

The Belt and Road turns five

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Executive summary

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CHINA'S BELT AND ROAD INITIATIVE (BRI) is an international trade and development strategy. Launched in 2013, it is one of the ways China asserts its role in world affairs and captures the opportunities of globalisation. The BRI has the potential to enhance development prospects across the world and in China, but that potential might not be realised because the BRI's objectives are too broad and ill-defined, and its execution is too often non-transparent, lacking in due diligence and uncoordinated.

THIS POLICY CONTRIBUTION recounts the background of the BRI and its context, what is known about the extent of the initiative and the intentions behind it. The initiative could address very large infrastructure investments gaps, which is welcome and needed. China's goal of forging stronger links with its trading partners around the world is legitimate assuming, of course, the underlying intent remains peaceful.

THOUGH MANY OBSERVERS welcome the BRI, many others oppose it for good reasons, while others misunderstand it and oppose it for bad reasons. We identify and discuss concerns about the initiative that relate to its geopolitical objectives, its priorities, its geographic scope, the role of state-owned enterprises, the allocation of resources and issues of transparency and of due diligence. In particular, we show that this initiative deals with a vast number of countries that are at very different states of development, and that an apparent lack of well-defined priorities holds the initiative back. We also highlight the issue of debt overload which is distressing several BRI countries and discourages further projects.

THERE ARE IMPROVEMENTS that China and other stakeholders in the BRI could make to get the most from their investments. The BRI, to be effective, needs to meet the basic conditions of a trade and development strategy, which are clear objectives, adequate resources, selectivity, a workable implementation plan, due diligence and clear communication. Involvement of multilateral lenders could help with this. Finally, China must improve the evaluation of the risks and costs of BRI projects and step up its approach to due diligence to demonstrate that it respects the long-term interests of those countries that are at the receiving end of its BRI projects.

Introduction

Over the last four decades world trade, spurred by advances in information, transportation and communication technologies, as well as liberalisation policies, has come to play a central role in countries' development strategies. A far greater share than before of the world's GDP is traded, China is the biggest trading nation and developing countries as a group now account for more than 40 percent of world trade. Meanwhile, in 2016 just one quarter of world merchandise trade took the form of consumer products (UNCTAD, 2018). Trade in primary commodities, parts and components, and capital goods accounted for three quarters of world trade, feeding complex international production networks – so-called global value chains. These networks are organised around three regional hubs: China, the European Union (centred on Germany) and the United States (World Bank, 2017). Participation in global value chains allows poor and rich countries to exploit comparative advantage in a more articulated way, while consumers benefit from lower prices and increased variety.

To capture these opportunities, and to consolidate friendships and enhance security, policymakers in China, the EU and the US have promoted economic integration in their regions ('the near abroad'). Each has taken a different path, reflecting their priorities and histories. The most ambitious of these endeavours has been the progressive enlargement of the European Community from six original members to a European Union of 28 countries, which have put into practice the four freedoms, namely the movement of goods, services, capital and people, across their territory. The EU has also forged Economic Partnership Agreements, which include a mix of aid, trade and policy coordination, with several dozen countries in its near-neighbourhood in eastern Europe, the Middle East and North Africa and sub-Saharan Africa. Less comprehensive in scope and more tightly focused on international trade is the network of Free Trade Agreements orchestrated by the United States and encompassing nearly all countries in North, Central and South America, with Argentina and Brazil notable exceptions. Meanwhile, to widen their circle of friends and to strengthen their position in global value chains in sectors such as automobiles, electronics and food processing, the US and EU have increasingly reached beyond their immediate regions, striking trade and investment deals with countries on the other side of the world.

What is the BRI, exactly?

While the EU and US have reached out to partners in their different ways, Chinese economic diplomacy has not been passive; in fact, reflecting China's comparatively recent opening 40 years ago, the contrary is true. Even before the BRI was launched in 2013, China had concluded some twenty trade agreements, started negotiations on a regional trade agreement with 15 other Asian nations¹, concluded about 100 bilateral investment treaties, established a significant foreign aid and cultural exchange programme, launched two international development banks and become a major investor in natural resources across the developing world. China joined the World Trade Organisation in 2001 after protracted negotiations and has played an increasingly active role in the International Monetary Fund and the World Bank in recent years. After many years of lobbying, the Chinese renminbi was included in 2016 as one of five currencies forming the Special Drawing Right².

1 The Regional Comprehensive Economic Partnership (RCEP) includes: Australia, Brunei, Cambodia, China, India, Indonesia, Japan, Laos, Malaysia, Myanmar, New Zealand, Philippines, Singapore, South Korea, Thailand and Vietnam.

2 See <https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/51/Special-Drawing-Right-SDR>.

The Belt and Road Initiative (BRI) was the latecomer in China's extensive set of international economic initiatives, but might well turn out to be the most ambitious. Just five years after its launch, the BRI has become the organising framework for China's economic relations with about half of the world's nations of any size.

The earliest mention of the BRI was in a speech given by Chinese president Xi Jinping in Astana, Kazakhstan, on 7 September 2013 (Xi, 2013). The framework he set out has featured consistently in his speeches since and has served as the foundation for the 100 or so Memorandums of Understanding (MoU) between China and other BRI participating nations. Recalling the Silk Road of ancient times, a trade route which linked China to Europe through Central and South Asia, Xi proposed a five point plan:

1. Policy consultation on joint development strategies and regional integration among all countries along the Silk Road;
2. Improved road connections and transport infrastructure that would facilitate creation of an economic belt (hence the name 'belt and road');
3. Reduced barriers to trade and investment;
4. 'Monetary circulation', including currency convertibility for trade and investment purposes and acceptance of each other's currencies, implying an increased role for the renminbi;
5. Increased exchanges among people (students, tourists, researchers, professionals in various fields) to share knowledge and promote understanding.

Xi also set out a basic principle of the BRI, a familiar refrain of Chinese foreign policy that is important for understanding the way the BRI functions: *"We respect the development path and domestic and foreign policies pursued independently by every country.... we will never interfere in internal affairs"*. The signal here is that the BRI is essentially a business proposition and it does not carry with it a dose of 'extraneous' conditions, such as those relating to macro-economic imbalances or governance, and nor does it imply the creation of an alliance.

The fundamental motives of the BRI are like those of US and EU international economic diplomacy, namely to consolidate friendships and to capture commercial opportunities. However, the BRI is different in both design and execution, reflecting China's development path and the global outlook of its leaders.

- First, under the BRI umbrella, China emphasises investment in infrastructure and in trade facilitation ('connectivity') more than it does, for example, elimination of tariff and non-tariff barriers. A government white paper (NDRC, 2015) on the BRI states: *"... with regard to transport infrastructure construction, we should focus on the key passage-ways, junctions and projects... We should build a unified coordination mechanism for whole-course transportation, increase connectivity of customs clearance... We should push forward port infrastructure construction... We should expand and build platforms and mechanisms for comprehensive civil aviation cooperation..."*. Projects that form part of the BRI – some of which preceded the initiative and have been subsumed under it – tend to be very large. They include, for example, a \$3.19 billion high-speed railway connection between Jakarta and Bandung in Indonesia, a \$3.14 billion railway link between Dhaka and Jessore in Bangladesh³, and a railway line between Serbia's capital Belgrade to Hungary's capital Budapest for \$3 billion⁴. The BRI goes beyond transport to include energy and industrial facilities, such as the construction of several nuclear reactors in Pakistan for more than \$6.5 billion, hydropower projects in Pakistan totalling \$5.7 billion, a \$2.2 billion

3 Data from the *China Global Investment Tracker* published by the American Enterprise Institute.

4 Ibid.

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investment by State Grid Corporation of China in Brazilian energy infrastructure and a \$2 billion industrial park in a special economic zone in Kenya. In emphasising infrastructure, China creates an outlet for its know-how and capacities in building and operating transport and energy facilities – ie roads, bridges, railways, ports, airports, power stations and electricity grids. According to the OECD steel committee, between 2006 and 2015, Chinese steel-making capacity more than doubled and now represents almost half of global steel-making capacity, yet global capacity utilisation in the steel industry declined from about 80 percent to 70 percent. To a limited extent, BRI infrastructure projects help mitigate the problems arising from these excess capacities.

- Second, the BRI explicitly aims to strengthen connections between China's poor and remote western regions and nations to the west, south and north of these regions, and with China's flourishing coastal agglomerations. Per-capita gross product in the western provinces of Qinghai and Xinjiang are about a third of gross product *per capita* in Beijing and Shanghai (National Bureau of Statistics of China, 2018) and reducing this gap by integrating these regions into global markets is a major goal of Chinese policy.
- Third, China's state-owned enterprises, such as Sinopec Group, China Communications Construction Group, China National Petroleum Company, State Grid Corporation of China, Power Construction Group of China and China Railway Construction Corporation, rather than its private sector, dominate the deals struck under the BRI and their implementation. They are often of a turn-key variety, ie not necessarily requiring much by way of competitive external procurement. State-owned banks, such as the Industrial and Commercial Bank of China and China Construction Bank, are the main source of finance for these projects. These SOEs might not always operate at the frontier of efficiency, and some have only limited experience of operating outside China, but they have the size, access to finance, access to low cost labour and engineering and risk-taking capacity to embark on infrastructure projects with a long-term horizon in difficult environments. These state-owned firms are primarily profit-driven, and they typically offer finance at commercial rates. However, when the need arises, they can also be guided by their political masters to include in their assessments of projects not just intrinsic profitability but broader national objectives, such as increasing trade, improving access to raw materials and sustaining employment.
- Fourth, with the rate of return to domestic investment declining, China needs overseas outlets for its very large domestic savings. In the five years to 2007, China's economy grew on average in excess of 10 percent a year, while in the five years to 2017, it grew at a rate of between 6.5 percent to 7 percent. This large deceleration was not accompanied by a decline in the domestic investment rate, but by an increase from around 41 percent of GDP to around 45 percent of GDP, implying a sharp decline in the efficiency of domestic investment.
- Fifth, unlike nearly all other large providers of bilateral and multilateral development finance, China's investments under the BRI come with few safeguards such as those related to environment, consultation of civil society and fiscal sustainability. Consistent with China's policy of non-interference in domestic affairs, even fewer conditions are attached to the BRI related to issues such as human rights, democracy and governance.

It is important to note that, while the BRI, differently from the EU and the US, emphasises infrastructure rather than trade agreements, that does not mean that trade agreements are neglected. In recent years, a considerable effort has been devoted to establishing a global network of agreements which are clearly intended to be complementary and synergistic with the BRI. In Table 1, the countries in shaded rows are those listed as BRI participating countries by the China International Trade Institute. Of the 44 countries listed as either having or envisaging trade agreements with China, 29 are BRI participants. Of these, 16 have a trade agreement with China in force, nearly all of which were concluded or were under negotiation before the BRI was launched in 2013. However, of these 16 BRI countries with a trade agreement, 14 are

negotiating a revised and presumably deeper trade agreement. Another group of BRI countries, 10 in number, do not have trade agreements with China and are negotiating them. In yet another group of BRI countries, 3 in number, trade agreements are under consideration.

Table 1: China's trade agreements (shaded rows = BRI countries)

Partner country	China's exports in \$ billions (rank)	China's imports in \$ billions (rank)	Trade agreements		
			In force	Being negotiated	Under consideration
Hong Kong, China	287.3 (2)	16.7 (24)	✓		
Japan	129.3 (3)	145.7 (2)		✓	
Korea, Rep.	93.7 (4)	159 (1)	✓	✓	
Vietnam	61.1 (6)	37.2 (12)	✓	✓	
India	58.4 (7)	11.8 (28)	✓	✓	
Singapore	44.5 (10)	26 (14)	✓	✓	
Malaysia	37.7 (12)	49.3 (8)	✓	✓	
Australia	37.3 (14)	70.9 (7)	✓	✓	
Thailand	37.2 (15)	38.5 (11)	✓	✓	
Indonesia	32.1 (17)	21.4 (18)	✓	✓	
United Arab Emirates	30.1 (18)	10 (31)		✓	
Philippines	29.8 (19)	17.4 (22)	✓	✓	
Canada	27.3 (20)	18.3 (21)			✓
Saudi Arabia	18.7 (25)	23.6 (15)		✓	
Pakistan	17.2 (26)	1.9 (64)	✓	✓	
Bangladesh	14.3 (31)	0.9 (75)	✓		
Chile	12.8 (33)	18.6 (20)	✓		
Myanmar	8.2 (37)	4.1 (46)	✓	✓	
Israel	8.2 (38)	3.2 (52)		✓	
Colombia	6.8 (43)	2.5 (55)			✓
Panama	6.3 (44)	0 (144)		✓	
Peru	6 (46)	9.5 (33)	✓	✓	
New Zealand	4.8 (51)	7.1 (34)	✓	✓	
Sri Lanka	4.3 (53)	0.3 (103)	✓	✓	
Cambodia	3.9 (58)	0.8 (76)	✓	✓	
Switzerland	3.2 (62)	39.9 (10)	✓		✓
Macao	3.1 (63)	0.1 (117)	✓		
Kuwait	3 (65)	6.4 (36)		✓	
Norway	2.6 (71)	3.2 (51)		✓	
Oman	2.1 (78)	12 (27)		✓	
Qatar	1.5 (95)	4 (47)		✓	
Costa Rica	1.5 (96)	0.7 (79)	✓		
Mongolia	1 (110)	3.6 (48)			✓
Laos	1 (111)	1.4 (71)	✓	✓	
Nepal	0.9 (116)	0 (155)			✓
Bahrain	0.8 (118)	0.1 (134)		✓	
Mauritius	0.8 (120)	0 (158)		✓	
Georgia	0.7 (121)	0.1 (137)	✓		

Papua New Guinea	0.6 (124)	1.6 (65)			✓
Brunei	0.5 (127)	0.2 (105)	✓	✓	
Fiji	0.4 (137)	0 (163)			✓
Iceland	0.1 (157)	0.1 (131)	✓		
Moldova	0.1 (168)	0 (154)		✓	
Occ. Palestian Terr.	0.1 (175)	0 (183)		✓	

Source: Bruegel based on WITS database, China Ministry of Commerce and China International Trade Institute. Note: The blue-shaded countries are those listed as the 65 participating countries in the BRI by the China International Trade Institute. Trade volumes and country ranks are for 2016.

The effect of the trade agreements with the 29 BRI countries in Table 1 is significant. China's combined trade with the BRI countries in Table 1 is greater than that with Japan and South Korea combined. Since China already faces low Most-Favoured Nation (MFN) applied tariff rates (0-3 percent on average, trade-weighted) in its two main export markets, namely the US and the EU, Beijing has achieved or through the BRI is on the way to achieving, largely unimpeded access to world markets⁵.

Related to trade and to the objective of improving understanding among nations, the BRI also places considerable emphasis on the temporary movement of people. China is already the largest source of students and tourists abroad, mainly in the direction of Western nations. In 2017 there were 847,000 Chinese students abroad⁶, of whom more than 430,000 were in the US⁷, UK⁸ and Australia⁹. However, Chinese students and tourists also represent a large proportion of visitors to BRI countries. And in 2016, China hosted more than 200,000 students¹⁰ and 2 million visitors from BRI countries (National Bureau of Statistics of China, 2018).

A gap in the market

Parties to the BRI have reason, on security and geopolitical grounds, to befriend China, or at least not to alienate it. Home to 1.3 billion people, and already the world's largest economy by some measures, it is both a source of fear and attraction. On narrow commercial grounds alone, China's offer to participate in the BRI is one that many countries can't refuse.

To start with, China's rise as an importer acts as a powerful incentive to join the BRI. China's imports of goods and services in 2017 amounted to \$2,208 billion, third in rank after the US and the EU (intra-EU imports excluded). Since 2007 these imports have grown at an annual rate of 8.8 percent compared to 3.9 percent in the US and 3.2 percent in the EU (intra-EU imports excluded). Over the same period, China's economy is less reliant on exports as its exports as a percentage of GDP have declined from 35 percent to 20 percent, and its current account surplus in percent of GDP has declined from 9.9 percent to 1.4 percent (World Bank, 2018a). China is no longer perceived as just a source of cheap imports. It is now the

5 By contrast, China's largest trading partners face high MFN applied tariffs in China. For example, the EU faces 8.2 percent tariffs on its non-agricultural products exported to China on average (trade-weighted), and the United States 6.5 percent (WTO *et al*, 2018). China has recently announced unilateral MFN tariff reductions across a wide range of products.

6 See <https://migrationdataportal.org/data>.

7 See <https://www.migrationpolicy.org/article/international-students-united-states>.

8 See <https://www.ukcisa.org.uk/Research--Policy/Statistics/International-student-statistics-UK-higher-education>.

9 See <https://internationaleducation.gov.au/research/International-Student-Data/Pages/default.aspx>.

10 See http://usa.chinadaily.com.cn/epaper/2017-03/02/content_28409976.htm.

largest export market for 20 countries¹¹, including large and medium-sized economies such as Brazil, Indonesia, Australia and South Korea, and 48 countries ran a merchandise trade surplus with China in 2016. The Chinese trade balance reflects its role as a manufacturer and assembler in global value chains – China runs a trade deficit on primary products and a trade surplus on manufactured goods. Countries that run a trade surplus with China are those that supply raw materials (especially oil but also agricultural commodities, metals and rubber), those that supply components for electronics, such as integrated circuits or LCDs, especially the Asian newly-industrialised economies, and those that supply high-end machinery and consumer goods, eg Switzerland. China holds an especially strong hand in negotiating with these countries. Countries that run the largest trade deficit with China are those that have the largest consumer markets: the United States, the European Union and India. They are among the most openly sceptical of the BRI.

Second, China has become a large foreign investor and finance provider. Since 2007, China's outward FDI flows increased from \$27 billion to \$125 billion, ranking fourth in the world, after the US, EU and Japan (UNCTAD, 2018). China has also rapidly become a large foreign creditor, as its external assets have increased from \$2,416 billion in 2007 to \$6,926 billion in 2017, the 8th rank in the world (IMF, 2018). Although it is difficult to compile precise data, partial statistical evidence and anecdotal evidence suggests China is now the largest foreign investor in many developing countries across Asia, Africa and Latin America. For example, Jayaram *et al* (2017) estimate that, in addition to being Africa's largest trading partner by a factor of three, China is now the first provider of infrastructure financing, third provider of aid, and owns the fourth largest stock of FDI in Africa despite being a latecomer.

Third, insofar as the BRI is seen as an infrastructure arrangement, it fills a large unmet need. The *Global Infrastructure Outlook* (Global Infrastructure Hub, 2017) finds that over half of global infrastructure investment needs in the next decades are going to arise in Asia, where \$21 trillion is needed in the period up to 2030¹². Comparing these needs with current investment trends, the *Outlook* identifies an investment gap in Asia of \$3.3 trillion up to 2030, with \$1.4 trillion missing for telecommunication projects, \$0.9 trillion missing for energy projects and \$0.5 trillion missing in each case for transportation and water projects. Taking these numbers at face value, in Asia alone there is an annual infrastructure investment gap of \$275 billion. To put this number into perspective, it compares with \$18.5 billion in total lending by the World Bank Group (World Bank, 2018b)¹³ to South Asia, East Asia and Pacific and Europe and Central Asia, and to \$29 billion of combined operations by the Asian Development Bank¹⁴ in 2017. Infrastructure investment needs on the African continent and in the Americas are smaller but the investment gaps are still significant, amounting to \$2 trillion and \$3 trillion, respectively (Global Infrastructure Hub, 2017).

The need for infrastructure in developing countries is unmet for many reasons, the most important of which is the high-risk and uncertain return associated with long-term investment in environments with weak governance, volatile macroeconomic and political conditions, and fragile public finances. Compounding these deterrents to infrastructure investment, foreign creditors, beginning with the multilateral development banks, have been led by a combination of unhappy experience and the pressure of civil society to adhere to extensive conditions. These come in four main types: a) safeguards relating to sustainability, impact on the environment and on communities; b) conditions relating to governance and macroeconomic stability; c) conditions relating to the financial sustainability of the project; d) proce-

11 Based on WITS (2018) trade indicators. This number is likely to be higher in reality as many oil exporting economies which export to China (Saudi Arabia, Iran, United Arab Emirates) do not report their exports to China. Furthermore, data is only for Mainland China and a significant share of exports reported to Hong Kong are likely to be directed to China.

12 A similar study by the Asian Development Bank (2017) projected infrastructure investment needs in Asia to sum to \$26 trillion between 2016 and 2030.

13 See <http://www.worldbank.org/en/about/annual-report/fiscal-year-data>.

14 See <https://www.adb.org/news/adb-2017-operations-reach-289-billion>.

The BRI fills a large unmet need; in Asia alone there is an annual infrastructure investment gap of \$275 billion

dures relating to procurement, such as open competitive bidding. A pervasive concern about corrupt decision-making underpins the adoption of several of these safeguards. While many of these precautions are clearly necessary, their cumulative effect can result in extremely long project design, approval and execution times. For example, the average duration of all World Bank projects (not just infrastructure), from board approval to conclusion is 5.6 years¹⁵. However, this estimate does not include project preparation and, for infrastructure, the complete project cycle might take twice as long. To communities with urgent needs for water, roads or electricity (not to mention to politicians who want to respond to these needs within an election cycle) the attraction of proposals that can cut through many of these impediments, can be approved quickly and that are turn-key, thus avoiding complicated procurement rules and coordination between multiple providers, is obvious.

Fourth, initial participation in the BRI requires only the signing of a brief four or five page confidential memorandum of understanding, which commits the country to very little beyond agreeing to work with China in line with Xi's framework to identify specific infrastructure projects that might or might not materialise¹⁶. In short, the BRI appears to bring with it significant opportunity while not asking for much other than for giving consideration to specific projects or deals that improve the 'connectivity' to China. The devil is in the details of the projects that follow, which typically require government guarantees and the pledge of collateral.

It is thus not surprising that many countries near and far from China's neighbourhood have expressed a strong interest in the BRI, and that the Chinese have responded. Since its formulation as a proposal to nations in Central Asia, the BRI offer has been extended to South East and South Asia (The 'Maritime Silk Road' sailing south from China along the Indian coast onto the coast of Eastern Africa and onto Europe), and then to eastern and southern Europe, Russia, the Arab countries, East Africa and, most recently, Latin America. In a short time, the BRI has become the touchstone of China's bilateral economic diplomacy and central to its foreign policy. It is Xi's signature initiative and China's Communist Party formally adopted the BRI under its Party Constitution at the National Party Congress in 2017.

An early assessment

The BRI is a young initiative. But, after five years, enough information exists to provide an initial assessment of the strategy. As more data becomes available on the performance of BRI projects, it will be possible to produce a more rigorous evaluation of its progress.

The BRI responds to the unfilled need for investment in infrastructure across the developing world and offers improved access to the world's fastest growing large market. As such, it should be viewed benignly, but it is not. Many observers view the BRI with suspicion. Official donors in Japan, the European Union and the United States have been especially active in voicing concerns. In this section we identify both those concerns that we believe reflect misunderstandings or that are, to a lesser or greater degree, exaggerated, and – crucially – those that reflect the BRI's genuine shortcomings.

Geopolitics

Many critics claim that the BRI is not really a trade or development initiative but a drive to extend China's influence. This charge is part true but is also disingenuous. From the Marshall Plan to the European Coal and Steel Community and to the (ill-fated) Trans-Pacific Partner-

15 Authors' calculations using data from <http://projects.worldbank.org/>.

16 One such memorandum, between China and the government of Victoria, a province of Australia, was recently made public at the insistence of opposition parties and the Australian Federal Government; see <https://www.abc.net.au/news/2018-11-12/victoria-china-belt-and-road-infrastructure-agreement-released/10487034>.

China's heft and the rapidity of its rise present a unique challenge to the established powers; the BRI is gaining traction at a time when the United States and the European Union are on the defensive

ship, initiatives such as the BRI have been motivated by geopolitical and security considerations as much as by economics.

Undoubtedly, China's heft and the rapidity of its rise present a unique challenge to the established powers. It does not help that the BRI is gaining traction at a time when the United States and the European Union are on the defensive. The US Administration has embraced protectionism. The EU is reeling from Brexit and from the advance of national populism across the continent. To assuage worries about its growing weight, China's leaders never tire of declaring that they have no ambition to dominate or to replace the United States in its global leadership role. But should China be believed?

At the core of the debate over China's influence are vastly different perceptions about what China is trying to do. For example, Yan Xuetong, a prominent Chinese political scientist wrote that China believes countries should follow their own paths: "[China] *views national sovereignty, rather than international responsibilities and norms, as the fundamental principle on which the international order should rest*" (Yan, 2019). In contrast, Jim Mattis, the former United States Secretary of Defence, widely considered a moderate, stated in his letter of resignation to President Donald Trump that it was "clear that China and Russia, for example, want to shape a world consistent with their authoritarian model – gaining veto authority over other nations' economic, diplomatic, and security decisions – to promote their own interests at the expense of their neighbours, America and our allies"¹⁷.

To these political debates must be added the hand-wringing over China's *Made in China 2025* plan¹⁸, which sets leadership in high-tech industries as an objective, in direct competition with Germany, Japan, the United States and the other advanced economies – and with a hefty dose of state support to boot. Although the two dozen or so high-tech firms with the highest stock market capitalisation are still predominantly American, Chinese firms in the digital and other sectors are quickly catching up in terms of research and development expenditure and are increasingly replacing European and US incumbent firms in leading R&D positions (Veugelers, 2018).

Valid as these geopolitical and macroeconomic concerns might turn out to be – a matter on which we choose not to deliberate here – it is important to judge the BRI on its merits as a trade and development initiative.

Objectives and priorities

The world is by now familiar with the EU's and the US's trade agreements. Stakeholders might accept or object to specific provisions in the US and EU agreements, or they might accept or reject them outright, but they know quite precisely what they are dealing with. Similarly, the World Bank's approach to lending and the conditions associated with it are clearly spelled out, as, typically, are the Bank's priorities in engaging with specific countries. In contrast, the BRI's objectives as stated, for example, in Xi's Astana speech and as subsequently applied in practice, are extremely broad and its modalities are undefined.

For some observers, this passes as pragmatism ('The Chinese Way'), but in reality, it reflects China's difficulty in coordinating such a vast overseas enterprise. As a result, many inside and outside China are confused about the scope of the BRI. Thus, international observers such as the World Bank, the Center for Global Development and the Center for Strategic and International Studies, describe the BRI differently as "*an ambitious effort to improve regional cooperation and connectivity on a trans-continental scale*" or as a "*vast investment scheme*", or as "*an infrastructure financing initiative for a large part of the global economy*". In its 2015 white paper (NDRC, 2015), the Chinese government described the BRI as aiming to create a single market, ie as "*promoting orderly and free flow of economic factors, highly efficient allocation of resources and deep integration of markets*".

The lack of clarity has political consequences since those who oppose the BRI can define it

17 See, for example, <https://edition.cnn.com/2018/12/20/politics/james-mattis-resignation-letter-doc/index.html>.

18 See <http://english.gov.cn/2016special/madeinchina2025/>.

pretty much as they wish. It also has economic costs since those tasked with executing the BRI can assume that ‘everything goes’ and pick and choose those projects or activities that suit them best, rather than those that correspond to well-defined development priorities.

Geographic scope

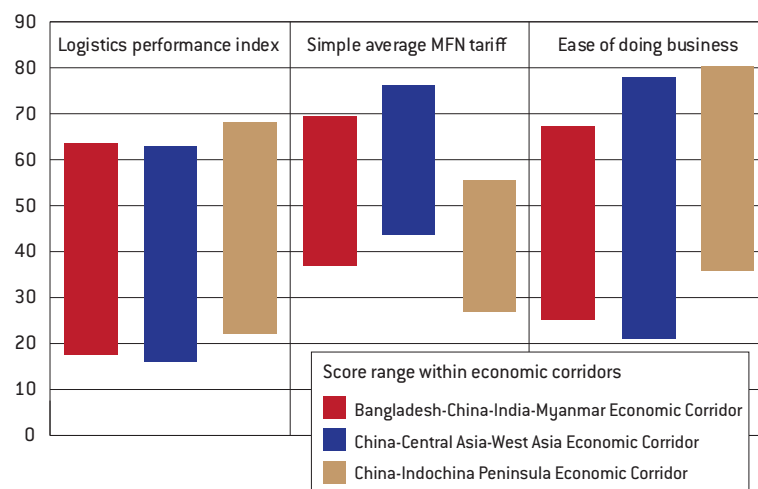
If the BRI’s objectives are not clearly communicated and understood, its geographic priorities are even less so. Intended to replicate the “Silk Road” in Xi Jinping’s original formulation, in the 2015 white paper the BRI is described as covering, but not “limited to, the area of the ancient Silk Road. It is open to all countries, and international and regional organisations for engagement, so that the results of the concerted efforts will benefit wider areas” (NDRC, 2015). In one analysis, the BRI is intended to link China with some 65 other countries that account collectively for over 30 percent of global GDP, 62 percent of population, and 75 percent of known energy reserves (World Bank, 2018c). More recent estimates put the number of countries that are part of the BRI in triple digits.

Even the largest development programmes are normally directed at specific regions, or at countries belonging to a well-defined group (eg the Least-Developed Countries). These programmes also provide some sense of country priorities within them. Not so the BRI. For example, Hillman (2018) identifies the six main geographic channels most often mentioned as constituting the BRI, and the countries most often mentioned as part of each channel. He finds that except for Pakistan – a BRI poster programme – Chinese projects are just as likely to be found outside this group of countries as within it.

Corridors

It is difficult to identify a shared agenda among BRI countries, even within the same geographic corridor. Clearly the needs of poor nations such as Pakistan, Myanmar and several in Central Asia and East Africa, are very different than those of EU members such as the Czech Republic, Portugal and Greece, which the BRI supposedly aims to reach. Countries within the same corridor have world-class infrastructure; in others infrastructure is inadequate. In the same corridor there are countries with good and bad logistics, liberal and restrictive trade policies, and strong and weak business climates (Figure 1). No guide is available from the BRI on how interventions across such a diverse group will be identified and prioritised.

Figure 1: Countries within same economic corridor show significant differences in terms of logistics performance, trade policy and business environment



Source: Bruegel based on World Bank (2018d) and WTO et al (2018). Note: Bars show the range of scores attained by countries within each economic corridor. All scores were rescaled to a range from 0 (lowest) to 100 (highest).

The BRI is often criticised inside China: that it is a waste of resources in a country that is still relatively poor and requires more investment in its own backward regions

State-owned enterprises

China's state-owned enterprises play a major role in the BRI. These firms certainly display genuine advantages, such as low costs and well-honed skills in their areas of specialisation, but they also often benefit from subsidised financing, soft budget constraints, monopoly or oligopoly positions at home, privileged supplier and customer relationships, an implicit or explicit state guarantee and various forms of other non-transparent subsidies. These SOEs will also tend to favour Chinese suppliers¹⁹.

Here is yet another indication that China's state capitalism and its one-party political system sit uneasily in a liberal-democratic world order. The US Congress agrees on little nowadays, but there is consensus across the political spectrum that Chinese policies have to change and that if they do not 'something has to be done about China'. This view is shared to a greater or lesser degree by the US's major allies²⁰.

These criticisms of China are well-grounded as they relate to the internationally most competitive products, such as steel, aluminium, solar panels, semiconductors and the already mentioned high-tech sector. But it is unclear whether this argument also extends to the kind of infrastructure projects being realised under the BRI. If Chinese firms withdrew from the infrastructure sector in developing economies, would others take their place? A dataset²¹ of World Bank infrastructure projects open to internationally competitive bidding suggests that over the last decade, Chinese firms have superseded western firms and gained a dominant share in construction, provision of capital equipment, and project design and engineering. In 2007, 5.5 percent of funds for World Bank projects outside of China were awarded to Chinese companies; in 2017 this share stood at 36 percent of total procured project costs outside China. Chinese firms now mostly face competition from developing countries such as Turkey. As mentioned previously, few private-sector investors are eager to underwrite the risky long-term infrastructure projects that Chinese SOEs are eagerly taking on. Perhaps this is the reason why, while many policymakers and politicians are vocal about the distortions associated with the BRI, the private sector is quite silent.

Allocation of resources

The BRI is also often criticised inside China. The main objection is that it is a waste of resources in a country that is still relatively poor and requires more investment in its own backward regions. Estimates by Dreher *et al* (2017) suggest that total official finance given by the Chinese government could amount to \$350 billion between 2000 and 2014, equal to approximately 0.5 percent of GDP generated in that period in China. This is a significant sum for a developing country and compares favourably with the \$360 billion of official development aid (ODA) and official development finance that was spent in the same period by the United States government. However, most of China's estimated \$350 billion outlay consists of export credits and loans extended at market rates. Counting only official finance granted on

19 Ghossein *et al* (2018) collected data on how Chinese-financed BRI projects select the firms that execute them. The authors find that very little information is available as most state-owned Chinese lenders do not disclose their lending activities: "The limited available data however indicate that Chinese companies account for the majority of BRI-procurement, even in light of their high share of total infrastructure projects in developing countries" (Ghossein *et al*, 2018).

20 This consensus has resulted in at least two concrete steps. First, the EU and the EU have separately brought WTO cases against China, challenging its status as a market economy. And, in 2018, the EU, Japan and the US joined forces to change the rules of the WTO to combat hidden subsidies and intellectual property theft, a thinly veiled attempt to target China specifically. On 12 November 2018, the EU, Japan and the US submitted proposals to the WTO's Council on Trade in Goods that propose stricter rules for the disclosure of government subsidies and introduce administrative sanctions against offending members. These proposals aim mainly at subsidies from Chinese government agencies or state-owned enterprises, which are alleged to lead to overcapacity and disadvantage non-Chinese companies. Furthermore, the EU, Japan and the US plan to increase protection of trade secrets, such as source codes, with instruments within and outside the WTO.

21 See <http://www.worldbank.org/en/projects-operations/products-and-services/brief/summary-and-detailed-borrower-procurement-reports>.

ODA-like terms, Dreher *et al* (2017) estimate Chinese foreign aid between 2000 and 2014 to amount to at least \$75 billion, an amount similar to ODA disbursements from the Netherlands in the same period (OECD, 2018). Thus, China's ODA may amount to only 0.1 percent of GDP between 2000 and 2014²².

Transparency

Lack of transparency is perhaps the defining trait of the BRI and the projects carried out under its umbrella. For example, the BRI is undoubtedly a very large programme, but how large? The amount China has committed under the BRI is unknown and the additional amount envisaged is vague. Numbers mentioned, which may include projects launched before the BRI, range from \$1 trillion over an unspecified period to \$8 trillion over 20 years (Hurley *et al*, 2018). But the formal pledges made up to 2014 to the Silk Road Fund, managed by the Central Bank of China, stood at just \$40 billion.

The discrepancy in these numbers reflects the fact that China's finance comes principally on commercial terms from its state-owned infrastructure firms and development banks, the China Development Bank and the Export-Import Bank of China, and that the grant element in most loans is small or non-existent. These banks do not disclose their lending sums and precise terms are difficult to identify.

The situation is especially murky for those projects that are non-debt generating and take the form of BTO (Build, transfer and operate) arrangements, where the main obligation is to buy the product (eg electricity) at a predetermined price. Other projects are paid off in the form of natural resources according to agreed price formulas, and some are carried out in exchange for a share of ownership in the mine, port or facility in question. How the cost and risks of BRI projects are shared between China and partners and according to which criteria, are not specified.

This lack of transparency in projects financed contrasts with the way in which development finance is normally provided through multilateral channels and most bilateral ones. The provision of aid and the clearance of a World Bank or, say, United Kingdom Department for International Development investment project is subject to a well-defined and transparent review process. In contrast, deals struck under the BRI and involving Chinese commercial banks are not²³. Even the BRI MoU between China and its partners is typically not publicly available. The involvement of China-supported multilateral banks could provide a remedy, but their participation remains marginal at this stage.

Due diligence

Another criticism levelled at the BRI is that some projects, such as a \$12 billion refinery in Ecuador²⁴ or a \$4 billion railway line between Addis Ababa and Djibouti²⁵ have been discontinued or seen enormous financial losses. To be sure, as the long and difficult experience of the World Bank shows, this is not the first time infrastructure projects in a difficult developing country context have run into trouble. Most recently, the World Bank had to cancel a \$265 million road project in Uganda²⁶. However, there is a widespread view, which is also often shared by Chinese observers, that not enough due diligence is present in BRI projects. The

22 In 2016, China reported granting 0.36 percent of its GDP as ODA to the OECD Development Assistance Committee, while the United States reported granting 0.15 percent of its GDP.

23 According to Hurley *et al* (2018), "for multilateral institutions such as the World Bank and the AIIB [Asian Infrastructure Investment Bank], the financing terms for loans to sovereign governments are publicly available. This practice is also followed by most bilateral development finance institutions. However, CDB [China Development Bank] and China Exim Bank do not disclose the terms of their loans, making it difficult, if not impossible, to accurately assess the present value of the debt owed by a country to China".

24 See <https://blogs.platts.com/2016/02/15/ecuadors-refinery-dream-fuel-for-thought/>.

25 See <https://www.scmp.com/business/banking-finance/article/2170549/botched-chinese-railway-project-africa-warning-belt-and>.

26 See <https://www.ft.com/content/cfc5faf2-a81a-11e5-9700-2b669a5aeb83>.

ability of the client to repay, either because of risks inherent in the project, or because of macroeconomic and fiscal constraints, stands out as an issue to which Chinese operators are not paying enough attention.

The possibility that over-eager lenders can push unwary borrowers into bankruptcy or default is not new and not limited to China – as shown by the collapse of banks and companies during the Asian financial crisis, the sub-prime crisis in the United States, the euro-area sovereign debt crisis and the large official lending to poor countries that eventually had to be forgiven (with conditions) under the Highly-Indebted Poor Countries Initiative and the Paris Club. Nor is the build-up of unsustainable sovereign debt usually associated with a single project. World Bank (2019), which analyses the rising indebtedness of low-income countries, shows that the phenomenon is overwhelmingly the result of increased current spending, not investment in infrastructure. Still, the fact remains that some BRI projects are very large compared to the size of the economies of the countries where they are implemented, as in the case of Laos and Montenegro, and that, moreover, projects tend to come in bunches (port, airport, road, all to develop the same region), which can make the overall package too large for the recipient's GDP.

There are well-known examples of Chinese lending proving unsustainable. An international airport and a deep-sea port near Hambantota in Sri Lanka, financed largely with loans from the Export-Import Bank of China, have been running large losses since completion. To escape mounting debt, the maritime port has since been leased for 99 years to China²⁷ and the airport will be operated by the Indian Airports Authorities²⁸. Recently, the government of Pakistan ran into a current account crisis on the back of large BRI infrastructure projects that increased public debt and worsened the balance of trade. Now, the country is seeking financial assistance from the IMF²⁹. Related worries arise over the financial sustainability of the China-Laos railway line as the project cost, \$6 billion, is equivalent to half of Laos's yearly GDP³⁰. Several of the countries interested in the BRI have low credit ratings, high debt and weak governance, and appear set to borrow new large amounts from China. Hurley *et al* (2018) identified eight countries where high debt levels, low credit ratings and high likely borrowing under the BRI cause concern: Djibouti, the Maldives, Laos, Montenegro, Mongolia, Tajikistan, Kyrgyzstan and Pakistan. Most of these countries have borrowed from the Export-Import Bank of China for very large infrastructure projects, the costs of which amount to double digit percentages of the countries' GDPs.

Policy implications

China's efforts to forge stronger links with its neighbours and more widely with its trading partners around the world are legitimate, so long, of course, as the underlying intent remains peaceful. The same can be said of any other country. The focus on infrastructure is welcome and needed. Enhancing bilateral trade by building transport infrastructure and concluding trade agreements will ultimately have the effect of stimulating global trade as well. The infrastructure investments under the BRI could reduce *global* trade costs by between 1.1 percent and 2.2 percent (de Soyres *et al*, 2018), even without accounting for efforts to improve the operation of customs and reducing other forms of barriers to trade.

Two facts are clear. First, China, the world's most populous nation, is not ready for a wholesale departure from the state-capitalist development model that has worked so spectac-

27 See <https://www.ft.com/content/e150ef0c-de37-11e7-a8a4-0a1e63a52f9c>.

28 See <https://economictimes.indiatimes.com/news/politics-and-nation/sri-lankan-government-reworking-mou-on-airport-deal-with-india/articleshow/65281702.cms>.

29 See <https://www.ft.com/content/005393f2-cd2d-11e8-9fe5-24ad351828ab>.

30 See <https://asia.nikkei.com/Politics/China-s-Belt-and-Road-rail-project-stirs-discontent-in-Laos2>.

To be effective, the BRI needs to meet the basic conditions of a trade and development strategy: clear objectives, adequate resources, selectivity, a workable implementation plan, due diligence and clear communication

ularly for it, and of which the BRI is in some sense an offshoot. Second, China is fully committed to the BRI and, one way or the other, it is going to continue along that path.

But the BRI, to be effective, needs to meet the basic conditions of a trade and development strategy, which are clear objectives, adequate resources, selectivity, a workable implementation plan, due diligence and clear communication. The established donors are right to be concerned that some of these conditions are not met, especially regarding issues related to due diligence and, more specifically, fiscal sustainability.

Detailed proposals for revamping the BRI are beyond our scope. But it is obvious that the BRI needs a better articulated, coordinated and more transparent plan that identifies objectives by corridor and by country and in each case specifies modalities. Clear communication is important given China's size and the challenge of coordinating such a broad endeavour within and outside of China. In a politically-charged environment, a failure to clearly define the BRI risks inflaming and empowering the opposition. Most importantly, China must do a better job of evaluating the risks and costs of projects. Chinese firms and banks have plenty of bad domestic loans to worry about; they do not need a set of international debt crises to deal with as well.

The BRI is and should remain primarily a Chinese initiative to retain its advantages in terms of access to financial resources, speed and execution. However, a more systematic effort to collaborate with multilateral institutions and learn from accepted standards where it is possible to do so – such as is envisaged in the MoU signed in 2017 with the multilateral development banks, could help overcome some of the BRI's shortcomings. A more transparent approach is likely to help Chinese and international firms to decide where their investments should go. And, if China envisages a BRI that will require several trillion US dollars of investment, it would surely benefit from leveraging its own efforts using other funds from bilateral and multilateral donors, and from the international private sector.

For many developing countries and even for some relatively wealthy nations such as Australia, New Zealand and EU members to the south and east, the BRI could represent a significant commercial and infrastructure investment opportunity and should be viewed as such. But, considering the preceding discussion, these nations should take special care in evaluating the projects and the commercial conditions attached to them. They should not rely on their Chinese counterparts for *ad-hoc* project proposals, and should instead develop their own infrastructure strategies based on a benefit-cost analysis of the main projects, yielding clear priorities. Obviously, money must be repaid, and the ability to pay for a large project must be evaluated based on the overall national fiscal condition, not just on the project's intrinsic profitability.

The Great Powers that vie with China for influence and for markets would be well advised to adopt a constructive stance toward the BRI. While insisting that China reforms its initiative along the lines of greater transparency, improved due diligence and safeguards, the EU and US should also acknowledge that there are very important areas of synergy between their own efforts and those of China. The BRI is consistent with their development efforts. It should be easy to see that infrastructure investment in Africa and expanded African trade can also improve the EU's commercial and investment prospects, and might even be in Europe's security interest writ large. The EU also has an interest in a Eurasian land bridge, which could provide a non-trivial boost to Europe-Asia trade (García-Herrero and Xu, 2016). The EU has also responded by highlighting its own connectivity initiatives linking the EU and Asia, which remain very modest in scope in comparison to the BRI³¹. Similarly, Latin America, in whose prospects and stability the United States has a vital economic and security interest, could benefit greatly from the BRI.

A notable effect of the BRI is to pose a challenge to the established donors to increase and accelerate their provision of infrastructure in developing countries and even within their own borders. Insofar as the BRI represents increased competition for stodgy development banks in

31 See https://eeas.europa.eu/regions/central-asia/52916/connecting-europe-asia-eu-strategy_en.

infrastructure provision, that is all to the good. The Compact with Africa (CwA), a G20 initiative that began under the 2016-2017 German G20 presidency, is intended to stimulate investment in African infrastructure by improving macroeconomic management, strengthening the business environment and attracting private sector interest. About a dozen African nations have joined the Compact and initiated a wide range of reforms. The CwA is an example of the kind of response that is needed, though one that remains untested for lack of enough private sector response to date.

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