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Belt and Road and the International Financial Architecture

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China's Belt and Road Initiative ("BRI") is well known as the largest infrastructure construction program in world history.[1] President Xi Jinping announced its two components in 2013; one is a land-based Silk Road Economic Belt and one a sea-based 21st Century Maritime Silk Road. His grand plan includes overland and maritime work to build bridges, highways, communications facilities, ports, railroads, pipelines, power systems, hydroelectric dams, and airports crossing 70 or more country borders connecting China to the rest of Asia, Europe, the Middle East, Africa, and South America. Further details on BRI's scale and scope can be reviewed on the PRC government's Belt and Road Portal.

Most of the reporting on BRI addresses allegations of corruption, less developed countries taking on excessive debt, or the economic viability of the BRI projects.[2] This much is known. Few, however, have noticed that BRI also is fostering very fundamental changes to the world's financial architecture.

Changes to financial architecture

First, some history. The US dollar has been the world's reserve currency since the Bretton Woods accords following the end of the Second World War. Even after the US left the gold standard in 1971, the world's central banks were content to hold dollars, development banks funded projects in dollars, and world-wide commodities, including oil, were priced in dollars. As the issuer of dollars and dollar denominated Treasury bank notes, which were as good as gold, the US government held sway over the function of the international financial system.

Being in a position to lead the banks who had no choice other than to use dollars with a connection to the US, the US government's power to impose its will was essentially unchallenged. As paper money fell out of use in favor of credit cards and other electronic payment systems, all transactions of any moment passed one way or another through processing systems in New York. That meant any transaction that touched US soil, even if only in a digital way, subjected the transferring parties to US jurisdiction. This fact informed the power to impose punitive economic sanctions on nations such as Libya, Iraq, Iran, Cuba, North Korea, Russia and their citizens.

A hundred years ago, when it was said the sun never set on the Union Jack, the Bank of England was similarly situated with the pound sterling to ensure an orderly and predictably capital friendly international payments regime. Seeking to hang on to what power remains, Brexit can be viewed as an effort to preserve sterling's international status. In the meantime, the US Federal Reserve, the International Monetary Fund and its World Bank, which was born as the International Bank for Reconstruction and Development, took the lead. With monetary union in Europe, its European Central Bank and the Euro are vying for a place at the table. The Chinese have learned how to play by the old rules.

China tried once before over 500 years ago. Walter B. Wriston, former Chair of Citibank and a prolific writer about the impact of the information revolution on international finance wrote, "*China was the first nation to issue paper currency, having done so in the eleventh century, but soon had to abandon the practice as its currency was nowhere acceptable*."[3] 25 years ago, looking to the future at what was coming, he presciently observed, "[t]*he velocity of change in economics, technology, science, and military capabilities is shifting the tectonic plates of national sovereignty and power*." Mr. Wriston was right.

Professor John A. Mathews of Macquarie University reports that the BRI is about to challenge the world's reserve currency, payments systems and basis of commodity pricing.[4]

Traditionally, China's currency, the yuan which is also known as renminbi ("RMB"), was not freely convertible, but that is changing as China internationalizes RMB. The BRI contracts favor Chinese developers, contractors and suppliers and usually require payments in RMB. To finance the BRI projects, China established its own international development banks, including a new Asian Infrastructure Investment Bank ("AIIB"). In 2013, the UK issued the first sovereign renminbi bond by a western government. The Financial Times reports, "*the UK has been keen to establish the City of London as a platform for overseas business in the Chinese currency as it starts to play a bigger role in the global economy*."[5]

For domestic payments, while American Express was granted approval to operate in China, Visa and Mastercard are still frozen out.[6] Essentially scale jumping over the West's credit card payment systems, China soon will roll out a digitization of the RMB. The very concept of money is changing rapidly. As Mr. Wriston predicted in 1993, the Information Standard has replaced the Gold Standard.

China imports more oil than any other country and pays Russia, Iran and Venezuela for oil in RMB; Prof. Mathews speculates that Saudi Arabia soon may follow suit.[7] The RMB is now convertible to gold in Shanghai and Hong Kong. In March 2018, China established a RMB based oil futures contract on the Shanghai International Energy Exchange that, in its first four months traded an equivalent of US $538 billion and may eventually challenge Europe's Brent and the West Texas Intermediate oil pricing benchmarks now traded in London and New York.

Prof. Mathews reports China recently established offshore RMB clearing hubs.[8] These are not located in Brussels where the SWIFT international payments system is headquartered. Further Prof. Mathews observes that BRI's RNB based trade and investment "*promises to promote Chinese soft power while serving as a means for countries to evade US sanctions*."[9] The power to impose sanctions is a demonstration of sovereignty. As China imposes its will to reorganize the assumptions forming the basis of the international financial system, the US's sovereign power may diminish, just as Mr. Wriston predicted.

Dispute resolution in the new financial architecture: *quo vadis?*

The impact, if any, of these changes to the underpinning of the world's financial architecture on international commercial arbitration is difficult to predict.

My view is that these potential changes to the international financial architecture should have no immediate impact on international commercial arbitration. Indeed, in November 2019 China announced, in a joint declaration with arbitration institutions from the Belt & Road Countries, its intent to promote arbitration for dispute resolution as a fair way of solving trade disputes[10)] Lu Pengqi, Deputy Director of the China Council for Promotion of International Trade, acknowledged that arbitration differs from country to country along the Belt & Road, which are mostly emerging economies and developing countries with various concepts, laws and regulations. "*We hope international arbitration institutions can promote the building of a community of arbitration laws under the Belt & Road Initiative by upholding the concepts of opening, sharing and serving, and facilitate the worldwide application of resolutions on a variety of disputes.*"[11)] And according to Luo Dongchuan, Vice President of the Supreme People's Court, China will advance its arbitration system reform and make efforts in building an arbitration friendly judicial environment.[12)] All practitioners will welcome those optimistic forecasts.

All construction projects include risks of potential loss and claims, and the larger the project, the larger those risks. As the BRI projects mature, we can expect a growing volume of claims will be presented to the arbitral institutions chosen by the parties. Because China and most of its BRI partner countries are signatory to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, the New York Convention, arbitration awards should be enforceable worldwide whether rendered in US dollars, British pounds, Euro or RMB.

Further to a large extent, the likely impact will turn on the reaction of the US administration and its financial allies among the capitalist economies, all of whom benefit from a certain and reasonably stable reserve currency.

In the near term, I would expect parties will adjust their claims as needed to accommodate the requirement for compensation for just claims under principles including *pacta sunt servanda*. By way of example, investors and lenders have learned to accommodate sharia law's prohibition on recovery of interest. Parties will adjust to a system based upon a new or alternative reserve currency. In the longer term, instability should make a neutral de-localized forum for dispute resolution even more desirable. To apply Karl Polyani's *double movement*, I predict the world's investors and traders will find a way to accommodate the more diffuse sovereignty presented by another reserve currency.

Conclusion

While the world's financial infrastructure morphs, the current US administration's talking points with China appear to focus on the balance of trade and intellectual property amongst others. In this era of change, as Ted Turner once put it, we can "*lead, follow or get out of the way*". But we should do so with our eyes open. These issues and more will still be with us once the world shakes off the current coronavirus pandemic.

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References

?1 This post is expressed as Michael J. Bond's personal opinion and does not represent the views of any organization or party.

?2 *See*, e.g., John Hurley, Scott Morris, Gailyn Portelance, "*Examining the Debt Implications of the Belt and Road Initiative from a Policy Perspective*", Center for Global Development, CGD Policy Paper 121, March 2018; and reports in the Financial Times on April 14, 2019, July 18, 2019, and December 10, 2019.

?3 Walter B. Wriston, "*The Twilight of Sovereignty*", Fletcher Forum of World Affairs, 1993.

?4 John A. Mathews, "*China's Long Term Trade and Currency Goals: The Belt & Road Initiative*", The Asia-Pacific Journal, January 1, 2019 ("*Mathews*").

?5 "*US attacks UK's constant accommodation with China*", Financial Times, March 12, 2015.

?6	"*China's central bank delays market entry for Visa and Mastercard*", Financial Times, January 13, 2019.
?7	*Mathews*.
?8, ?9	*Ibid*.
?10	"Arbitration Institutions to form mechanism under Belt and Road Initiative" November 8, 2019.
?11, ?12	*Ibid.*

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