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The challenges facing China's Belt and Road Initiative

China’s new global investment strategy

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THE CHALLENGES FACING CHINA'S BELT AND ROAD INITIATIVE

China's Belt and Road Initiative remains a grandiose and abstract wish list rather than a coherent blueprint of interconnected international investments. Once it is set into motion many of the infrastructure projects will encounter financial uncertainties as well as political and security risks.

China's "Belt and Road Initiative" is President Xi Jinping's signature foreign policy initiative. First announced in 2013, the land-based "Silk Road Economic Belt" and its maritime twin, the "21st Century Maritime Silk Road" are ambitious plans aimed at placing China at the heart of regional trade networks and restoring it to a prominent geopolitical

RECOMMENDATIONS

- Western governments should engage China on global issues in order to shape rules jointly, rather than attempting to socialise Beijing or fearing newly created institutions.
- Western governments should engage Beijing in specifying how the Belt and Road Initiative will advance the interests of potential foreign partners.
- China and the international community can draw lessons on political and security risk, and labour and environment issues, from Chinese overseas investments in the past two decades.

Beijing's vision and action plan for the Belt and Road, to date, offers clearer potential advantages for China than possible partner countries

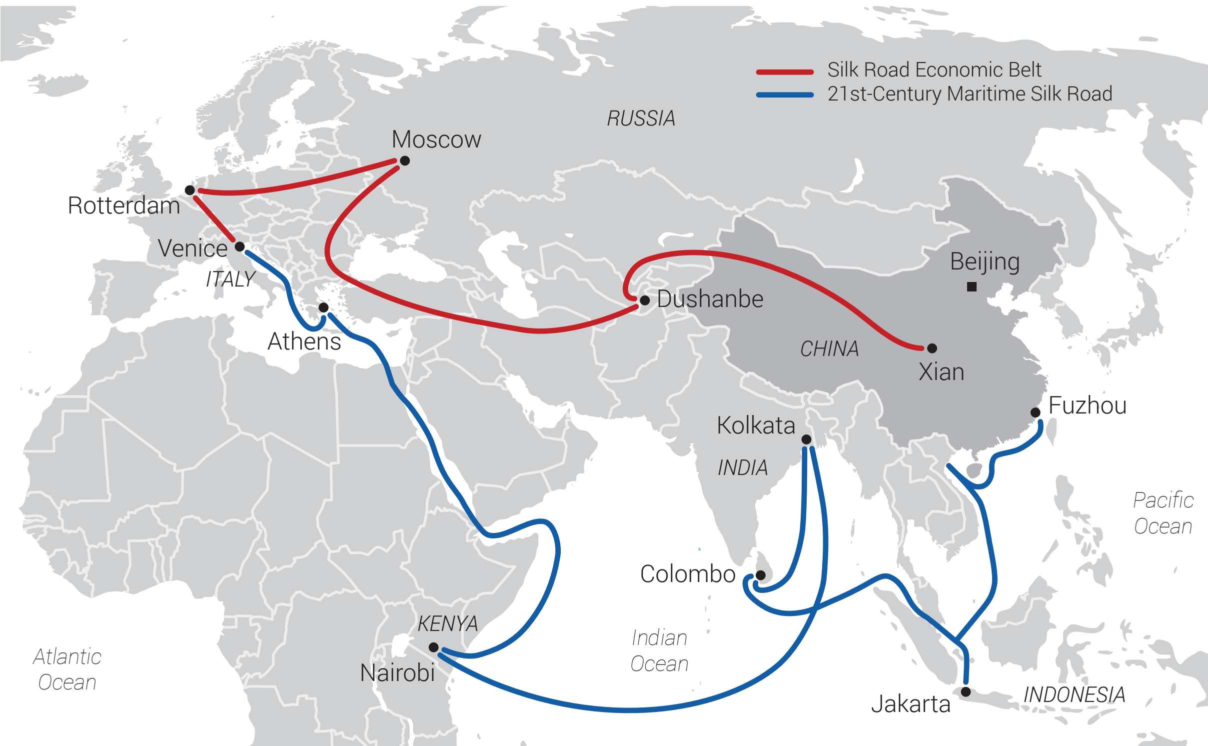
The enthusiasm for the Belt and Road is at odds with the growing risk aversion plaguing Chinese institutions

position in Asia. The combined Belt and Road envisage new transport infrastructure, industrial corridors, power lines, railways, ports and trade routes that will enable a two-way flow of goods, people and ideas that stretches from China to the Middle East and Europe.

Commentary on the Belt and Road Initiative has thus far tended to view it as part of China's attempt to redefine global norms and institutions. The detractors of the Belt and Road argue that Beijing, frustrated with the lack of flexibility and reform in the Bretton Woods system, views the Belt and Road as a way of regaining China's historic position as a great regional power. But the Belt and Road Initiative, despite the ambitious intentions surrounding it, remains a grandiose and abstract wish list rather than a coherent blueprint. The Belt and Road is likely to face a number of challenges, both domestic and international. While many of the planned infrastructure investments will materialize, they may be more limited than the pledges. And as China's geopolitical weight increases in the region, so too will the security burdens it will have to bear.

Lofty Ambitions…

China is backing this ambitious plan with its financial clout and new lending mechanisms: In December 2014, Beijing created the Silk Road Fund, to which it pledged $40 billion for infrastructure development across Asia, mainly in Central Asia. In June 2015, China created the Asian Infrastructure Investment Bank (AIIB), a financing mechanism akin to the Asian Development Bank, which will fund infrastructure development throughout Asia. A month later, Beijing



The Belt and Road Initiative will involve some 60 countries, making up a third of the global economy and more than half the world's population.

and fellow BRICS – Brazil, Russia, India and South Africa – oversaw the creation of the New Development Bank (formerly the BRICS bank). Each of these new institutions is expected to add $100 billion to the financing pool, although the full amounts pledged will not be made available before 2020. By 2049, the centenary of the founding of the People's Republic of China, President Xi would like this new iteration of the Silk Road to become a reality.

Beijing presents the Belt and Road Initiative as an opportunity to forward mutual beneficial cooperation between China, Asia, and the world. Other countries will treat it more cautiously. On the economic front, new commercial routes established through the Belt and Road should help development in China's Western provinces. It will also offer Chinese industries, which are struggling in a saturated and slowing domestic market, new opportunities to move some overcapacity from China, particularly in construction and heavy industry, to overseas markets. And as China and its neighbouring markets become more deeply integrated, thanks to reduced tariffs and simplified customs administrations, the Chinese currency, the renminbi, should underpin trade settlement and bond issuance.

…And complex realties

The Belt and Road Initiative will encounter numerous hurdles overseas, but also some of a more domestic nature. For one, even though the idea itself seems to be President Xi's brainchild, it is unclear which part of the bureaucracy is spearheading it. The action plan for the Belt and Road Initiative was issued in March 2015 by three ministries: the Ministry of Foreign Affairs, the National Development and Reform Commission as well as the Ministry of Commerce, but it reads more like a statement of ambitions from well over a dozen additional bureaucracies and provinces. Without clear goals and guiding principles, various ministries will pull in different directions. And the financing available for them – which contrary to headlines is finite – will be stretched. While Beijing underlines that the Belt and Road will follow market principles, with many government bodies and companies vying for a piece of the funding cake, the risk of inefficient investments is high.

Second, the enthusiasm for the Belt and Road is at odds with the growing risk aversion plaguing Chinese institutions, be it for fear of corruption probes or due to the economic slowdown and greater scrutiny on expenditures. After almost two decades of overseas investments, Chinese companies and officials are facing intense pressure to show that their ventures in far flung corners of the world have reaped benefits, but many of them are finding it hard to do so: In 2013, for instance, the Vice President of China's Mining Association estimated that 80% of Chinese overseas

The port in Beihai in southwest China, starting point of the country's ancient marine silk road and one of the main export channels of the 21st-Century Maritime Silk Road © Xinhua/Huang Xiaobang mining investments had failed. In the oil and gas sector, companies have reportedly paid roughly one-fifth more for oil and gas assets than the industry average.

In this context, the head of the AIIB, Jin Liqun, expects to make an annual profit of 6-10% on the bank's loans portfolio, a tall order for a development bank. The AIIB will therefore need to be quite selective in the projects that it finances and could be hard pressed to find ventures that meet high returns on investments. There will also be limits to investments as Central Asian economies are still relatively small. While some countries in Southeast and South Asia will wish to advance their own corporations and industries in the initiative, presenting competition to Chinese companies. Debt repayment questions already face a number of China's foreign partners, including Ukraine, Zimbabwe, and Venezuela. Ultimately, the headline amounts pledged by the Belt and Road could end up being much lower, leaving Chinese companies hard pressed to fund their overseas ventures, or disappointing recipient countries.

International Challenges

While Chinese deep pockets – if they can remain deep – are welcome in a large number of Eurasian and European capitals, there are increasingly mixed feelings about China's rise in many quarters. These national sovereignty concerns put into question whether the expected losses on a number of Belt and Road-linked ventures will make up in geopolitical gain. While some countries, including Kazakhstan and Pakistan, will be grateful for Chinese investments, there could very well be shifts in political viewpoints over engaging China in the lifetime of the Belt and Road. Beijing's assertive stance on maritime disputes could generate pushback as Chinese companies extend their reach into countries – and especially into their ports – along the "21st Century Maritime Silk Road".

Even along the Silk Road Economic Belt, where China has long standing ties with Central Asian states, fear of a flood of goods and workers from China could lead countries along the way to greet Chinese investments with suspicion. Further afield, European countries will welcome Chinese funding in key industries, but questions regarding Chinese companies' ability to meet European labour and environmental standards will arise. Similarly, European leaders increasingly fear that building trade linkages with China could deepen the trade imbalance that is already heavily skewed in China's favour.

As China's global economic footprint extends even further, Beijing's vulnerability to geopolitical and security challenges will increase. Not only will Chinese investors need to deal with political risk and operational insecurity in Central Asia, South Asia and the Middle East, but Chinese interests could also become embroiled in domestic politics. China's foreign policy will be pushed further to engage more proactively than its "non-interference" policy calls for. But for Chinese companies, Beijing's more active diplomatic engagement, as was seen in Sudan and South Sudan, does not necessarily guarantee a risk-free environment for commercial ventures. They will remain susceptible to domestic politics and internal conflict.

More fundamentally, the biggest challenge for Beijing will be to communicate its intentions and its vision for the Belt and Road as they represent China's views of its re-emergence as a regional and global power. Other regional and global powers, such as Russia, India, Japan, and the United States, may view the Belt and Road as infringing on their areas of influence, driving competition rather than cooperation. The creation of the AIIB has fuelled concern about China's desire to reshape global rules and norms. And given the lack of strategic guidance from Beijing and the number of corporate and government actors involved in the execution of the Belt and Road, there will be successes and failures to come.

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Cover photo: Workers on a suspension bridge at The Grand Canyon of Zhangjiajie in China's Hunan Province © Zhang Mingtao/ChinaFotoPress

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