Breaking Up the Belt and Road Initiative

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Abstract

This paper aims to evaluate one of the domestic feasibility challenges the Belt and Road Initiative (BRI) faces, namely the lack of central coordination and oversight. By applying the principal-agent theory and the two-level game model, I argue that the proliferation of subnational diplomacy under the BRI has exacerbated information asymmetry, thus hindering the central government's capacity to effectively regulate local initiatives. It is therefore necessary to reconfigure existing local governments' incentive structures to avoid unfaithful implementation.

Keywords: Belt and Road Initiative; subnational diplomacy; principal-agent problem.

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1 Introduction

Despite President Xi Jinping's call for the Belt and Road Initiative (BRI) to switch from xieyi (写意 freehand style, a metaphor for grand design) to gongbi (工笔 detailed strokes, a metaphor for more detailed planning), the BRI is still surprisingly ill-defined to many (Ang, 2019), partially because of its lack of central coordination mechanisms (Huang, 2016, 314) and heavy reliance on local initiatives.

The central government recognizes that the burden of bringing the BRI to fruition falls on local governments (Zhao, 2015). A daunting challenge the central government faces is how to ensure faithful implementation of its vision. Hence, in order to evaluate the prospects of the BRI, it is important to examine the central-local dynamics in China.

This paper situates the local implementation of the BRI into the broader context of the entrenched principal-agent problem in China, with a specific focus on the growing role of local governments in forging and intensifying cross-border interactions under the BRI (Li, 2014, 275). I will argue that cross-border interaction manifested as substate diplomacy aggravates the principal-agent problem in China, as it creates information asymmetry that disproportionately favours the agent, i.e. the local governments.

Although the Chinese central government has rebranded and integrated various existing regional cooperation mechanisms, such as the Shanghai Cooperation Organization (SCO), Association of Southeast Asian Nations Plus (ASEAN Plus), and the Greater Mekong Sub-region Economic Cooperation (GMS), to push for the BRI (Yu, 2017, 356), the nontransparent nature of substate diplomacy remains a formidable obstacle for effective central oversight.

The rest of the paper will progress as follows. First, I will introduce and review the principal-agent problem in China, pointing out the limitation of a state-centric approach to assess the BRI. Specifically, I will draw on the two-level game model and the experience of the Portuguese austerity negotiation with the Troika to theorize how diplomacy disproportionately empowers the agent.

I will then turn to prove how the BRI gives rise to subnational diplomacy in China which skirts the central government's scrutiny. I will finally conclude with a discussion of possible central responses to the more robust subnational diplomacy under the BRI.

2 The Principal-Agent Problem and the Two-Level Game

A principal-agent relationship emerges when a principal entrusts an agent to perform a certain task (Yung, 2009, 61). In the case of the BRI, the principal is the Chinese central government which entrusts the implementation of its grand design to local governments, the agents.

The problem arises when the two parties have different interests and asymmetric information (the agent having more information), such that the principal cannot directly ensure that the agent is always acting in the principal's best interest (Bebchuk and Fried, 2006).

The tension between the central and local governments is not new in Chinese politics. First proposed in 1988, the fragmented authoritarianism framework used to describe China's policy-making process finds that policy made at the centre becomes increasingly malleable to the parochial organizational and political goals of various vertical agencies and spatial regions that enforce policy.

Outcomes are shaped by the incorporation of the interests of the implementation agencies into the policy itself (Mertha, 2009, 996). To put it briefly, the local implementation of central policies is not always faithful to the central government's plans.

China's foreign relations, although largely controlled by the central government, are also not entirely free from local influence.

The state-centric approach that some scholars use to describe Chinese interstate relations as being directed solely by the central government is flawed (Shambaugh, 2004/2005; Garrison, 2005). As Mingjiang Li points out in his study of China's relations with Southeast Asia, subnational governments, in particular the provincial governments of Yunnan and Guangxi, have demonstrated extraordinary autonomy in cross-border interactions.

Within the possible national foreign policy parameters, local governments push for transnational collaboration and cooperation in economic, social, cultural and non-traditional security arenas (Li, 2014, 276).

The principal-agent theory is a useful analytical tool for a better understanding of the implementation challenges of the BRI. The relationship between central and local governments fits into the paradigm, as the central government has proclaimed that local governments are the crucial agents entrusted to deliver the project. As well, cross-border interactions engender information asymmetry, which is essential for explaining the diminished central oversight.

The BRI is distinct from other within-border policies because it actively incentivizes subnational governments to engage and cooperate with foreign actors directly.

Cross-border interactions, especially diplomacy, have a tendency to be nontransparent and disproportionately empower the agent who directly engages with foreign actors.

In Putnam's two-level game model of the entanglement of international and domestic politics, he highlights that the diplomat (the agent) who sits at the negotiation table is the key personnel who connects two game tables: one international table with fellow diplomats and international advisors, and another domestic table with political figures, spokespersons for domestic agencies, and representatives of domestic interest groups (Putnam, 1988, 434). While the agent has firsthand information and the capability to manipulate these negotiations, the principal often must passively rely on the information and policy alternatives provided by the agent.

A compelling case that illustrates this power imbalance and the agent's tendency to exploit it is the Portugal-Troika negotiation, after Portugal experienced a sovereign debt crisis from 2010 to 2015.

In Moury and Standring's study, they have found that contrary to popular belief, many austerity measures were added to the bail-out package by Portuguese ministers rather than IMF or EU officials, as Portuguese ministers saw these negotiations as an opportunity to advance their own agenda without having to debate with their domestic rivals.

The agents, Portuguese ministers, are made stronger in relation to their principal, the Portuguese parliament, as they are the only ones who know what happened behind the closed doors of international meetings. These strategies, it is argued, constitute a tactic of depoliticization in which both the material constraints and the discourse used to frame them are employed to construct imperatives around a narrow selection of policy alternatives (Moury and Standring, 2017, 660).

Although we cannot know what happens behind the closed doors of BRI provincial executives' meetings with their counterparts, the two-level game model and the Portugal-Troika case shed some light on the inherent agent-favoring nature of diplomacy. In the Portuguese case, it is difficult for the Portuguese parliament to discern which bail-out conditions are added by the Troika and which by Portugal's own executives.

That is to say, agents who privately prefer certain policies can take advantage of the need to compromise, the secrecy of the negotiations, the legitimacy attached to the deals and the difficulty of reneging past commitments to enhance their power vis-à-vis that of domestic groups and other party members (Moury and Standring, 2017, 662). In contrast to within-border policies, it is much more difficult for the domestic principal (the central government) to extend its oversight power beyond borders, hence the agent's power in relation to the principal increases.

In short, international negotiations sometimes enable government leaders to do what they privately wish to do, but are powerless to do domestically (Putnam, 1988, 457).

3 Subnational Diplomacy under the Belt and Road Initiative

In the previous section, I have outlined the relevant theoretical frameworks, namely the principal-agent relationship and the two-level game model. In this section, I will apply these two frameworks to the BRI and illustrate how the BRI encourages the proliferation of subnational diplomacy and how such over-reliance on local initiatives jeopardizes the overall implementation of the BRI.

Among various forms of subnational cross-border interactions, this paper focuses on subnational diplomacy (地方外事/外交) because diplomacy is still the most common and influential instrument of foreign policy employed by local governments to push for the BRI.

3.1 Pre-BRI Subnational Diplomacy

Before I elaborate on how the BRI transforms subnational diplomacy in China, it is necessary to note that subnational diplomacy was existent prior to the launch of the BRI.

Zheng Feng's research on three Chinese local governments' interactions with three different international institutions —Shanghai Municipal Government and the World Trade Organization (WTO), Beijing Municipal Government and the International Olympic Committee (IOC), and Guangdong Provincial Government and World Health Organization (WHO) —reveals a pattern of local governments acting as the central government's loyal agents to fulfil the central government's commitments to those international institutions (Feng, 2014, 78). Even in cases where the local government entities seek to change international deals, the change still needs to happen via the central government.[1] To sum up, in pre-BRI times, local governments would play a passive role in diplomacy, serving primarily as the acceptor, implementor, and adaptor of international institutions' rules (Chen, 2008, 6).

3.2 The Proliferation of Subnational Diplomacy

The launch of the BRI opens up a new window of opportunity for subnational diplomacy in China. Internally, local governments are pushed by the pressure of slower economic growth. On the one hand, the BRI provides extraordinary economic opportunities for local economic growth.

On the other hand, due to the considerable development gaps between different regions (most notably between eastern and western China), different local governments have distinct international interests at stake, which means that they can no longer passively "wait [for central orders], rely [on central resources], and demand [support from the central government]" (Chu and Yang, 2018, 49). Henceforth, it is crucial for local governments to actively seek suitable foreign partners based on their own resources and needs.

Externally, local governments are pulled by the central government. Although there are strategic and security elements in the BRI, the initiative is predominantly an economic one which belongs to the low politics category, reducing local governments' concern of accidentally trespassing political red lines. In addition, the central government has also been tolerant, if not supportive, of the delegation of more power to the local government.

An example of this is the call to establish "a track two mechanism for dialogue," through which "local authorities of China and other BRI countries can engage in diverse communication, dialogue, exchange, and cooperation, focusing on joint efforts to build the Belt and Road" (Leading Group, 2019, 37). Financially, the central government has also endorsed the early release of local government bonds specified for BRI construction (Renminwang, 2019).

The result of the combined internal push force and external pull force is remarkable, allowing subnational diplomacy to proliferate in two areas. First, local governments have taken on a more active role in directly participating in existing international institutions and sometimes even helping to set up new institutions.

The Shanghai International Arbitration Center (SHIAC) has designed arbitration rules for free trade area and aerospace, as well as establishing a BRICS Dispute Resolution Center (Zhongguo Yidai

[1] For example, see the Wenzhou Study Meeting of Common Interests to Resist the Proposed EU CR Law and subsequent central-government involvement in Mertha (2009, 1009–1011).

Yilu Wang, 2019). The SHIAC has also announced its ambition to build an international arbitration centre for the BRI in the future (Zhongguo Yidai Yilu Wang, 2019). In 2017, the Secretariat of Belt and Road Local Cooperation Committee (BRLCC) was confirmed to be permanently headquartered in Hangzhou (Yang, 2017). BRLCC has been initiated jointly by the Chinese People's Association for Friendship with Foreign Countries (CPAFFC) and Hangzhou Municipal Government under the framework of the World Organization of United Cities and Local Governments (UCLG), which is the largest local government umbrella organization in the world, with 1,500 member cities and 200 local government associations in more than 130 countries (Yicai Global, 2017). Hangzhou expects to use the BRLCC as a platform to attract UCLG member cities and encourage their local governments to participate in the BRI.

Second, there has been a surge in the number of BRI-themed subnational diplomatic platforms.

The Thematic Forums of the Second Belt and Road Forum for International Cooperation held in Beijing, for example, brought together over 300 provincial, state, and city-level officials from over 40 countries as well as representatives of various international institutions (Sun, 2019). Yiwu, a city next to Hangzhou, has also seized the opportunity to host the 2019 UCLG ASPAC Executive Bureau Meeting and Dialogue on International Cities' Economic and Trade Cooperation under the Belt and Road Initiative (Yiwu Municipal Government, 2019). The Yunnan Provincial Government has also established 11 bilateral and multilateral regional cooperation mechanisms with 9 countries (Zhongguo Yidai Yilu Wang, 2017).

There are two noteworthy shifts in Chinese subnational diplomacy after the launch of the BRI. Of course, the first shift is on the scale of subnational diplomacy. In 2014, there are fewer than 5 provinces that mentioned the BRI in their local government work reports.

By the year 2015, all 31 provincial and municipal governments proposed certain tasks related to collaborating with foreign partners as a part of the BRI (Chen and Wei, 2016, 34). Subnational diplomacy also spilt over from major cities like Beijing and Shanghai to lower-tier cities like Yiwu. Second, the role local governments play has become more active.

Instead of accepting orders from the central government and implementing rules as they are told, local governments have taken upon themselves the task to write new rules and build new institutions.

3.3 Exacerbation of the Principal-Agent Problem

What does the proliferation of subnational diplomacy mean for the implementation of the BRI? My argument is that it contributes to the exacerbation of the principal-agent problem, as it disproportionately empowers the local governments whose interests are not perfectly in alignment with those of the central government.

While the central government envisions a coordinated scheme in which each province serves its specialized role maximizing its comparative advantage, in reality, local initiatives are far less concerted due to local protectionism.

Uncoordinated local initiatives have led to unhealthy competition and excessive investments. According to Chen's count, there are over 30 cities which self-proclaim to be the "starting point of the BRI," not to mention other labels like the "core zone" (核心区), "bridgehead" (桥头堡), "hub" (枢纽), etc.

These self-labelled titles not only cause confusion overseas, but also drag peripheral cities into this race-to-the-bottom, as cities feel that titles are necessary for attracting central and foreign attention and support.

Huzhou, for instance, coined the title of "origin of the silk road, hometown of the Classics of Tea" (丝绸之源,《茶经》故里) out of the pressure to attract provincial attention (Yang and Zhang, 2015, 281). Similarly, Yang Minghong, dean and professor of Social Development and Western China Development Studies at Sichuan University, clarified during a meeting at the Institute of Chinese Studies (ICS) on June 9, 2016, that the central leadership has not said anything about Tibet's importance to the initiative.

Instead, it is the regional leaders who have been connecting Tibet to the BRI in order to get more funds (Bhutia, 2017, 20–21). Not only is there a title war, neighbouring provinces and cities are also involved in an ownership war over resource advantages. For example, in a fight for the opportunity to construct a free trade port, both Guangzhou and Shenzhen played the Hong Kong card to prove their positional advantages (Du, 2017). Over-investment is also a severe threat to the sustainability of the BRI.

Along the coastline between Hebei and Tianjin, four major ports, Qinhuangdao, Jingtang, Tianjin, and Huanghua, are actually operating under full capacity at the moment, yet all of them continue to invest and expand under the BRI, reflecting the waste of resources due to competitive pressure (Qi, 2015, 49).

4 Discussion and Conclusion

In the sections above, I have analyzed why the cross-border nature of the BRI exacerbates the principal-agent problem in China and illustrated the harm of the problem with concrete examples. The question remains: how can the Chinese central government effectively regulate the local governments despite the intensified information asymmetry?

My answer to this question is that instead of addressing the information asymmetry problem directly, a more effective approach might be reconfiguring the local government's incentive structure. As the principal-agent theory explains, the problem arises when the agent's interest is not in perfect alignment with the principal's. In the BRI case, I have identified three possible sources of conflicts in interests. The first conflict lies in the cadre evaluation system.

As local officials rely on a good performance to be promoted, their personal priority is to impress the cadre evaluation system which currently prizes economic performance rather than coordination (Liao, 2019, 7). This reveals why neighbouring provinces and cities fall into a vicious cycle of competition rather than cooperation, as cadres view each other as potential competitors for promotion opportunities.

Secondly, the encouragement or tolerance of subnational diplomacy is a result of a policy arrangement instead of an institutional arrangement. That is to say, local cadres are uncertain of when this window of opportunity will be closed, hence it is only rational for them to exploit it as a short-term asset which is in conflict with the long-term central vision.

Thirdly, since subnational diplomacy is still relatively new, many local governments (especially in western and inland China) have not yet built sufficient capacity to deal with foreign affairs. Without

guidance and support from the central government, local governments are forced to pursue immediate gains as their insufficient resources cannot support long-term plans.

In sum, aside from constructing a more holistic and forceful central coordination mechanism, the principal-agent problem can also be ameliorated by incorporating coordination into the cadre evaluation system, institutionalizing subnational diplomacy, and injecting more resources into local governments.

In conclusion, this research has evaluated one of the major implementation risks of the BRI, namely the principal-agent problem in China which is exacerbated by the increasingly preeminent role of subnational diplomacy. I argue that while the information asymmetry is difficult to overcome in the short term, the central government has the alternative of altering local government's incentives to ensure more faithful implementation.

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