‘One belt, one road’ initiative of China

Case Background

China’s economy has been growing very rapidly for more than two decades until the financial crisis of 2007-08 shook the global economy. Shifting from inward looking policies to opening up policies has dramatically accelerated the growth. Special focus on the export-led growth strategy did alter the growth dynamics of China. This could be visualised from the facts that during the last six years before the financial crisis i.e. 2001-2007 the GDP growth was at an average rate of 11 percent. Domestic investment was more than 41 percent of GDP, which is a very health ratio. As the country effectively implemented the strategy of export promotion and import substitution, the current account recorded surplus of more than 10 percent of GDP during the same period. However, such impressive growth lost momentum in the post-crisis period. In the six years since the global financial crisis, the growth rate slowed down to around 6 percent, down more than 5 percent from the pre-crisis period. China’s current account surplus has fallen sharply to around 2 percent. David Dollar (2015) closely observes that the export led growth pattern of China manifests three problems. First, technological advance has slowed down. Second, marginal product of capital is dropping. The falling capital productivity of China is indicated by rising empty apartment buildings, unused airports and serious excess capacity in manufacturing sectors. Third, the domestic household consumption is very low, which is less than one-third of GDP.

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The case writer(s) B.Venkatraja, Assistant Professor - Economics, may be reached at venkatraja@sdmimd.ac.in Author(s) have prepared this case as the basis for class discussion rather than to illustrate either effective or ineffective handling of the situation. This case is fictionalized and any resemblance to actual person or entities is coincidental. This publication may not be digitized, photocopied, or otherwise reproduced, posted, or transmitted, without the permission of SDMRCMS, SDMIMD, Mysore. For Teaching Notes please contact sdmrcms@sdmimd.ac.in.

The impact of economic slowdown is cumulative. The aggregate demand is badly affected and it is the lowest ever. Rising unemployment and increased futuristic savings are the real concerns of sustainability of China's decades of growth. China's response to the changing growth dynamics is both external and internal. On the external from, China has launched an expensive 'One Belt, One Road' initiative popularly termed as Belt and Road initiative.

Objectives of the initiative

The Vision and Action Plan document prepared by the National Development and Reform Commission (NDRC) established by the Government of People's Republic of China (2015) spells out the major objectives of the Belt and Road initiative.

- to embrace the trend towards a multipolar world, economic globalisation, cultural diversity and greater IT application;
- to uphold the global free trade regime and open world economy in the spirit of open regional co-operation;
- to promote orderly and free flow of economic factors, highly efficient allocation of resources and deep integration of markets;
- to encourage the countries along the Belt and Road to achieve economic policy coordination and carry out broader and in-depth regional cooperation of higher standards;
- to jointly create an open, inclusive and balanced regional economic cooperation architecture that benefits all.

Conceptual framework

The Belt and Road initiative is a systematic project, which proposes to connect China with Asian, European and African countries more closely for deriving mutual benefits. The initiative is to connect the vibrant East Asian economies at one end and development European markets at the other, and encompassing African countries with huge potential for rapid economic progress. The National Development and Reform Commission (2015) has outlined the framework for the Belt and Road initiative. The Belt and Road initiative has two broad projects. First, the Silk Road Economic Belt (inland ways); and the second, the 21st Century Maritime Silk Road (water ways).

The Silk Road Economic Belt focusses on the following on-land connectivity:

1. Linking China to Europe through Central Asia and Russia
2. Linking China to Middle East through Central Asia and West Asia
3. Linking China with South East Asia, South Asia and Indian Ocean

The 21st Century Maritime Silk Road is designed to provide connectivity to the rest of the world using China's coast via water ways. Under this, two routes of connectivity are initiated:

1. Linking China to Europe through South China Sea and Indian Ocean
2. Linking China to South Pacific Ocean through South China Sea

Focussing on the above five routes, the initiative brings together more than 70 countries along the Belt and Road through building up six international economic co-operation corridors with a massive investment of more than $1 trillion. The following are the six international economic corridors for further opening up and co-operation among the countries along the Belt and Road.

New Eurasian Land Bridge Economic Corridor: This is an international railway line from China's Jiangsu province to Rotterdam in Holland. It passes through Kazakhstan, Russia, Belarus and Holland linking to a number of ports in Europe. China has already opened three international freight rail routes. First, connecting to Duisburg in Germany; Second, to Czech Republic; and third, to Hamburg in Germany. These routes provide inter connectivity and make cargo transport convenient with one declaration, one inspection and one cargo release.

China – Mangolia – Russia economic corridor: Under this project China, Magnolia and Russia will jointly take up the building of New Silk Road and establish a new economic corridor through road and railway connectivity among them to facilitate transportation. Special focus has been levied on the development of Mongolia's Steppe Road and Russia's Eurasia Land Bridge.

China – Central Asia – West Asia economic corridor: This corridor provides railway link from Xinjiang in China to Mediterranean Coast and the Arabian Peninsula via Central Asia and West Asia. The corridor passes through Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan and Turkmenistan of Central Asia and Iran and Turkey in West Asia.

China – Indochina Peninsula economic corridor: An economic corridor has been proposed to link China to five countries of Indochina Peninsula. These countries agreed to jointly build transportation network, raise fund and promote sustainable development. Already many projects of highways, expressways and railway routes connecting from Peninsula region to South Asian cities.

China – Pakistan economic corridor: As per the drawn up plan, an economic corridor from Kashgar in China to Gwadar Port at the east bay in Pakistan will be constructed comprising of highways, expressways, railways, international airports, oil and natural gas pipe lines and optic fibre networks. An amount of $46 billion is estimated towards this.

Bangladesh – China – India – Myanmar economic corridor: The four participatory countries agreed to co-operate and work together in the areas of transportation infrastructure, investment and commercial circulation, and people to people connectivity.

Financing the dream project

The Belt and Road initiative is a massive project covering more than 70 countries across Asia, Africa and Europe. The focus areas are laying down the trade routes from China to Asia, Africa and Europe via on-land and sea routes as well as venturing into energy projects. The project execution demands huge investment. China has provisionally estimated her investment liabilities at $1trillion. In 2015 China announced that $160 billion was already invested on the construction projects. It is pertinent to note that China's resources are crunching due to her recent slowdown which poses threat to the success of the project. The ability of China to further invest for the project could be challenged from the fact that the current Debt to GDP ratio is exceeding 250 percent. Under such critical circumstances, China arranges for some alternative ways for funding the project.

1. Silk Road Infrastructure Fund: In 2014 China led Silk Road Infrastructure Fund was created with $ 40 billion drawn from China's FOREX reserve. The Fund has already financed a hydro-power project in Pakistan and in a natural gas project in Russia.

2. Asian Infra Investment Bank: The Bank was created in 2014 with $100 billion consisting of 21 Asian countries. China has 21 percent share in the Bank.

3. New Development Bank: BRICS countries established New Development Bank in 2014 with the initial capital of $50 billion. The Bank is headquartered in Shanghai with the largest contribution to the share capital.

4. China Development Bank has recently announced an investment of $890 billion in more than 900 projects along the Belt and Road across 60 countries.

Is the initiative a game changer for China?

Thirty years of growth transformed China from inward and agricultural economy to manufacturing economy. The current growth is primarily driven by exports. However, of late China has been passing through slowdown in growth which is the worst ever in the last 3 decades. The domestic demand has fallen to unbearable level while same is increasing in neighbouring countries. The series of initiatives since

2013 launched by China are mainly outward looking policies. Focus shifted to revive traditional Silk Road. China has planned a massive investment exceeding $ 1 trillion along the Belt and Road spreading across over 70 countries. One of the major questions raised across is will China be successful in bringing a transformational shift in the slumping domestic macro economy through her external investments?

Opinions are highly divided. United States of America is pessimistic about the success of the initiative. Harry G. Broadman, CEO of Proa Global Partners LLC fears that the Belt and Road initiative would be a bridge to nowhere. Harry's worry is owing to continued downward trend in the Chinese economy even in 2016. In contrary, Philippe Le Corre of the Brookings Institution is optimistic. In an interview with the Harvard Political Review, Philippe speculated that the Maritime Silk Road, a mundane collection of shipping lanes and maritime trade routes, will work. China firmly believes that this initiative can be a game changer for the ailing economy. China's claim is not unreasonable.

One Belt, One Rad project might foster China's emergence as global economic leader. More than 70 countries along the Belt and Road will associate with the project. The trade network extends from erstwhile Silk Road. Since 2013 China entered into several bilateral and multilateral agreements with participating countries. With burgeoning trade network China may enlarge export production and can even sustain the same. China's massive investment on the infrastructure and energy projects across Asia, Africa and Europe will have significant multiplier effect on the growth of the host economies. This by default makes China command the goodwill of more than one third of the countries of the world. China rises to the supremacy with the support of more than half of the global population who have more than 40 percent contribution to the global GDP. This might tilt the global economic equation to her favour. The economic supremacy of USA would be challenged. The success of the initiative might bipolarise the world between US and China.

Under this initiative, China is aggressively negotiating towards creating a free trade zone along the Belt and Road. Until now China has signed free trade agreements with 12 countries including Singapore, Switzerland, Hong Kong, Taiwan, Pakistan, Chile, Peru, Costa Rica and Iceland and another eight countries are under consideration including Japan, Korea, Australia, Norway etc. China being basically an export oriented economy, such free trade regime would enable China to sell her manufactured goods without cross boarder tariff/quota restrictions. Hence China-made products will be very competitive and can hit market at highly affordable rates. Increased overseas demand will domestically deploy lot of buildings, manufacturing units, airports, apartments etc. to the optimum otherwise they remain idle. China currently faces the problem of significant over capacity in steel, construction and heavy machinery sectors. The ongoing economic slowdown has exposed such excess capacity built up by China. It is expected that free trade will work favourably to China in utilising her resources fully. A massive investment of more than $1 trillion on infrastructure and energy sectors is also anticipated to create huge demand for China labor, materials and post project services. This again secures deployment of domestic excess capacity abroad. This should put a hold to the growing unemployment of China.

Widening trade network and free trade will offer ample space for promoting exports which is arguably the engine of Chinese growth but has lost sheen post subprime crisis. Quick, restriction less and cost effective on-land and water connectivity to half of the countries of the world might help China flooding and dumping home-made manufactured products in such partner nations. Chinese infrastructure investment along the Belt and Road will have multiplier impact on employment and income of the host countries. This should trigger the consumption and effective demand for varied goods and services in host countries particularly in Asia and Africa and to meet them they may have to depend on China. Such dependency created through investment in host countries will not only promote Chinese exports, but also secure sustained long run markets. Through this project, China will be able to create future market for her goods.

One of the major benefits of the initiative to China would be securing energy security. The initiative is expected to re-draw energy economics of China. Energy being an engine of growth, desperation of China to ensure domestic energy security is understandable. Striving towards this, China has strategically planned massive investment in some of the energy rich economies. For instance, China has made more than $200 billion investment on infrastructure in Kazakhstan which is the potential energy partner of China. Infrastructure deals led to energy deals as well and now Chinese companies control more than 25 percent of Kazak's oil production. The planned 2,000 mile high speed railway from western China to Tehran will provide easy access to Iranian oil. It is noteworthy that China has invested heavily in Turkmenistan since 2013. This amounted to growing control of China over Turkmenistan's energy sector. Now China based companies own more than 50 per cent of gas exports of Turkmenistan. Further, China has signed $15 billion deals in gas and uranium with Uzbekistan. To materialise the objectives of the agreement, nearly 600 Chinese companies are working in Uzbekistan on 70 projects.

One Belt and One Road initiative will strengthen and stabilise Chinese money market. This inference could be reached based on the experience of China over the last two years. Opening of the Chinese economy to the economies of the Belt and Road necessitated opening of bond market as well. Bond market provides much needed source of finance at reduced costs to the Belt and Road initiative. Opening of the bond market has attracted the attention of several foreign institutional investors to China market. The holding of foreign institutions and individuals increased by 68 percent to 670 billion Yuan during 2013 and 2014. This enhances the inflow and holding of foreign exchanges in large volume. Such reserve could be redeployed by China to effect another round of investment multiplier. Significantly, a part of investment to the One Belt, One Road initiative is funded by reserve of foreign exchanges. Hence, the money market growth and the project initiative are complementary and mutually dependent.

This project may enable China in fulfilling the most ambitious effort of making Yuan a globally convertible and reserve currency in the long run. In the short run, China could see currency gaining strength. This is because China is engaged in trade negotiations with several countries along the Belt and Road which provides an opportunity to push partner countries for trade in Yuan or swap currencies. China has recently signed an agreement with Nigeria as per which Yuan freely flows across Nigeria as an alternative US dollar for transactions. China could successfully enter into currency swap agreements especially since 2013 with countries like United Kingdom, Brazil, Hungary, Albania, European Union, Switzerland, Sri Lanka, Qatar, Canada, Nepal, Suriname, Chile, Tajikistan, Ghana, Zimbabwe and South Africa. These countries have integrated Yuan into their system.

China may also re-gain global investors' confidence. Bilateral and multilateral trade negotiations, free trade zone, strengthening domestic economy, growing economic supremacy, increased acceptability of Yuan across the world will raise investors' confidence in China's money market and commodity market. Positive economic environment will enable inflow of foreign investment and the consequent rise in foreign exchange reserve in the long run. This will be the key factor sustaining Chinese economic growth in the long run.

China can anticipate, based on these expected benefits to be accrued from the Belt and Road initiative, a rapid economic recovery. At this initial stage of the initiative, with the drastic progress made in several projects, one could predict that such massive external investment on several infrastructure and energy projects in many countries along the Belt and Road has multiple benefits to the China economy. This will contribute to the acceleration of macroeconomic growth of China and the enduring slowdown in GDP will be broken down.

Risks and challenges

It will be incorrect to infer that China's initiative is a smooth affair. It is pertinent to identify the risks and challenges confronted to the project implementation.

Sustainability of investment and growth: One of the major challenges to the successful project is sustainability of the investment and sustained growth. Since the initiative aims to invest along the belt and road towards infrastructure development spreading over the decades, sustained growth of China as well as the partner countries is a significant factor. For China slowing down growth may be a major setback. This would create resource crunch to the overseas infrastructure investment. Prolonging of global economic stagnation may also adversely affect the actually realised investment.

National sovereignty concerns and trust deficit: Many Central Asian countries, though having long standing tie ups with China, fear China's dominance in their internal affairs. The fear triggers from the anticipated interactions in domestic policies, flooding of China made products in the domestic market, deployment of China labour in pursuance of the projects ignoring local labour. European economies are concerned about the ability of the China firms to meet European standards of environmental practices. Their worry is also due to the possible trade imbalance which is already tilting in favour of China.

Vulnerability of geopolitical and security challenges: China's global engagements will be affected by the political and economic instability in the host countries which are beyond the control of Beijing. Asian, African and Latin American countries through which the initiative passes are frequently encountering political crisis and terrorist attacks. China will remain susceptible to domestic political instability and internal conflicts.

Vulnerability to external credit risks: Countries along the belt and road neither have any credible credit worthiness in the past nor could be expected from many in future as well. China's project will be vulnerable to such credit risks of partner nations.

Institutional challenges: The countries being involved in the initiative have diverse growth levels. Further, governance, technological up gradation and ease of doing business vary drastically. Level of domestic reforms and reform policy measures also differ country to country. Multilateral initiative of China is feared of being affected by such institutional differences.

Global co-operation: Since the initiative involves more than 70 countries, their heart felt co-operation in implement the project becomes critical. However, in the current global political scenario China getting support by all stake holders appears to be very remote. Countries like Russia may not like China's growing interference in the global economy. US is very much sceptical about the project.

Implications to India

India is silent about get on board 'One belt One road'. There is a case for India to join the league.

- Better economic connectivity for India to Asia and European economies.
- Access to the proposed infrastructure in Asia and Europe which are in transport, industrial corridors, telecom hubs, trade, travel, energy transfer etc.
- From the geostrategic perspective, involvement in one belt one road initiative would assist India to implement effectively Spice Route and Mausam Project.
- It is also believed that using the platform India can also expand diplomatic relations with in the league.

It is interesting to see India's future course of action towards this initiative. Will India join the initiative and co-operate with China or compete keeping herself away? India need to fix her 'Prisoner's Dilemma' to gain equally from the success of the initiative. Co-operation rather than competition can the strategic option for India in the metrics of the game.

For further discussion: Discussions across literature talk on the subject of potential threat of China to American economic supremacy. It is said that the global trade balance and economic power will be bipolarised between US and China. The emergence of China with global influence will tilt the equations of balance of power in favour of China. There is a need to explore to what extent the Belt and Road initiative will challenge American hegemony. It requires further reading and study.

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