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China's Belt-and-Road Initiative: Future Bonanza or Nightmare?

By Linda Lim

Synopsis

Despite its growing prominence internationally, China's Belt-and-Road Initiative (BRI) is facing a host of challenges. Unless these are addressed, Beijing will find the BRI ending up more a nightmare than a bonanza.

Commentary

XI JINPING'S signature Belt-and-Road Initiative, BRI (which the rest of the world still calls One-Belt-One-Road or OBOR) has attracted a great deal of global attention. The United States and some European Union countries are apprehensive that BRI signals China's attempt to dominate the two-thirds of the world's population, and 40 percent of global trade, accounted for by BRI countries.

BRI links China with faster-growing emerging markets, providing an alternative to slow-growing, increasingly protectionist Western markets, and outlets for its abundant domestic savings and industrial excess capacity. Developing infrastructure and relationships in BRI countries will help private and state companies venturing abroad, where they will learn to compete internationally and thus "become stronger", while also moving China "closer to (the world's) centre stage", as President Xi wishes.

Challenge of Infrastructure Play

But funding infrastructure projects is always a challenge. They are large, capital-intensive and expensive, with long construction and payback periods, thus involving high risk. They are also characterised by externalities or spillovers: because social exceed private costs and benefits, left to private investors there will be under-investment.

Because of this, public funding is the most common funding model for infrastructure projects. Governments can borrow at lower cost than private entities, given an implicit sovereign guarantee against default. They have a longer time-horizon, and investing to prioritise social benefits in instances of “market failure” is their responsibility.

Consortia are also a popular model, involving public-private partnerships, and multilateral and regional agencies, such as the World Bank, Asian Development Bank, and Asian Infrastructure Investment Bank. Consortia can raise more capital and obtain more expertise from diverse multiple sources, and reduce the risk for any individual lender/investor as well as the borrower/project.

In developing countries capital is scarce, so at a premium, while borrowing from cheaper foreign sources requires repayment in foreign exchange, adding currency risk. Governance risk arises from governments often lacking the expertise to evaluate, implement and monitor projects, and leakage through corruption is common, increasing cost, delay and quality problems.

Political and Other Risks

There is also political risk, since the distribution of costs and benefits may not be equitable, and social unrest may result from disputes over land appropriation and compensation, labour, and environmental consequences such as harm to local farming, forests and fisheries. Authoritarian governments are not transparent, and may use coercion to resolve disputes, while democratic governments may change and demand changed terms.

BRI countries pose additional high country risks. Many are low-income so lack capital, human resources, and capacity to earn export revenues to pay for imports of materials and equipment for BRI projects, posing high risks of debt and currency crisis. There may be domestic political or economic turmoil, unstable or unpopular governments, and contentious relations with neighbours sharing or affected by projects like dams.

A recent study by the Centre for Global Development identified eight countries (Djibouti, Kyrgyzstan, Laos, Maldives, Mongolia, Pakistan, Montenegro, Tajikistan) where the immediate marginal impact of BRI projects in the lending pipeline would raise their debt-to-GDP and debt-to-China ratios to “high risk” levels.

Even without such debt concerns, China’s eagerness for infrastructure projects in BRI countries may not mesh with perceived local needs and could heighten political risk for host governments who collaborate with them.

For example, in relatively developed Malaysia, one business person I interviewed said: “Most of the OBOR initiatives in Malaysia are not positive for the country. The large infrastructure projects like railways and ports are strategic for China but will be white elephants for Malaysia. The deal terms are poorly contrived for Malaysia. But Malaysia only has itself to blame for letting its politicians make such deals.”

Chinese Business Model

The preferred Chinese infrastructure business model does not help win local support, based as it is on exporting Chinese equipment, materials, management and labour to the recipient country so there is minimal local content, job creation, training and supplier linkages. This adds to the perception that BRI projects are for China's rather than host countries' benefit.

As another business respondent put it: "The Chinese are relentless in pursuit of profit/advantage without considering negative implications for local communities." Chinese companies have been accused of poor business practices, such as undercutting local suppliers, failing to honour contracts and to comply with local regulations, while delivering inferior quality and reliability, such as plagued Chinese-built power plants in Indonesia.

Another business person familiar with BRI projects told me: "Big Chinese companies are unfamiliar with private enterprise and market economies, because they are all linked to the Chinese government and follow a top-down mode of operation. They are comfortable only with G2G deals."

Chinese companies' preference for working through local political leaders, rather than directly with communities affected by their projects, may mean that project social costs are not adequately calculated and compensated for. This results in protests which can stall projects, as has happened with the Myitsone dam and Kunming-Kyaukphyu railway and oil-and-gas pipeline in Myanmar.

If the local leaders China works with are incompetent, corrupt, greedy or unpopular, this rubs off on them, while dissatisfaction with Chinese projects can rub off on the local leaders who collaborate with them — in both cases, heightening political risk.

China's Creeping Arrogance

In Sri Lanka, the government's leasing Hambantota port to a Chinese state-owned company in payment of debts incurred for its construction contributed to its local electoral losses in February 2018. And in Indonesia, there are rumours that President Jokowi's encouragement of Chinese investments could undermine his prospects for reelection in 2019.

Chinese companies also lack experience operating in ethnically and culturally diverse countries, and are frequently accused of lacking respect for local practices and customs, such as observation of Muslim prayer times and the fasting month. They show no interest in learning about or understanding local populations (or eating their food), displaying what one of my respondents called "unconscious arrogance due to their superior feeling of the success of China".

This can backfire on local ethnic Chinese populations in Southeast Asia, who already dominate business in some countries, are favoured as local partners by Chinese companies, and would be resented if seen to benefit disproportionately from China investments. Other local Chinese worry that the unpopularity of high-profile Chinese projects could exacerbate latent anti-Chinese feelings that could adversely affect them.

What Can China Do to Correct Image?

What can China do to counter these destabilising negative perceptions of BRI projects?

First, Chinese companies should undertake only projects which are financially, economically and politically viable, and environmentally and socially sustainable. Including such calculations means many projects will not make the cut. Second, they should partner with other lenders and investors, from different countries. Diversification reduces risk, and dilutes the image of being Chinese.

Third, they should make investment decisions together with the host country, not unilaterally, to ensure that the projects are “mutually advantageous” as claimed. Fourth, they can help recipient countries to repay their loans by earning foreign exchange, for example, by establishing industrial zones for companies relocating labour-intensive manufacturing from China, and by developing markets in China for their exports.

Fifth, they should employ better public relations. This includes being transparent and communicating with local media and host communities about project rationales. And they should reduce high visibility – opening ceremonies should include other foreign partners and investors as well as more locals, and projects should be “branded” not as “Chinese” but as “national” projects, to reduce fears of a loss of sovereignty.

Sixth, they should employ locals as labour and management, provide technical and skills training, and work with all stakeholders, not just the government or party-in-power. In addition, they should train, encourage and expect their Chinese employees to understand, respect and engage with local cultures. All this requires fundamental changes in corporate culture and business model.

Be ‘Less Chinese’

In short, to be successful, BRI projects should become less Chinese. While this might seem to run counter to China’s hope for “soft power”, the billions invested will otherwise not deliver, and may even undermine, its foreign policy goals.

Today, with a massive US\$57 billion investment in energy and infrastructure projects in the China-Pakistan Economic Corridor, the Pakistan government has to employ a 15,000-strong military force to protect Chinese workers. Despite this, in February 2018, a Chinese shipping executive was shot dead in his car in Karachi in “a targeted attack”. If China does not learn to adapt to life outside the Great Wall, the Belt-and-Road Initiative risks turning into a foreign policy nightmare, not a bonanza.

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