scope and are time -consuming. BIT literally only applies to bilateral level. To reach such agreements with so many countries there must have been a painstaking process, not to mention that all these BITs today have to be resigned. The cost of future negotiations might become a burden. Third, overlapping and conflicting content tends to cause administrative confusion. So many BITs, signed by numerous countries with complex contents, would easily result in the "Spaghetti bowl effect", which may be troublesome for investment supervision and international coordination, makes it difficult for foreign investors to abide by the laws, and is not good for solving FDI disputes through internationally standardized methods. Last, BIT is yet to be signed between China and some unstable countries, such as Afghanistan, Iraq, Nepal and East Timor, in order to provide guarantee for the interests of Chinese enterprises' investment in these countries.

In FDI area, BIT is currently the best practice, which provides a solid guarantee for the promotion of the investment cooperation with the countries along the Belt and Road at the bilateral level. But given their outdated model and provisions, the BITs need to be upgraded and resigned.

3. Policy suggestions

Currently the international investment rules are at a key historical moment, where the outdated need to make way for the new, and China needs to make more active and innovative efforts to get involved. The Belt and Road Initiative needs more detailed guidelines for investment cooperation and more pragmatic investment rules to guarantee FDI interests.

3.1 To propose FDI cooperation guidelines for

① Countries along the Belt and Road not yet signing BIT with China include eight countries, i.e. Afghanistan, Bhutan, East Timor, Iraq, Maldives, Montenegro, Nepal and Palestine. Data source: UNCTAD (http://investmentpolicyhub.unctad.org/).

② Countries along the Belt and Road not yet signing DTT with China include 11 countries, i.e. Afghanistan, Bhutan, East Timor, Iraq, Maldives, Palestine, Cambodia, Jordan, Lebanon, Myanmar and Yemen. Data source: State Administration of Taxation of China (http://www.Chinatax.gov.cn/n810341/n810770/index.html).

BRI

As an initiative, the Belt and Road is flexible in some ways, and the principles guidelines for investment could be further specified. A set of guidelines on investment cooperation with the countries along the Belt and Road, without the hassle of building a new institution or a new mechanism, would be a good option. But the key problem for that would be how to establish guidelines and principles, and how to guarantee the interests of China and maximize the holistic interest inside the area along the Belt and Road. The guidelines for investment cooperation are supposed to be based on the Vision and Actions on Jointly Building the Silk Road Economic Belt and 21st-Century Maritime Silk Road, and the contents should include industrial complementary openness, disputes settlement through friendly negotiations and risk control.

In 2016, G20 Guiding Principles on Global Investment Policymaking was adopted, which is a good example for BRI. The guidelines for the investment cooperation are in nature not legally binding, but since BRI brings mutual benefits and win-win outcomes, the guidelines are likely to play a significant demonstration role. When more investment projects are implemented, and a win-win outcome is achieved, those guidelines will become more convincing, and there might even be a chance that the Belt and Road could begin to build functional mechanisms or institutions for its investment cooperation.

Admittedly, only guidelines are far from enough. The Belt and Road Initiative needs to convince people with morality and integrity, with feasible investment rules that yield mutual benefits and a win-win outcome. Therefore, implementation of the rules is the very key, and integration, upgrading and renewal of investment rules should be conducted at the multilateral, regional and bilateral levels.

3.2 Multilaterally to propose global FDI rules and long-term mechanism

The ideal goal at the multilateral level would be to set up a global coordinating institution for investment, just like the WTO, and build a set of rules that could work worldwide. To that end, China should first focus on building comprehensive global investment guidelines or rules that cater to the common needs of all the countries based on the original MAI and MFI, and it must adhere to Sustainable Development Goals (SDGs) during the rule-making. However, given the difficulty and workload, it could not be accomplished in a short term. Therefore, a second-best choice would be to fully leverage the existing MIGA and ICSID. Many countries along the Belt and Road have higher possibilities of political risks, and China must make the best use of the current risk guarantee mechanisms, dispute settlement mechanisms, and international organizations or treaties to protect the interest of Chinese enterprises' overseas investments.

3.3 Regionally to innovate rules by methods of RCEP and AIIB

Regional investment rules have witnessed dramatic change. Compared with the developed countries, China is a newcomer, whether in theories or in practices, and needs to catch up. On one hand, China should closely study the TPP's contents about investment, continuously innovate investment issues in the FTA, and make down-to-earth efforts to propose feasible clauses. Not all but some new rules could be employed, for example, the labor and environmental standards, competitive neutrality and investor-state dispute settlement mechanisms. But during the rule-making and the implementation, it is necessary to appropriately adapt and lower standards to cater to the diversity of countries along the Belt and Road and the actual needs of the investment cooperation. On the other hand, some current regional mechanisms or institutions could be used by China during the investment cooperation with countries along the Belt and Road, especially the RCEP and the AIIB. Courageous attempts can be made within the region, and China can gain the initiative and right of speech.

3.4 Bilaterally to upgrade BITs and promote liberalization and facilitation

Bilateral-level breakthroughs are the most obligatory and easiest to make. China can quicken its efforts to upgrade the investment agreements signed with countries along the Belt and Road and strive to develop new-generation agreements. The goal is not only to protect direct investments, but also to boost and facilitate them, and more importantly, to quicken the pace of opening and liberalizing the investment industry (Ma, 2015).

Given the risks posed to the investments in countries along the Belt and Road, on one hand, China must fully leverage BITs' strength to guard against political risks and use the current rules to safeguard the interests of China's overseas investments. On the other hand, the facilitation and liberalization of BITs should be propelled, the construction of coordinating mechanisms for investment promotion must be quickened, and attempts must be made in practice to expand access to the investment industries by China and its counterparts.

The diversity of countries along the Belt and Road also requires that BIT upgrading be performed at a stable pace according to their specific national attributes. So it is the same with the high-standard investment clauses. Though the management model for "pre-establishment national treatment plus negative list" is the trend, it cannot be rashly implemented by the countries along the Belt and Road, as most countries are developing countries, not to mention that China's new rules are in the experiment. An option is to pilot this development model with some more developed countries along the Belt and Road. Considering the risks posed to investments, it is advisable that the investor-state dispute settlement mechanism be introduced, if fairness and rationality can be guaranteed and the interests of the large number of developing countries can be taken into full considerations.

3.5 Unilaterally to deepen domestic reform and pilot new rules

Domestic political reforms are necessary for the construction of international rules. China will definitelycontinue its innovation in investment management systems, experiment FTZ new policies and integrate with new international rules (Shi, 2015). As an old Chinese saying goes, "Those who govern must first be self-governed, those who blame others must first blame themselves, and those who contribute must first be capable enough.," if China wants to participate in the making of international investment rules, and to build investment standards for the Belt and Road that could meet the interests of China and all the other stakeholders, China must make itself a role model first by implementing high-standard investment rules inside its territory. On one hand, the "pre-establishment national treatment and negative list" model needs to be progressively implemented for foreign investments in China, and the negative list should be cut shorter and shorter. On the other hand, the management mechanism for overseas investments should be established, where automatic registration, other than administrative approval, plays a major role. China is to improve supervision during the whole process of the investment, and reduce administrative intervention. Only when it becomes a role model in implementing the new rules can China be able to take the initiative to guide the cooperation and adopt relevant rules to achieve a win-win outcome during its investment cooperation with countries along the Belt and Road..

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