

China's Belt and Road Initiative: A Political Economy Perspective

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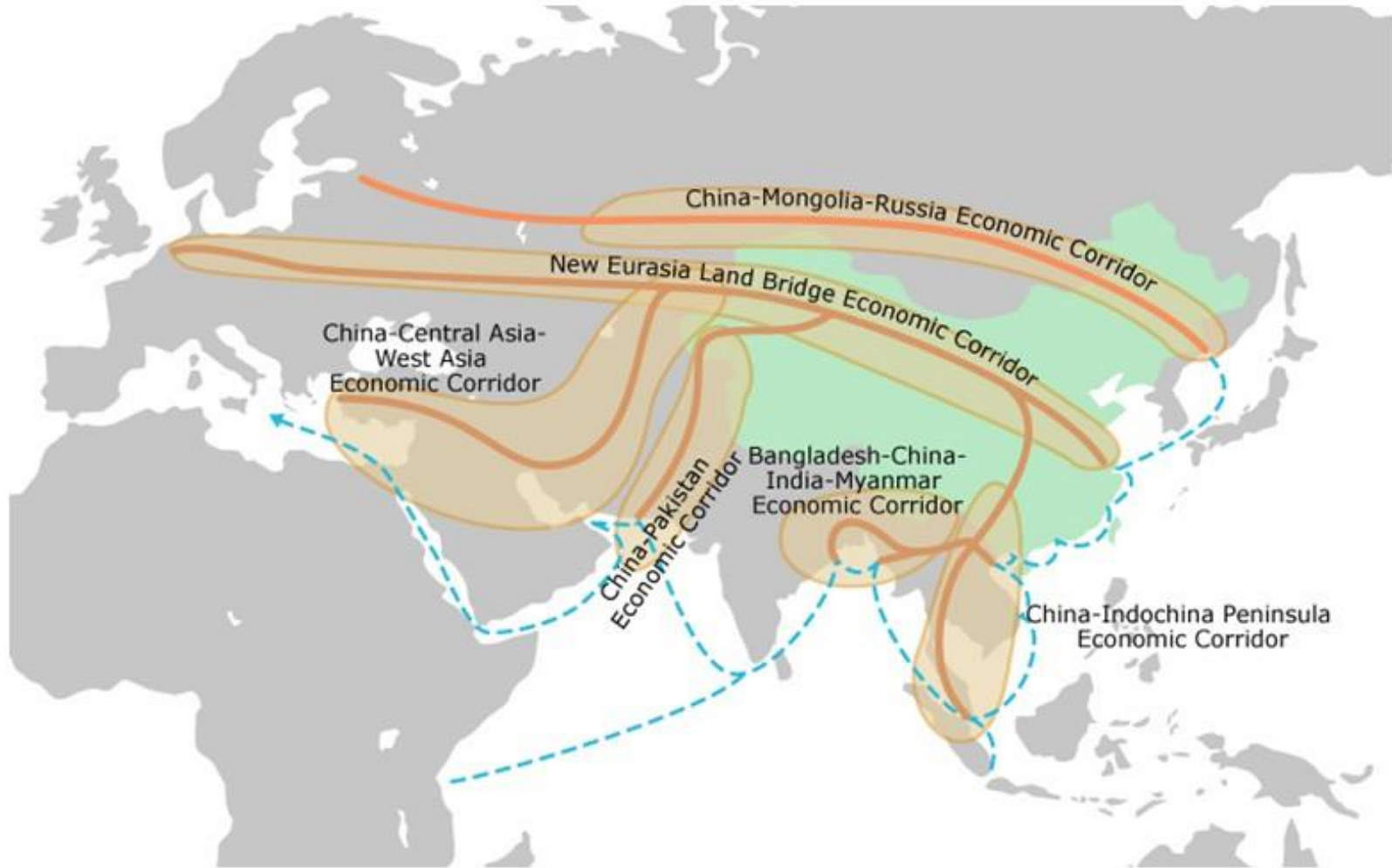
1. Background¹

- The *Belt and Road Initiative* (BRI) refers to the Silk Road Economic Belt and 21st Century Maritime Silk Road, a significant development strategy launched by the Chinese government with the intention of promoting economic co-operation among countries along the proposed Belt and Road routes.
- The BRI aims to connect Asia, Europe and Africa along six routes, which covers 60% of the world's population living in 60-plus countries. This covers 30% the global Gross Domestic Product (GDP) and 35% of world trade.

1. Background¹

- The six routes include:
 - (1) The New Eurasia Land Bridge Economic Corridor;
 - (2) The China-Mongolia-Russia Economic Corridor;
 - (3) China-Central Asia-West Asia Economic Corridor;
 - (4) China-Indochina Peninsula Economic Corridor; and
 - (5) China-Pakistan Economic Corridor;
 - (6) Bangladesh-China-India-Myanmar Economic Corridor.
- Cooperation covers five major areas: policy co-ordination, facilities connectivity, unimpeded trade, financial integration, and people-to-people bonds.
- The cooperation mechanism of the BRI rests on the principles of joint development through bilateral and multilateral co-operation to promote regional and inter-regional integration of the development of the countries along the route.

The Belt and Road Initiative: Six Economic Corridors Spanning Asia, Europe and Africa



2. The Financial Dimension of the BRI

2.1 The Silk Road Fund²

- The US\$40 billion Silk Road Fund was established in December 2014 to finance the BRI, with its main investment in infrastructure, resources, industrial and financial co-operation.
- The Fund was set up as a limited liability company in December 2014 with its founding shareholders including *China's State Administration of Foreign Exchange*, the *China Investment Corp*, the *Export-Import Bank of China* and the *China Development Bank*.
- On 14 May 2017, President Xi Jinping delivered a keynote speech at the opening ceremony of the “Belt and Road Forum for International Co-operation”, and announced that China would contribute an additional 100 billion yuan to the Fund.

2.2 The Asian Infrastructure Investment Bank

- The *Asian Infrastructure Investment Bank (AIIB)* is a multinational financial institution founded to finance the huge infrastructure needs across Asia and countries along the BRI.
- *AIIB* focuses on financing projects in energy and power, transportation and telecommunications, rural infrastructure and agriculture development, water supply and sanitation, environmental protection, and urban development and logistics.
- As of December 2015, all of the 57 Prospective Founding Members of *AIIB* had signed the Articles of Agreement.
- As of 17 June 2017, *AIIB* had 80 approved members/prospective members in total (including Hong Kong).

2.2 The Asian Infrastructure Investment Bank

Table 1 The 57 Founding Members of AIIB

Australia	Austria	Azerbaijan	Bangladesh
Brazil	Brunei	Cambodia	China
Denmark	Egypt	Finland	France
Georgia	Germany	Iceland	India
Indonesia	Iran	Israel	Italy
Jordan	Kazakhstan	Kuwait	Kyrgyzstan
Laos	Luxembourg	Malaysia	Maldives
Malta	Mongolia	Myanmar	Nepal
Netherlands	New Zealand	Norway	Oman
Pakistan	Philippines	Poland	Portugal
Qatar	Russia	Saudi Arabia	Singapore
South Africa	South Korea	Spain	Sri Lanka
Sweden	Switzerland	Tajikistan	Thailand
Turkey	United Arab	United Kingdom	Uzbekistan
Vietnam	Emirates		

3. The Political-Economy Rationale for the BRI

3.1 From Rule Follower to Rule Setter

- China spent 15 years to negotiate, with substantial tariff reduction and concession in opening up domestic market, in order to be admitted into the World Trade Organization (WTO).
- China's admission to WTO was not just for greater access to global market and the avoidance of annual negotiation of Most Favoured Nation Clause.
- It aims to transform itself from a rule follower to a rule setter – to enhance its footprint and influence in shaping the world order.

3.2 Geopolitical Consideration

- US influence has been shrinking in East Asia and the Pacific region, in particular after America's withdrawal from the Trans-Pacific Partnership (TPP) in 2017.
- The TPP, which includes Canada, Mexico, Japan, Australia, New Zealand, Chile, Peru, Malaysia, Singapore, Vietnam and Brunei, was originally designed for tariff reduction and economic cooperation among member countries.
- Chinese leadership wants to take the place of US to shape the economic and political order of the Asian-Pacific region.

3.3 Reduction in Excess Capacity

- In response to the downside economic pressure brought about by the outbreak of the Global Financial Crisis (GFC) in 2008, the central government initiated a 4-trillion yuan stimulus package which prompted rapid credit expansion.
- Excessive capacity, in which market demand falls short of potential output capacity, has long been a problem amid China's investment-led growth model.

3.3 Reduction in Excess Capacity

- The 2008 stimulus package intensified the already pressing problem of excess capacity. Local governments injected capital in investment projects through local government financial platforms (LGFPs) to boost economic rebound.³

Table 2 Average Utilization Rates of Selected Industries 2012

Industry	Average Utilization Rates (%)
Steel	72.0
Cement	71.9
Flat Glass	73.1
Electrolytic Aluminum	71.9
Shipbuilding	75.0

Source: Cai (2014); Lan (2013); McDonald (2013)

3.3 Reduction in Excess Capacity

- Central Asia, the Middle East and sub-Saharan Africa need investments in infrastructure on a massive scale, in order to speed up economic development.
- In Asia alone, the Asia Development Bank (ADB) estimates that the demand for infrastructure investment will be up to \$1.7 trillion every year until 2025 (Hewko 2017).
- Infrastructure investment along the countries of the BRI reduces the size of China's excess capacity.

3.4 Diversification of Overseas Direct Investment (ODI)

- The RBI facilitates China's "going out" policy by increasing ODI, which yields higher return than investing in US Treasury Bond.⁴
- ODI facilitates China's acquisition of foreign research and development (R&D) (Ren 2013). It is evidenced by the fact that prior to 2009, China's ODI mainly flew to developing countries and some resource-rich developed countries such as Australia and Canada, but advanced countries such as US and EU has become increasingly popular for attracting China ODI since 2009 (Rosen and Hanemann 2012).
- The motivation behind is the desire to upgrade Chinese firms' technology, acquire updated managerial skills and tapping global talents to keep them globally competitive.

3.5 Resources and Energy Security

- China's share of global energy demand is expected to rise to 24 percent in 2040. It is estimated that coal usage will decline from 62 percent in 2016 to 36 percent in 2040, while the share of oil will gradually decrease from 19 to 16 percent.
- Over this period, natural gas demand will double from 6 to 13 per cent, while the share of renewable resources is expected to rise from 3 to 18 per cent.
- Over the same period, China's dependence on oil imports will rise from 63 to 72 per cent, while the figure for gas imports will grow from 34 to 43 per cent.
- China's increasing reliance on oil and gas imports, particularly the transit by sea, is regarded by Beijing as a national security vulnerability given that an estimated 80 percent of China's crude oil passes through the Strait of Malacca (Len 2018).

3.5 Resources and Energy Security

- BRI is used to diversify its import sources, as well as to explore alternative supply routes, including overland transit pipelines to bypass this possible transit blockage in the sea route.
- China can access to new energy development in Pakistan and Central Asia through China-Pakistan Economic Corridor to diversify energy access and avoid volatility in the Middle East (Viehe, Gunasekaran, and Downing 2015).
- On top of supply route diversification, China strengthens its international cooperation at all levels and across all sectors of energy industry to develop an integrated energy network that will connect China and the global energy system.

3.6 Market Diversification

- A key goal of the BRI is to expand and diversify export markets, in particular after the GFC.
- Shrinking exports to the US and EU after GFC prompted China to rethink the overreliance on western markets.
- China also wants to change its export composition by exporting fewer low-value-added consumables such as textiles, toys and electronics, and more capital goods including telecoms equipment, construction machinery and electric turbines (Wildau and Ma 2017)

3.7 RMB Internationalization ⁵

- The BRI will promote renminbi as settlement currency of bilateral trade between China and countries along the Belt and Road routes. The volume of bilateral trade between China and these countries rose from US\$877.2 billion in 2012 to reach US\$995.5 billion in 2015 (Xinhua 2016).
- The BRI also boosts renminbi outflows through the capital account. Renminbi-denominated ODI extended to 49 countries in the belt and road regions, with investment amount reaching US\$14.8 billion in 2015, which was 18.2 percent higher than in 2014.
- In addition, it is expected that BRI will heighten the role as an investment and reserve currency – a key feature of any global currency. Demand for investment denominated in renminbi is increasing in Belt and Road countries, which have also become more open to using the currency as a reserve asset (Peng and Liu, 2016).

3.7 RMB Internationalization

- This provides an opportunity to increase the diversity and scale of renminbi-denominated products in offshore markets. Demand for new renminbi-denominated financial products such as local government bonds and asset backed securities is likely to increase.
- Currently, the use of RMB outside of China is still limited. RMB only accounted for 2.5% of all international payments recorded by SWIFT⁶, as opposed to 43.3% for the dollar or 28.7% for the euro.
- Further, about 70% of the international transactions involving the RMB were between Hong Kong and the mainland. If Hong Kong is excluded, then the RMB only accounts for 0.8% of global SWIFT payments (Graceffo 2017).

3.7 RMB Internationalization

- The eight most traded currencies are (in descending order): the U.S. dollar (USD); the European euro (EUR), Japanese yen (JPY), British pound (GBP), Swiss franc (CHF), Canadian dollar (CAD), Australian/New Zealand dollar (AUD/NZD) and South African rand (ZAR). RMB is not traded actively.
- By the end of 2016, the four major reserve currencies held by countries are USD (64%), EUR (19.7%), GBP (4.4%) and JPY (4.2%), followed by CAD (2.0%), AUD (1.8%) and RMB (1.1%).⁷

4. Can the BRI succeed?

- Michael Clauss, German ambassador to China, pinpointed several critical issues that will affect the success of BRI.
- ‘Not surprisingly, a project of this scale and ambition raises questions: do the highly indebted Chinese state and overleveraged SOEs really have the financial firepower to sustain this project? Are the terms really attractive and transparent enough for foreign companies? Can local populations be convinced that these projects are in their interest, despite in many cases having minor local input? Can China allay suspicions that, besides pouring concrete onto roads and into ports, the initiative might also mean very concrete political influence?’ (Clauss 2017)

5. BRI: The Role of Hong Kong

5.1 BRI Financial Centre⁸

- Hong Kong has one of the highest **concentration of banking institutions** in the world. Approximately 70 of the largest 100 banks in the world have an operation in Hong Kong.
- Hong Kong ranked third in the Global Financial Centres Index (GFCI) released by the Z/Yen Group in September 2015, after London and New York.
- Hong Kong is widely recognized as the **leading fund management centre** in Asia with a large concentration of international fund managers. As of end-2014, Hong Kong's combined fund management business amounted to US\$2.27 trillion (up 10.5% over 2013) while assets under management under private banking totalled US\$397 billion.

5.1 BRI Financial Centre

- Hong Kong has one of the world's **most active and liquid securities markets**. There is neither control over capital movements nor capital gains or dividend income tax. Hong Kong's stock market was the third largest in Asia and sixth largest in the world in terms of market capitalisation in July 2015.
- There were 1,808 companies listed on the Hong Kong Exchanges (HKEx) as of July 2015, with a total market capitalisation of more than US\$ 3.4 trillion. Hong Kong is one of the world's most active markets for initial public offerings (IPO), with US\$18.6 billion raised in the first seven months of 2015.
- As the leading offshore renminbi bond market in the world, Hong Kong has accumulated substantial experience in issuing renminbi-denominated bond.

5.2 Professional Business Hub

- The different forms of collaboration among Belt and Road countries will involve numerous contractual relationship among investors and governments over issues such as ownership, control and profit sharing.
- Backed by world-class legal, arbitration, and business services (e.g. accounting, auditing and consultancy) as well as global connectivity, Hong Kong could serve as a convenient business hub for liaison in terms of holding conferences, undertaking contract negotiations and business consultancy.

5.3 Infrastructure Logistics Centre

- In the past, Chinese infrastructure developers used and managed their own supply chains. In recent years, however, it has been more common for infrastructure developers to seek third-party logistics support for their overseas projects.
- With huge demand for infrastructure development along Belt and Road countries, China may not be able to supply all construction materials directly from China timely and efficiently. Chinese developers may seek to hire external parties to build project-specific logistics facilities to help streamline the delivery of major equipment and building materials from the Mainland. Hong Kong's logistics and maritime advantages put the city in a strong position to perform the function as an infrastructure logistics centre (Lam 2015: 9).

5.4 Regional Education Hub

- In 2014-15, 436,585 overseas students studied in the UK's higher education (HE) sector, which was equal to 19.3% of the UK's total number of students in HE.⁹ With every student spending HK\$1 million for a HE degree, exporting education brings the UK HK\$436.5 billion, which is about 3.2 times of Hong Kong's exports of financial services.

5.4 Regional Education Hub

Table 3: Place of Origin of Students in Hong Kong's UGC-funded Universities (2014-15)

Place of origin of students	Number of students	Percentage
Local	81,759	84.36
China	11,610	11.98
Others	3,542	3.65
Total	96,911	100

Source: University Grants Committee, Available at:

http://cdcf.ugc.edu.hk/cdcf/searchUniv.do?actionType=searchUniversity&mode=&lang=EN&universities=CityU&universities=HKBU&universities=LU&universities=CUHK&universities=HKIEd&universities=PolyU&universities=HKUST&universities=HKU&fields=Enrol_Origin_2014 (Accessed on 9 May 2016)

- Table 3 shows that 11.98% in Hong Kong's UGC-funded universities came from mainland and only 3.65% came from Asian and other countries.

5.4 Regional Education Hub

- Actually, Hong Kong is one of cities having high concentration of top-100 universities in Asia and in the world. According to [QS World University Rankings](#) 2015/16, HKUST and HKU are ranked 5th and 6th in Asia. HKU, CUHK and HKUST are ranked 45, 74 and 77 respectively by Times Higher Education in 2016.
- Since income elasticity of education tends to be larger than one, rising household income in Asia will sustain the demand for quality higher education.¹⁰
- Hong Kong needs to internationalize its campuses by recruiting more students and professors overseas, and develop branch campuses with reputable universities in the world. More private universities, local or overseas, can be established.

5.4 Regional Education Hub

- Singapore can be a model for Hong Kong's development as a regional education hub. Singapore offers a wide variety of quality universities ranging from local to international. Apart from the four local universities - the National University of Singapore (NUS), Nanyang Technological University (NTU), Singapore Management University (SMU) and Singapore University of Technology and Design (SUTD), nine leading international institutions have established an Asian campus in Singapore.
- Singapore universities have also collaborated and offer joint programs with 29 high-calibre international universities such as The Wharton School of the University of Pennsylvania, Massachusetts Institute of Technology (MIT) and New York University School of Law.¹¹

6. Conclusion

- BRI is one of China's most important national development strategies in the 21st century, which was motivated by multi-dimensional political economy considerations.
- China's goal is much more than economic. Rather it aims to enhance its leading role in global development and national security amid recent dynamics of geopolitics.
- Its success rests on the mutual trust among participating countries and an acceptable distribution of mutual benefits among countries.
- Hong Kong's endowment of efficient and professional services in financial and business sectors enables it to take up a unique and strategic role under BRI. If Hong Kong can effectively perform this strategic role, it will offer Hong Kong a new momentum for growth and development in the coming decades.

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Endnotes:

- ¹ The background information is mainly derived from Hong Kong Trade Development Council (2017).
- ² For details of the Silk Road Fund, see <http://www.silkroadfund.com.cn/> (Accessed on 23 April 2018).
- ³ For more detailed discussion on LGFPs, see Kwong (2016a)
- ⁴ The yields for 3-month, 6-month, 12-month, 2-year, 5-year, 10-year and 30-year US Treasury Bond are 0.28%, 0.43%, 0.61%, 0.84%, 1.33%, 1.87% and 2.68% respectively on 18 March 2016. For details, see Bloomberg Business (2016).
- ⁵ Discussion in this section is mainly derived from Liu et.al. (2017: 7-8)
- ⁶ The Society for Worldwide Interbank Financial Telecommunication (SWIFT) provides a network that allows information exchange of financial transactions among financial institutions worldwide.
- ⁷ Calculated based on the data from International Monetary Fund (IMF). Available at: <http://www.imf.org/en/News/Articles/2017/03/31/pr17108-IMF-Releases-Data-on-the-Currency-Composition-of-Foreign-Exchange-Reserves> (Accessed on 6 May 2018).
- ⁸ For further discussion of this section, please see Kwong (2016b).
- ⁹ Data derived from UK Council for International Student Affairs, Available at: [http://institutions.ukcisa.org.uk/Info-for-universities-colleges--schools/Policy-research--statistics/Research--statistics/International-students-in-UK-HE/#International-\(non-UK\)-students-in-UK-HE-in-2014-15](http://institutions.ukcisa.org.uk/Info-for-universities-colleges--schools/Policy-research--statistics/Research--statistics/International-students-in-UK-HE/#International-(non-UK)-students-in-UK-HE-in-2014-15) (Accessed 9 May 2016). The percentage is calculated based on data from Higher Education Statistics Agency, Available at: <https://www.hesa.ac.uk/> (Accessed on 9 May 2016).
- ¹⁰ See Matsuda, Sone and Murata (1999) for an empirical study of income elasticity of education.
- ¹¹ See ‘Singapore Fast Becoming a Global Education Hub,’ Available at: <http://www.prweb.com/releases/2012/6/prweb9622334.htm> (Accessed on 9 May 2016)



Thank you!