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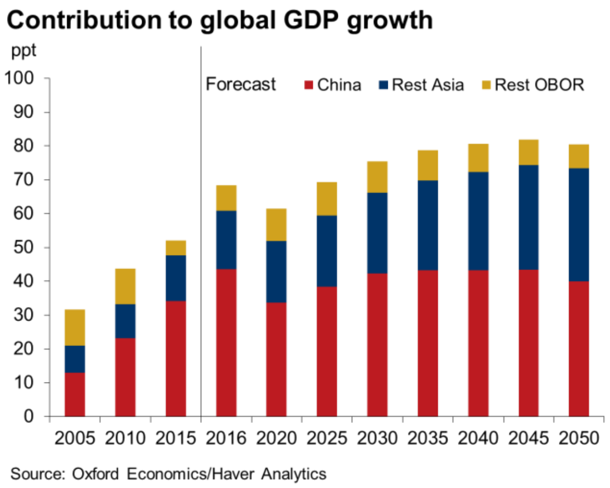
Research Briefing | China

One Belt, One Road – China's grand ambition

Economist

Tianjie He
Economist
+852 3103 1086
Louis Kuijs
Head of Asia Economics
+852 3103 1096

- **Dubbed by some as a modern-day Marshall Plan, China's One Belt, One Road (OBOR) initiative will build roads, ports and railway tracks along ancient trading routes to Asia, Europe, the Middle East and Africa. This will support long-term growth and development in the economies involved through better connectivity and cement China's global influence. However, we do not expect it to have a major impact on mopping up excess capacity in China's heavy industry.**
- Launched in 2013 by President Xi Jinping, OBOR is a China-backed global connectivity initiative, aiming at creating a better infrastructure network spanning 65 countries covering 60% of the global population and about one third of global GDP.
- While it's hard to quantify the total number of projects and amount of financing, the China Development Bank alone has reserved US$890 billion for over 900 projects, highlighting the magnitude of this undertaking. Nevertheless, we think that the short-term impact of OBOR on total investment and overall economic growth in the vast region is likely to be modest.
- That said, if well managed, we expect the OBOR to support long-term growth and development in the economies involved, particularly in some of the least developed parts of the world, although China needs to avoid its engagement with recipient countries becoming unbalanced - that China's manufacturing exports crowd out domestic production and result in trade deficits that may lead to economic and/or political tension.
- We also expect it to help boost China's global influence. However, while Chinese construction firms will largely benefit from new opportunities for overseas infrastructure construction, we do not expect the OBOR to have a major impact on mopping up excess capacity in China's heavy industry.



OBOR could further boost growth in an already rapidly growing part of the world, and OBOR triggered infrastructure, trade and investment reduce downside risks to growth.

Contact: Tianjie He | tjhe@oxfordeconomics.com

One Belt, One Road: a glimpse of China's ambition

China's OBOR aims to improve global connectivity – in terms of both physical infrastructure and finance, trade, policy coordination, and "people-to-people" connectivity

Launched by President Xi Jinping in September 2013, the "One Belt One Road" (OBOR) initiative is designed to improve global connectivity and enhance physical infrastructure, to better link China with the rest of Asia, Europe, Africa and the Middle East, and facilitating financing to support infrastructure construction. It also seeks to boost "soft" connectivity, such as trade and investment liberalisation, and "social and cultural exchange"[1]. In this *Research Briefing* we discuss the key drivers and objectives of the initiative, highlight the results, and examine the possible future impact, globally and on China's own economy.

Originally a political slogan forming part of Xi's 'China Dream'[2], One Belt, One Road was fleshed out in more detail in the action plan for the implementation of the initiative released in March 2015. The plan maps out the land-based *"Silk Road Economic Belt"* (the Belt) and the oceangoing *"21st Century Maritime Silk Road"* (the Road) (Chart 1).

Chart 1

Source: Xinhua News Agency

It envisages the creation of multiple economic corridors under two trade routes…

The Belt connects China with Central Asia and Europe, focusing on a "Eurasian land bridge" – a logistics chain from the east coast of China to Western Europe – and economic corridors connecting China with Mongolia and Russia, central Asia, West Asia and Southeast Asia. The Road links China's east coast to Europe via the South China Sea and the Indian Ocean, aiming to build efficient transport routes between major sea ports and connecting China with Southeast Asia, Oceania, the Middle East, and North Africa through the Mediterranean.

…encompassing 65 countries, with 4.5 billion people and about one-third of global GDP

In its broadest definition, the OBOR scheme involves 65 countries (See Appendix) with a combined population of 4.5 billion (60% of the world's total) and about one-third of global GDP. China's government is devoting significant amounts of political capital, energy and money to it. Responding to criticism that OBOR seems a solo act by China, President Xi instead describes it as a "chorus". This language is meant to alleviate concerns abroad that China will dominate the initiative and projects.

[1] The Ministry of Culture released an action plan for the OBOR cultural development in December 2016.

[2] The 'China dream' is President Xi's signature slogan, aiming to build a 'moderately prosperous society' by 2021 and to realise the 'great rejuvenation of the Chinese nation'.

Contact: Tianjie He | tjhe@oxfordeconomics.com

The OBOR has multiple objectives, including explicit goals to stimulate Asian and global economic growth, and implicit ones such as redirecting China's domestic overcapacity

The initiative is a means to multiple ends. Explicitly, it is intended to increase prosperity for the underdeveloped parts of China, particularly in the west of the country, through domestic investment and economic integration with Asian neighbours. It is also meant to foster greater connectivity and economic development along the routes, promising an infrastructure boost for Asia's least connected regions. Moreover, Beijing expects the OBOR to secure China's energy supply through diversification of import sources and transport routes.

Among the more implicit goals, China tries to find new sources of growth abroad, especially for construction companies and various industries suffering from excess capacity. OBOR also supports outward investment and RMB internationalisation. It helps to diversify export markets and promote the international expansion of Chinese technology as part of its broader plan to upgrade its place in global production and value chains. Moreover, the OBOR is a vehicle to expand the political influence and the reach of Chinese power in Asia and elsewhere.

What has happened so far?

Since its launch in the fall of 2013, the OBOR has gradually gained traction with new projects and financing coming on stream

Since its launch four years ago, OBOR has gradually gained traction with new projects and financing coming on stream, such as the flagship 418-kilometer rail link with Laos and the US$46bn China-Pakistan Economic Corridor (CPEC). More than 100 countries and international organisations have joined the initiative, with nearly 50 having signed inter-governmental cooperation agreements with China on joint construction.[3] On May 14-15, Beijing will host a high-level Belt and Road Forum for International Cooperation (BRF). China intends to review progress and discuss ways to boost cooperation. Its leadership sees it as an important diplomatic event to pitch the OBOR.

While there is no official data on the total number/value of OBOR projects, the China Development Bank (CDB) said in 2015 that it had reserved US$890 billion for over 900 projects (in transportation, energy, resources and other sectors) across 60 countries.[4] Meanwhile, the Export-Import Bank of China (EXIM) said in early 2016 that it had started financing over 1,000 projects in 49 OBOR countries.[5] Most of the existing projects are concentrated in South Asia, Southeast Asia and Central Asia, given their geographical proximity and close relationship with China, but there are also investments in East Africa and Southeast Europe. We have compiled a list of major OBOR projects in the Appendix, based on a People's Daily newspaper report on the achievements of the OBOR initiative published late last year and other news sources.

China's trade, investment and construction activity in OBOR countries is on the rise

While the impact of the plan is hard to quantify at this stage, China's trade, investment and construction activity in OBOR countries is on the rise. China's bilateral trade with 65 countries along the OBOR was US$962 billion in 2016, one quarter of the total. The share of exports going to the OBOR region has grown steadily, to 28% in 2016 (Chart 2), nearly 12 ppts higher than the share of exports to the EU and 10 ppts higher than that to the US. The share of China's imports coming from OBOR countries has fallen in recent years (measured in US$). While this is in part because of the fall in commodity prices, it also points to possible problems with China's economic engagement with the OBOR countries

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[3] He Lifeng, Director of the National Development and Reform Commission (NDRC) highlighted during the 2017 NPC meetings in March.

[4] Vice President of CDB, Li Jiping reported in 2015, according to the State Council Information Office http://www.scio.gov.cn/ztk/wh/slxy/31213/Document/1436404/1436404.htm

[5] EXIM Bank's press release on 14 Jan 2016, http://www.eximbank.gov.cn/tm/Newlist/index_343_27977.html

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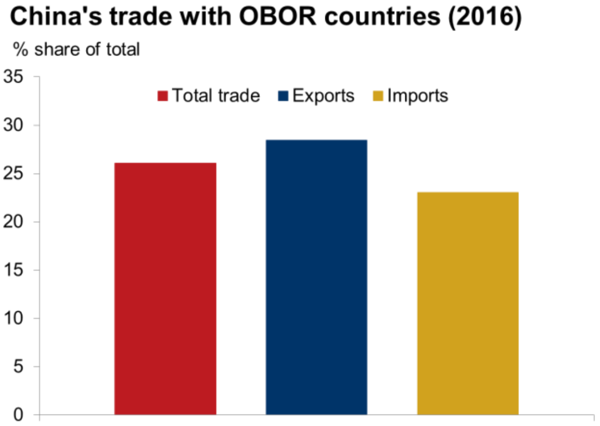
– that China's manufacturing exports crowd out domestic production and result in trade deficits that may lead to economic and/or political tension.

Chart 2



Source : Oxford Economics/CEIC

The share of China's exports going to the OBOR region has grown steadily, to 28% in 2016, but the share of China's imports coming from OBOR countries has fallen in recent years (measured in US$).

According to China's Ministry of Commerce, non-financial outward direct investment to OBOR countries totalled US$14.5 billion last year, slightly less than in 2015, when China's overall ODI (including non-financial ODI) to OBOR countries rose twice as fast as total ODI. Also, the value of new engineering contracts signed by Chinese companies in the OBOR region has increased steadily – it rose 36% y/y in 2016. Moreover, China has established 56 economic and trade cooperation zones in 20 countries along the route by end-2016, with investment exceeding US$18 billion.

Where is the financing coming from?

To provide development funding, three new initiatives have been launched: the Asian Infrastructure Investment Bank (AIIB), the New Development Bank (NDB) and the Silk Road Fund, with a total initial capital base of US$240 billion (Table 1).

Table 1

China has set aside huge amounts of financial resources to fund the physical aspect of the OBOR

Funding Mechanisms (in US$ billion)

Institutions	Authorised capital size	Recent lending per year	Possible lending per year by early 2020s
Multilateral development banks			
Asian Development Bank (AIIB)	100	1.7	10-15
New Development Bank (NDB)	100	1-1.5	5-7
Silk Road Fund	40	2-3	2-3
Commercial banks	An estimated US$90 bn annual lending by the "big four" banks in 2016		
Policy banks			
China Development Bank (CDB)	…	15 (2015)	…
Export-Import Bank of China (EXIM)	…	24 (2015)	…

Source: Oxford Economics, company annual reports and press releases

While these new institutions have started to play an active role in project financing, most of the funding for OBOR projects actually comes from China's policy banks and commercial banks. Based on the annual reports and public announcements by the "big-four" state-owned banks, we estimate that together they have extended US$90 billion

Contact: Tianjie He | tjhe@oxfordeconomics.com

But we think short-term impact of OBOR on total investment and overall economic growth in the region is likely to be modest

loans to the OBOR countries in 2016, while China's policy banks are also major lenders (Table 1). Thus, bilateral financing from China's commercial and policy banks dwarfs multilateral financing and we expect that to remain the case in the future.

Nevertheless, even the combined annual financing flows likely to be generated by these and other international multilateral institutions (such as the World Bank and Asian Development Bank) are modest compared to infrastructure spending and needs in the vast OBOR region (the Asian Development Bank estimates the annual infrastructure investment needs at US$1.7 trillion until 2030). Thus, the OBOR scheme is unlikely to "crowd out" other international development cooperation. However, this also implies that the short-term impact on total investment and overall economic growth in OBOR countries is likely to be modest.

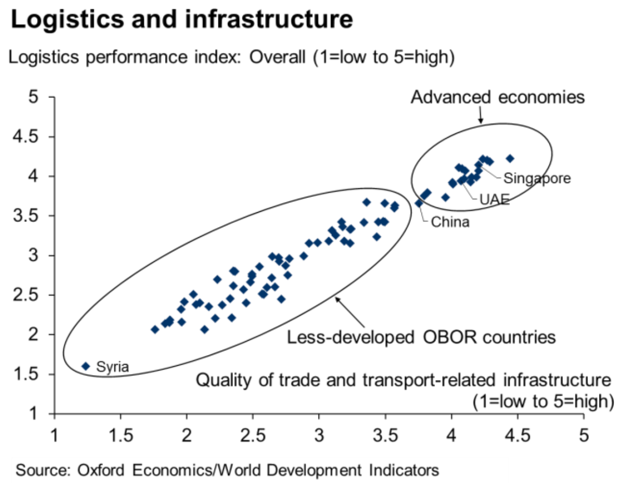
Likely impact – outside China

If well managed, we expect OBOR to support long-term growth and development in the economies involved through better infrastructure connectivity

Despite the modest short-term macro impact, if well managed, we expect OBOR to support long-term growth and development in the economies involved. Better infrastructure should facilitate trade and investment, create new market demand and contribute to global development. OBOR generated infrastructure may in particular benefit some of the economically least developed parts of the world, including Central and South Asia, which have especially large infrastructure gaps and often have difficulties financing new projects.

As noted, there is clearly a lot of room for developing infrastructure in OBOR countries. The level and quality of logistics and infrastructure is generally low, compared to developed countries (Chart 3). Infrastructure deficiencies mean high transport costs, which hamper market access, cross-border trade and economic development. If China's own experience is any guide, better infrastructure and greater regional connectivity should improve access of OBOR countries to the global market, better leverage comparative advantages and underpin long-term development.

Chart 3



While there is large variation, overall the quality/level of logistics and infrastructure is low in OBOR countries, compared to the developed ones.

OBOR could further boost growth of an already rapidly growing part of the world and...

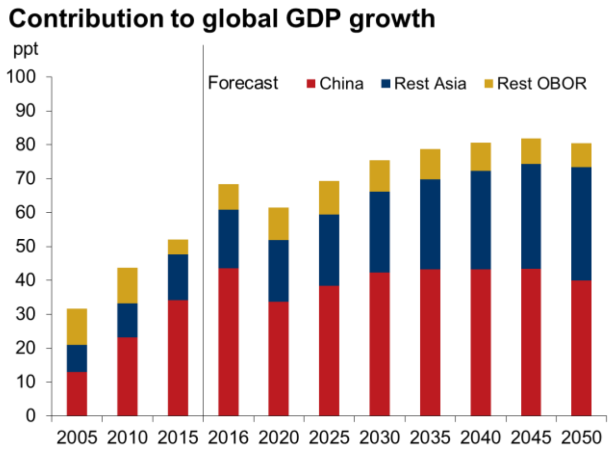
OBOR infrastructure could further boost growth in an already rapidly growing part of the world. GDP growth in OBOR countries averaged 4.2% in 2014-16, compared to the global average of 2.6%. We estimate that the region contributed 68% of global GDP growth in

Contact: Tianjie He | tjhe@oxfordeconomics.com

...OBOR triggered infrastructure, trade and investment reduce downside risks to growth

2016, with Asia's contribution (including China) well above 50% (Chart 4).[6] We estimate that by 2050 the OBOR region will contribute 80% of global GDP growth, with China's share remaining broadly stable at around 40% and that of the rest of Asia doubling from the current 15% to over 30%. This fairly constructive projection of the OBOR region is subject to downside risks, including from global trade protectionism and, domestically, from supply side constraints. OBOR infrastructure, as well as regional trade and investment collaboration, reduce those downside risks.

Chart 4



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What is in it for China?

It helps to boost China's regional and global influence

OBOR helps to boost China's regional and global influence by providing "public goods" and taking on significant financial risks that other investors would shy away from. The establishment of the AIIB shows China's attempt to reform the global financial governance system to accommodate its increased economic influence. Setting up the AIIB may have speeded up the long-stalled reform to the governance of the International Monetary Fund (IMF) to give emerging market contributors greater voice – this was finally approved by the US Congress in late 2015. Meanwhile, the Asian Development Bank (ADB) pledged to increase its lending capacity to remain relevant and effective in the region. Regardless of whether these moves were directly motivated by the AIIB, healthy competition will improve the efficiency of resource allocation and stimulate global financial governance reform.

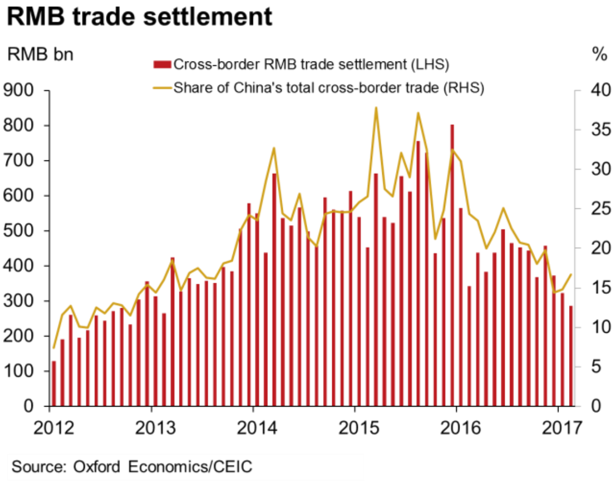
It could boost the internationalization of the RMB, if China will eventually remove its capital account constraints

Furthermore, OBOR could boost the internationalization of the RMB by encouraging its use in both trade and financial transactions. RMB trade settlement increased to an average 30% of China's total cross-border trade in 2015, from a mere 7% at the beginning of 2012 (Chart 5). However, its share fell in 2016, largely because of the pressure on the RMB and measures to contain capital outflows. Indeed, China's capital controls presents a fundamental constraint for RMB internationalization. Without an open capital account and unfettered access to onshore financial markets, the incentive for nonresidents to hold the RMB is limited. But, if, as we expect, China eventually liberalizes its capital account, we expect the room for RMB internationalization will be boosted by the OBOR initiative as regional trade and investment networks further expand and deepen.

[6] Our global economic forecast, which covers 62 out of 65 countries along the routes

Contact: Tianjie He | tjhe@oxfordeconomics.com

Chart 5



The OBOR could boost the internationalization of the RMB by encouraging its use in both trade and financial transactions, but under the condition that China eventually liberalizes its capital account.

But we do not expect the OBOR to have a major impact on the excess capacity in China's heavy industry

For China's domestic economy, some policy makers see OBOR as a way to find new sources of demand abroad, especially for Chinese construction firms and excess capacity industries. We think Chinese construction firms will benefit significantly from OBOR. However, we do not expect it to have a major impact on the excess capacity in China's heavy industry.

Based on the scale of OBOR investment as shown in Table 1 above, the annual demand for heavy industry products in OBOR projects will simply not be large enough compared to the scale of overcapacity in China's heavy industries. In our rough estimation, total annual OBOR spending of US$140 billion per year would generate around 22 million ton of annual steel demand at current prices.[7] That compares to estimates of excess capacity in China's steel industry ranging from 250 to 450 million ton per year. Moreover, it is expensive to transport heavy industry products over long distances; sourcing closer to the project will often be more economically efficient, especially for cement. Finally, as suggested above, political considerations make it unviable for OBOR projects to rely too much on imports and services from China. As noted by David Dollar of Brookings, recipient countries, especially those with relatively strong governance and sizable local domestic industries, such as India and Indonesia, are very unlikely to be willing to see Chinese companies doing all the work and/or accept large amounts of Chinese debt.[8] While this may be different in countries with weaker governance that are more accommodative, such as Pakistan or Cambodia, that is a double-edged sword since there financial risk of projects will be higher.

In conclusion, China has devoted significant amount of political capital, energy and financial resources to the ambitious OBOR initiative and it has made some notable progress over the past three years. The short-term macro impact is likely to be modest. However, if well managed, we expect the initiative to support long-term growth and development in the economies involved. And it should raise China's international influence and eventually help the internationalization of the RMB. We also think the OBOR will benefit China's construction firms via new sources of demand, but we do not expect it to have a major impact on excess capacity in China's heavy industry.

[7] This assumes spending on steel is 15% of the total project construction costs and a conservative total mark up of 100% from the steel mill to the project.

[8] "China's Rise as a Regional and Global Power: The AIIB and 'one belt, one road'", July 2015.

Contact: Tianjie He | tjhe@oxfordeconomics.com

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Appendix

Table 1

"China plus 64 countries" along the Belt and Road	
Region	**Country**
East Asia	China
Southeast Asia	Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Timor-Leste, Vietnam
Central Asia	Kazakhstan, Kyrgyzstan, Mongolia, Tajikistan, Turkmenistan, Uzbekistan
South Asia	Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka
Middle East and Africa	Bahrain, Egypt, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Oman, Qatar, Palestine, Saudi Arabia, Syria, United Arab Emirates, Yemen
Central and Eastern Europe	Albania, Armenia, Azerbaijan, Belarus, Bosnia & Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Latvia, Lithuania, Macedonia, Moldova, Montenegro, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Turkey, Ukraine

**Oxford Economics' Global Economic Model (GEM) covers 62 out of 65 countries listed above (except Timor-Leste, Turkmenistan and Palestine)*

Table 2

Major projects under the OBOR 2013 - to present		
Location	**Project**	**Timeline**
Southeast Asia		
Laos	China-Laos railway	Started in Dec-15
Myanmar	Sino-Myanmar crude oil pipeline	Began operation in Jan-17
Vietnam	Hai Duong thermal plant	Started in Apr-15
	Yongxin coal-fired power plant	Started in Jul-15
Indonesia	Jakarta-Bandung high-speed railway	Started in Jan-16
Thailand	China-Thailand railway	Expected to start this year
Central Asia		
Kyrgyzstan	Bishkek power station	Reconstruction started in May-14
Uzbekistan	Kamchiq tunnel	Began operation in Jun-16
Kyrgyzstan-Uzbekistan	China-Kyrgyzstan-Uzbekistan railway	Restarted in Jan-16
Tajikistan	Vahdat-Yovon railway	Started in May-15 & completed in Aug-16
South Asia		
Pakistan	China-Pakistan economic corridor - a collection of infrastructure projects worth about US$46 billion	
	Port of Gwadar	Began operation in Nov-16
	Karot hydropower project	Started in Jan-16
	Karachi nuclear power plant	Started in Mar-16
	Peshawar-Karachi highway	Started in May-16
Bangladesh	Padma bridge	Started in Aug-16
Nepal	Pokhara International Airport	Started in Apr-16
Sri Lanka	Hambantota port	Second phase completed in Aug-16
Middle East		
Saudi Arabia	Yanbu refinery project	Began operation in Jan-16
Egypt	EETC 500kV transmission lines project	Started in Jul-16
Africa		
Ethiopia	Ethiopia-Kenya power transmission line	Started in Aug-16
	Ethiopia-Djibouti electric railway	Began operation in Oct-16
Kenya	Mombasa–Nairobi standard gauge railway	Started in Jan-15
Nigeria	Abuja-Kaduna railway	Began operation in Jul-16
Europe		
	China-Europe freight train service now has 51 routes linking 27 Chinese cities to 28 European cities*	
Russia	Moscow-Kazan high-speed rail	Started in Jun-15
	China-Russia East Route natural gas pipeline	China section started in Jun-15
Hungary-Serbia	Budapest-Belgrade railway	Hungary-Serbia section started in Dec-15
Belarus	China-Belarus Industrial Park	Basically completed in Sep-16
Azerbaijan	Trans-anatolian natural gas pipeline	Started in Mar-15
UK	Hinkley Point C nuclear power	Started in Sep-16

*Source: Oxford Economics, People's Daily, *Xinhua news report on 16 April 2017*

Contact: Tianjie He | tjhe@oxfordeconomics.com