SUMMARY

- Internationally, the “One Belt One Road” project will unleash a regional infrastructure boom by connecting China with Asia, Europe and Africa by land and sea, and boost renminbi internationalisation by encouraging its use in both trade and financial transactions.
- Domestically, it will help export China’s excess capacity, which should enhance investment returns and stabilise growth. Rather than a means of reviving China’s excess investment, it is a medium-term step to help rebalance China’s economy via consumption-led growth.
- Politically, Beijing is using the project to secure foreign trade relationships in response to some major trade pacts that have excluded China. However, the potential risks to China associated with the “One Belt One Road” strategy are not negligible.

China’s “One Belt One Road” (OBOR) project is a political-economic strategy conceived to “kill three birds with one stone” by achieving long-term international, domestic and political objectives. It is also evidence that Beijing is developing a coherent set of policies to realise President Xi Jinping’s “Chinese Dream”, in which he seeks to combine national and personal aspirations to “reclaim national pride and enhance personal well-being”. In economic terms, this amounts to creating incentive compatibility between the state and the people to maximise national and individual interests.
What is “One Belt One Road”?  
OBOR is also dubbed the “New Silk Road”, as it borrows the concept of the historical “Silk Road” in the late nineteenth century when China built a network of silk trade from Chang'an (now Xi'an) in the east to the Mediterranean in the west. It is President Xi’s strategic plan to connect Asia and Europe by investing in infrastructure projects to enhance trade and cultural relations, supported by vast financial resources, including a USD40-billion Silk Road Fund, the USD100-billion Asia Infrastructure Investment Bank (AIIB) and the USD50-billion New Development Bank (NDB).

“One Belt” refers to the “Silk Road Economic Belt”, which starts from Xi’an and passes through major cities like Almaty, Samarkand, Tehran and Moscow before ending in Venice. It plans to build roads, railways, and gas pipelines across central Asia to Europe.

“One Road” refers to the “21st Century Maritime Silk Road”, which begins in Fuzhou and links major coastal cities including Hanoi, Jakarta, Kuala Lumpur, Kolkata (formerly Calcutta) and Nairobi before joining the “Silk Road Economic Belt” in Venice. It will build ports and maritime facilities from the Pacific Ocean to the Baltic Sea (see Map1).

Map 1: The New Silk Road (One Belt One Road)

Source: Xinhua Finance Agency

Economic expansion
OBOR has three pillars: 1) spreading economic development around the world through infrastructure investment and new trade routes; 2) creating interdependence between China and other countries and regions via global partnership networks; and 3) focusing on Asia as part of a new “neighbourhood diplomacy”. By building closer economic ties with the regional economies along the “New Silk Road”, Beijing is aiming to tie these regions’ prosperity to their relationship with China, hence laying the foundation of an economic empire centred in China.
Greater financial cooperation between China and the “New Silk Road” countries should encourage deeper integration of markets, backed by the increased use of the renminbi for trade and financial transactions. These opportunities will also create a major role for China-dominated multi-lateral organisations, such as the AIIB, the NDB, the Shanghai Cooperation Organisation\(^1\) and the ASEAN +1.

OBOR is the next step of China’s strategic development after its “bring in” policy (to attract foreign investment and technology) and “go out” policy (to encourage Chinese companies to expand abroad) strategies. It is also an extension of the “go west” policy, initiated in 2000, to boost the under-developed western provinces.

**Domestic growth and rebalancing**

OBOR will also have a significant impact on China’s domestic economy by providing an investment platform for boosting national infrastructure spending, urbanisation and trade. The OBOR strategic framework comprises five domestic development zones with infrastructure plans connecting each to the other and to neighbouring countries (Map 2):

1. The northwest zone: Xinjiang will serve as the transportation, trade and logistics hub for linking central, south and west Asian countries.
2. The southwest zone: Guangxi will develop economic ties with ASEAN, the Pearl River-Xizang (Tibet) and the Beibu Gulf, and Yunnan will build an international transport corridor linking China with the Greater Mekong sub-region.
3. The northeast zone: Inner Mongolia will build railway links with Heilongjiang and Russia. A Eurasian high-speed rail transport will also be built linking Beijing and Moscow.
4. The inland zone: Chongqing will serve as the economic hub in western China, developing railway transport for the China-Europe corridor.
5. The coastal zone: Hong Kong, Macau and Taiwan will integrate into the economic hubs of the Yangtze River Delta, the Pearl River Delta, the west coast of the Taiwan Straits and the Bohai Rim; Fujian Province will serve as an economic hub for the Maritime Silk Road.

These initiatives will unleash a regional and domestic infrastructure boom, helping to stabilise China’s growth while structural reforms are being implemented. China’s large state companies will likely lead most of the OBOR projects, paving the way for the small (including private) companies to follow.

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\(^1\) The Shanghai Cooperation Organisation (SCO) is a Eurasian political, economic and military organisation established in 2001 with six members (China, Kazakhstan, Kyrgyzstan, Russia, Tajikistan and Uzbekistan), five observers (Afghanistan, India, Iran, Mongolia and Pakistan), three dialogue partners (Belarus, Sri Lanka and Turkey) and three guest attendees (ASEAN, Commonwealth of Independent States and Turkmenistan). The six member countries account for 60% of Eurasia’s land mass and a quarter of the world’s population. The SCO focuses on military, security and economic cooperation, with an increasing number of infrastructure projects related to telecommunications, transport and energy in recent years.
It would be wrong to view OBOR as an escape route for China to revive its investment-led growth model. As we argued recently, the expenditure-switching from investment to consumption in the Chinese economy is inherently liable to contraction. So investment cannot be allowed fall too quickly, otherwise the negative shock will crush growth before consumption can catch up to become a growth driver. OBOR can help rebalance China towards consumption-led growth by preventing investment from falling too fast during China’s structural reforms.

**Political strategy**
Arguably, OBOR is also an effort by China to counter US-driven trade agreements, such as the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP) 3, both of which exclude China. These new trade pacts are seen as part of the effort by the US to contain China due to concerns about China’s ulterior motives for naval expansion and energy security. From China’s perspective, however, economic growth is key to its national security, as it legitimises the Communist Party’s rule and OBOR is part of its survival tactics.

Since 2010, the US has been working closely with South Korea, Japan, Taiwan, the Philippines, Australia and India in its “pivot to Asia” policy initiative. This has made it hard for China to expand its influence over

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3 See "Chi on China: The AllB: Reviving China’s Investment-led Growth or Rebalancing towards Consumption?” 13 May 2015.

3 TPP is a twelve-member Asian regional trade agreement, initiated by the US, including major Asian trading nations such as South Korea, Japan, Singapore, Vietnam and Malaysia. The TPP bloc accounts for 38% of world GDP. TTIP is a proposed US-EU free-trade agreement that governs market access and cooperation. Both TPP and TTIP exclude China, which means that their trade regulations could adversely affect China’s trade relations with these markets.
regions to its east and prompted China to rethink its strategy of concentrating investment in the eastern coast. Through OBOR, Beijing is trying to find an alternative by targeting the western and southern parts of the country and expanding internationally to the west.

The real question is not whether China can be contained, but through which channels it will exercise its influence as a new international player. Economic expansion is one possibility; military confrontation is another. China’s former leaders pursued a “peaceful rise”. The current generation of leaders may not necessarily take the same reserved approach.

In our view, Beijing still sees its geopolitical and security interests as best served by tying other countries into ever closer trade and investment relationships. It is a strategic vision based on economic power. Granted, OBOR will enhance China’s economic and political clout, which would imply an expansion of its military influence. But as China builds closer economic ties with the world, it will also have a lot to lose if it upsets international relations. It is not in Beijing’s best interest to instigate international instability.

**The risks for China**

However, OBOR also carries some potentially big risks for China. Some of the countries participating in the OBOR scheme have poor economic fundamentals, including large fiscal and current account deficits. Beijing will be taking on greater default risk by investing in them or by providing them with capital. A wider use of the renminbi may also expose China to Forex risk.

For example, China swaps renminbi for country X’s currency at the current exchange rate. If country X uses the funds to buy Chinese machinery but China does not spend currency X at once to buy goods from country X, it would be exposed to Forex risk if currency X depreciates.

The politics may also backfire for China. Given China’s poor track record in operating in foreign countries, including clashes in work ethics and the lack of human rights in labour treatment, a major increase in the scale of China’s external activities could increase the risk of damaging Beijing’s political image or creating instability in the host countries. Expansion of Chinese influence throughout central and south Asia will also create tensions with major players in those regions.

Nevertheless, if China encourages free trade and abides by international norms and market rules, OBOR would be positive for global markets by fostering new trade networks and better allocation of capital. The investment opportunities will outweigh the risk.

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One Belt One Road: One stone kills three birds

24 June 2015 – 6

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