



Chi on China

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HYPE, SUSPICION AND TRUTH OF THE BELT AND ROAD INITIATIVE

*Three things cannot be long hidden: the sun, the moon, and the truth.
Buddha*

SUMMARY

- The two-day Belt and Road (BAR) Forum that Beijing hosted in mid-May this year outlined action plans for building new trade and investment global networks. It left an impression that Beijing had an integrated implementation strategy to expand its global influence. Really?
- Optimists argue that the BAR initiative would bring significant economic benefits to the global economy through China's financial support for, and enhanced policy coordination with, the BAR countries. But critics fear that it would just be a ruse for China's self-economic and political interests. Who is right?
- Nevertheless, even with its faults, the BAR initiative is going to improve global connectivity and China will emerge inevitably as an economic leader in Asia. The key for realising the BAR benefits is for China to abide by international rules; evidence shows that it might just be doing that.

Chinese President Xi Jinping first conceived the idea of the Belt and Road plan in October 2013 as a pillar strategy for realising his "Chinese Dream"¹ in the long-term. The plan was made official in March 2015². The two-day high-level BAR forum on 14 and 15 May this year seemed to have outlined action plans to boost trade and investment along the BAR routes (Map 1). It announced that China would top up the USD40-billion Silk Road Fund³ by another

¹ President Xi Jinping seeks to realise his "Chinese Dream" by combining national and personal aspirations to "reclaim national pride and enhance personal well-being". In economic terms, this amounts to creating incentive compatibility between the state and the people to maximise national and individual interests.

² "Vision and Actions on Jointly Building Silk Road Economic Belt and 21st Century Maritime Silk Road," National Development and Reform Commission (NDRC) News Release, 28 March 2015. See http://en.ndrc.gov.cn/newsrelease/201503/t20150330_669367.html

³ The Silk Road Fund was set up in 2014 in preparation for supporting the Belt and Road initiative.



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USD100 billion, encourage overseas renminbi fund business and create a RMB380 billion special lending scheme for the China Development Bank and the Export-Import Bank of China to expand renminbi foreign loan business.

Map 1: China's Belt and Road initiative



Source: BNPP Asset Management

IS THERE A BAR STRATEGY?

As I argued earlier, China's BAR initiative is a political-economic strategy conceived to "kill three birds with one stone" by achieving longer-term international, domestic and political objectives⁴. Many players are excited about the long-term prospects of BAR boosting global trade and investment by linking countries and regions that account for 60% of the world's population and 30% of global GDP. They think Beijing has an implementation strategy by pointing to many examples of Chinese-funded BAR projects.

The truth is that there is no implementation plan and no BAR projects as such! The forum in May explained, for the first time, President Xi's vision and intentions of his BAR idea, but it provided no details of any strategy or project list. The BAR initiative is not a coherent trade and investment plan but a series of wide-ranging projects that serve Beijing's economic and political aspirations (whatever they may be).

Meanwhile, different levels of the Chinese government have used the initiative as an excuse to launch investment projects. The media and many analysts have assumed that all these are BAR projects, even though they may not have any official BAR status. Many of these projects were planned and initiated before President Xi took office, but have been folded into the grand narrative of the BAR initiative. Beijing has talked about 67 or so countries would be included in the BAR plan, but it has also said that there would be no geographical restrictions. What actually gets built will depend on individual deals struck between Chinese and foreign firms, subject to diplomatic negotiations between the governments.

The reality is that the BAR initiative is a vision based on an evolving concept. For example, the initial BAR policy document calls for building six economic linkages across the Eurasian landmass, but it does not specify the routes of

⁴ For my earlier research on BAR, please see:

"Chi on China: The AIIB, Reviving China's Investment-led Growth or Rebalancing towards Consumption?" 13 May 2015.

"Chi on China: China's One Belt One Road: Part 1 (24 June 2015) and Part 2 (8 July 2015).

"Chi on China: Mega Trends of China (3): The Belt and Road Strategic Plan", 13 January 2016.

connection or target any specific industries and infrastructure projects. This leaves open the possibility of any projects any routes depending on the evolvement of the political objectives and environment.

THE COMMERCIAL REALITY

Critics often doubt the commercial viability of many of the so-called BAR projects, and there is no lack of examples of failure. China's foreign-project data seems to show that the BAR projects do have difficulties in generating revenues. Chinese foreign (engineering and construction) projects enjoyed a decade of steady revenue growth until 2015 when Beijing started prioritising the BAR initiative. Their revenue growth has slowed to a trickle since then (Chart 1).



A macroeconomic explanation for the slowdown in this foreign income is the fall in commodity prices in 2014 and 2015. Since most of China's foreign projects are focused on resource extraction, income from these projects were hit hard by the decline in commodity prices. The question is whether BAR can reignite revenue growth in the foreign projects? The jury is still out.

There has been a sharp increase in the newly-signed foreign contracts and some recovery in their revenues since mid-2016⁵. However, the rising gap between the contracted projects and realised revenues (see Chart 1) raises the suspicion that many Chinese firms were probably responding to political pressure by rushing to sign all sorts of phony deals and then letting them quietly rot away. Indeed, many provinces and cities have sent overseas delegations to find projects and signed MOUs to satisfy the political directive, regardless of whether the projects are viable or not.

To be fair, it is too early to judge whether the BAR initiative would succeed or fail because building new trade networks and infrastructure will take a long time⁶. Meanwhile, BAR enthusiasts have overstated the ability of China's new financing channels, notably the Asian Infrastructure and Investment Bank (AIIB), to fund infrastructure investment in the economies along the BAR routes.

⁵ Although there is no evidence that all of these projects are related to the BAR infrastructure push and not all signed contracts will be realised, this data is nonetheless an indicator for the BAR initiative.

⁶ There is no lack of casual views on judging China's BAR initiative. For example, see "Why China's One Belt One Road Plan Is Doomed To Fail", SCMP, 8 August 2016; <http://www.scmp.com/week-asia/opinion/article/1999544/why-chinas-one-belt-one-road-plan-doomed-fail>.

THE POLITICAL SUSPICION

Development bankers argue that Asia's infrastructure deficit is not a result of a lack of funding but of viable projects. So critics opine that while China has money it may still struggle to find profitable projects to invest in. But it would still channel funds into commercially nonviable strategic projects to bolster its economic security or boost growth in its impoverished regions and to establish political influence in the recipient countries.

India, in particular, has been very critical of China's BAR initiative, criticizing its connectivity projects for "overriding sovereignty" of other nations⁷ and seeing China's port-building exercise in the Indian Ocean, notably in Sri Lanka and Pakistan, as a platform for military expansion. In general, many countries suspect that China's BAR diplomacy is just a ruse for advancing its economic and geopolitical interests, despite Beijing's assurance of its purpose of building a community of common interest.

The truth is probably a bit of both. China wants to boost its economy and create a regional production chain centred on its manufacturing power which, in my view, is a way of building an "empire" for expanding its economic and political influence⁸. So the BAR initiative is about exporting Chinese technology and industrial goods to emerging markets.

Chinese banks and the AIIB will finance infrastructure projects in building highways, railways, ports, airports, power grids, oil and gas pipelines, telecom networks etc. in the BAR countries. They will create demand for Chinese capital and industrial goods and services in the recipient countries and generate income for them to trade with China and pay for the Chinese loans and investments. Ideally, when these trade, investment and financing deals are settled in renminbi, the BAR initiative will become a powerful tool for internationalising the renminbi. So it is a win-win outcome, from Beijing's perspective that is.

Undoubtedly, China is putting its interests first, but there are also benefits for the BAR countries. China's economic and political leverage will inevitably grow, but that might be a trade-off for countries anxiously seeking economic development but are ignored by the multinational development banks.

ABIDE BY INTERNATIONAL NORMS

Relating to the political suspicion are concerns that Beijing would use the AIIB as a tool to reshape the global economic architecture by bypassing the global standards established by the existing world order. But evidence shows that the AIIB has been just another multilateral development bank led by a team of foreign officials and former bankers that come from global institutions. This development is important because it counters the spirit of the AIIB's founding document that clearly states that it would be a financing tool for Beijing's BAR initiative. It also shows that the concerns about the AIIB upsetting the global governance structure have so far been exaggerated.

In my view, the shift in the AIIB's focus was a result of its own success. Beijing might originally hope to create an institution that would be a quasi-Chinese government fund for financing Chinese industries to export their excess capacity. However, within 18 months of China's proposal to set up the Bank in October 2013, 57 countries signed up to become founding members, including many European countries that have high governance standards. The AIIB is simply too big and too diverse to function as a unilateral tool of China's money politics.

The AIIB's first moves have been cooperation with the existing order rather than confrontation or competition. In all of its nine projects in the BAR countries between 2014 and 2016, it complemented efforts of the World Bank, the

⁷ See "China Defends Pak Corridor After Modi Criticism of Projects", *Indiatoday*, 18 January 2017; <http://indiatoday.intoday.in/story/china-pakistan-economic-corridor-narendra-modi-pakistan-occupied-kashmir/1/860334.html>

⁸ See Chapter 10 in "Demystifying China's Mega Trends: The Driving Forces That Will Shake Up China and the World", by Chi Lo, Emerald Publishing 2017.

Asian Development Bank and the European Bank of Reconstruction and Development by contributing USD1.73 billion to their projects. Most importantly, none of these loans were made in renminbi, thus countering Beijing's ambition of using the AIIB to push renminbi internationalisation.

These signs should serve to allay fears that China is building its own institution to challenge the existing world order of development finance. Evidence so far seems to suggest that the AIIB represents an evolution rather than a revolution in development finance. Together with the AIIB, BAR is a bold strategy that must be taken seriously. It may prove a long-term stimulus not only for China's growth but also for the growth of the developing world, as the latter badly needs infrastructure investment.

The investment opportunities will likely outweigh the risks if China goes by its words in encouraging free trade and abides by international norms and market rules. But if the BAR initiative is a smokescreen for China to advance its self-interest at the expense of the others, it could be a disruption for markets. At this point, the BAR plan deserves the benefit of the doubt to be a positive force for the global system.

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