MARSH & McLENNAN INSIGHTS | BRINK ASIA

NAVIGATING THE NEW SILK ROAD

Expert Perspectives on China's Belt and Road Initiative
Vol. 2

MARSH GUY CARPENTER MERCER OLIVER WYMAN

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INTRODUCTION

The articles contained in this publication have been selected for the ways they examine critical issues surrounding China's Belt and Road Initiative (BRI), namely the initiative's economic impacts, both domestically and internationally, as well as its geopolitical implications.

Following the launch of volume 1 of Navigating the New Silk Road in 2017, this edition benefits from the BRI's recent track record of successes and challenges. This compendium collates knowledge and expertise from the world's leading experts to provide practical and timely insights on the various risks and opportunities associated with Belt and Road Initiatives.

All articles first appeared on BRINK Asia, the digital news service of Marsh & McLennan Insights, managed by Atlantic Media Strategies, the digital consultancy of The Atlantic. BRINK Asia gathers timely perspectives from experts on risk and resilience around the world to inform business and policy decisions on critical challenges.

THE PROMISE–AND RISK–OF BELT AND ROAD

Robert Subbaraman
Head of Emerging Markets Economics at Nomura International

Lisheng Wang
China Economist at Nomura International

The Belt and Road Initiative, a China-led initiative that seeks to connect China to its neighboring countries via land- and sea-based infrastructure development, will be one of the defining geoeconomic themes in the next decade. So far, more than 80 countries and international organizations have already joined the BRI, and we estimate investment will total at least $1.5 trillion over 10 years under this game-changing initiative, with significant win-win implications for both China and recipient economies.

From China's perspective, the economic benefits accruing from the initiative are many, but there are also multiple risks that the Chinese authorities need to manage effectively. So far, the risks are not acute, but caution is nevertheless warranted.

KEY BENEFITS TO CHINA

The BRI can be advantageous to China in several ways. Here, we list the five key ways in which China can benefit from this initiative:

A new source of aggregate demand

Following the global financial crisis, slower world trade and rising protectionism in developed economies has meant that productivity gains from Asia's value supply chains may have peaked. Reducing excess capacity has been a key priority for Chinese authorities. According to the Chinese government's 2018 work report, the BRI is aimed at undoing this deadlock of stagnant demand and restarting global growth by building a platform for investing in infrastructure across regions. One of the key expected outcomes is the generation of more external demand for Chinese goods from recipient countries. Consequently, this should help boost external demand for China's exports, ease China's manufacturing overcapacity burden, as well as boost the investment and output growth in China to some degree. We estimate that the BRI could boost China's real GDP growth by at least 0.1 percentage points annually over the next decade, which, cumulatively, could be sizable.

The BRI will also result in greater trade integration globally. In 2006, the U.S. was the largest trade partner for 127 countries globally, while the corresponding number for China was 70. By 2012, in only six years, China became the largest trade partner for 128 countries and the number for the U.S. stood at 76. Importantly, for China, this number continues to climb, although there have been no official statistics on the exact number in recent years. BRI countries accounted for 25.7 percent of China's total trade in 2016, and further growth is expected in the years ahead.

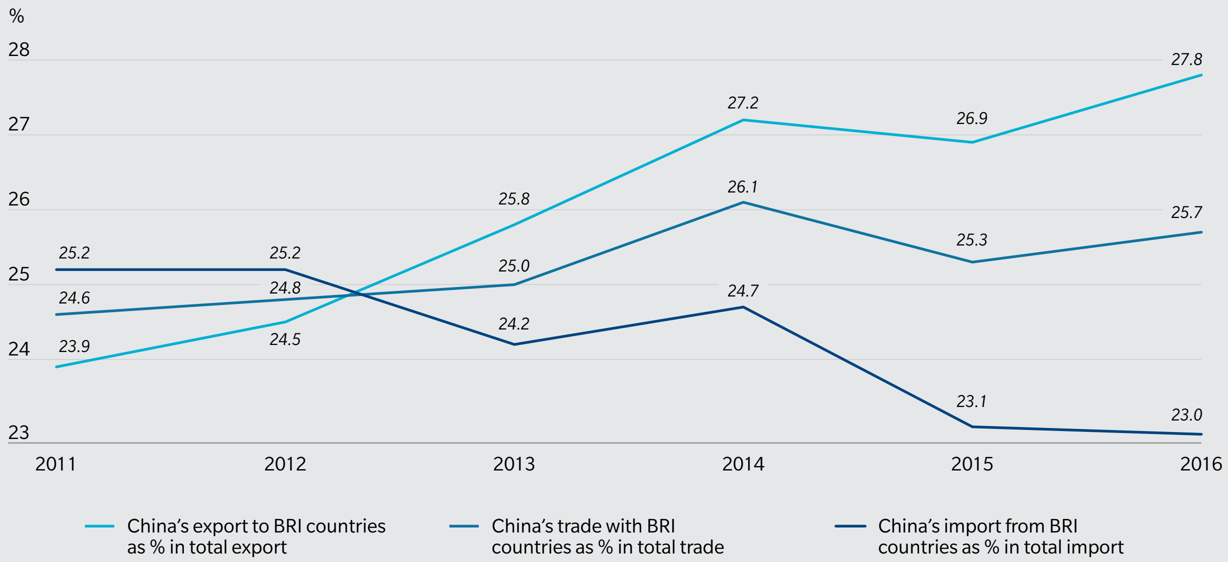
Moving higher in the global value chain

In all fairness, the BRI will not be able to absorb all of China's excess capacity by itself. It is also about enabling China to move higher in the value chain. China has established itself as a low-cost manufacturing hub but with rising labor costs. It now needs to establish itself in high value-added products such as telecom, high-speed railways, machinery, and construction and engineering, consistent with the Made in China 2025 strategy.

The BRI offers China the platform to relocate low-cost manufacturing via outward FDI to low-cost countries, mostly in Asia and Africa, while upgrading its domestic production facilities. Financing BRI projects is often associated with using Chinese goods (construction materials) and technology (high-speed rail), making the BRI recipient countries—with large infrastructure deficits—a captive market for these high value-added Chinese goods. China's investment in high-speed rail projects in Southeast Asia is a fitting example in this regard. Similarly, investing in telecom

EXHIBIT 1: CHINA'S TRADE WITH OTHER BRI COUNTRIES AS % OF ITS TOTAL TRADE

Source: State Information Centre of China and Nomura Global Economics



Note: We estimate the statistics based on the 2016 BRI country list, including China and 64 countries.

networks in developing countries should benefit Chinese telecom equipment manufacturers.

More balanced regional development within China

Economic growth in China has been uneven, with much of the growth benefit feeding through primarily to southern coastal provinces, while growth in the land-locked western, northeastern and central regions has been slower. The BRI's economic corridors aim to integrate these less-developed regions with the outside world, thereby triggering faster trade and investment growth.

Higher return on capital in the foreseeable future

Infrastructure building across BRI countries will enable China to better use its forex reserves, which stood at $3.1 trillion as of March 2018, rather than directing its investments toward low-yielding U.S. Treasuries.

In the initial years, infrastructure investment may offer a relatively low return on capital and is often exposed to high default risks due to political and economic factors. However, the return on capital may pick up significantly once infrastructure, institutional and market environments are developed, especially in countries with abundant natural and labor resources. As such, BRI-related investments are more like an entrance fee that China and other industrialized countries must pay in the short term before reaping longer-term gains.

Environmental protection and secured commodity supply

The BRI provides China's manufacturing firms with practical channels to offset rising labor costs, that is, outsourcing and offshoring, most of which are green, as required by BRI-related regulations. The relocation of manufacturing plants, especially those in heavy industries, from China to other BRI recipient countries could help mitigate the air and water pollution problems that have long troubled China.

Additionally, the BRI also helps China secure new sources for commodities and natural resources at lower costs. For example, having more roads and railways in the China–central Asia–west Asia economic corridor and more ports along the Maritime Silk Road (once operational), China will become more closely linked with oil exporters in the Middle East, resulting in significantly lower transportation costs through both land and sea routes.

KEY RISKS FOR CHINA

Undoubtedly, the BRI does expose China to multiple risks. First, BRI projects are susceptible to providing low returns, delayed returns and even a risk of default at this current, early stage. This could partly be due to certain infrastructure investments not being profit-driven. Most recipient economies are emerging market economies, with still-underdeveloped legal institutions or frameworks and, in some cases, unstable political systems, posing security risks.

Many BRI countries have lower sovereign credit ratings, weak fiscal positions and underdeveloped financial systems. The implementation of BRI projects could be delayed by political, institutional and financial issues in recipient countries, incurring losses for the investing entity.

Second, the sustainability of financing could pose another challenge. China's domestic debt is already very high, with an over-leveraged domestic financial sector. It could look to supplement its financing by involving other countries, but given the nature of BRI investments at the current stage of uncertainty over returns and higher risk premia, private investors could be deterred.

MITIGATING THE RISKS

However, in our view, the loan default risk posed by BRI-related investments should be limited on China. We estimate $1.5 trillion of BRI investment over 10 years implies just $150 billion of investment annually, which is dwarfed by the scale of China's domestic fixed asset investment of $9.3 trillion, based on 2017 data, and new loans of $2 trillion, provided by the banking sector.

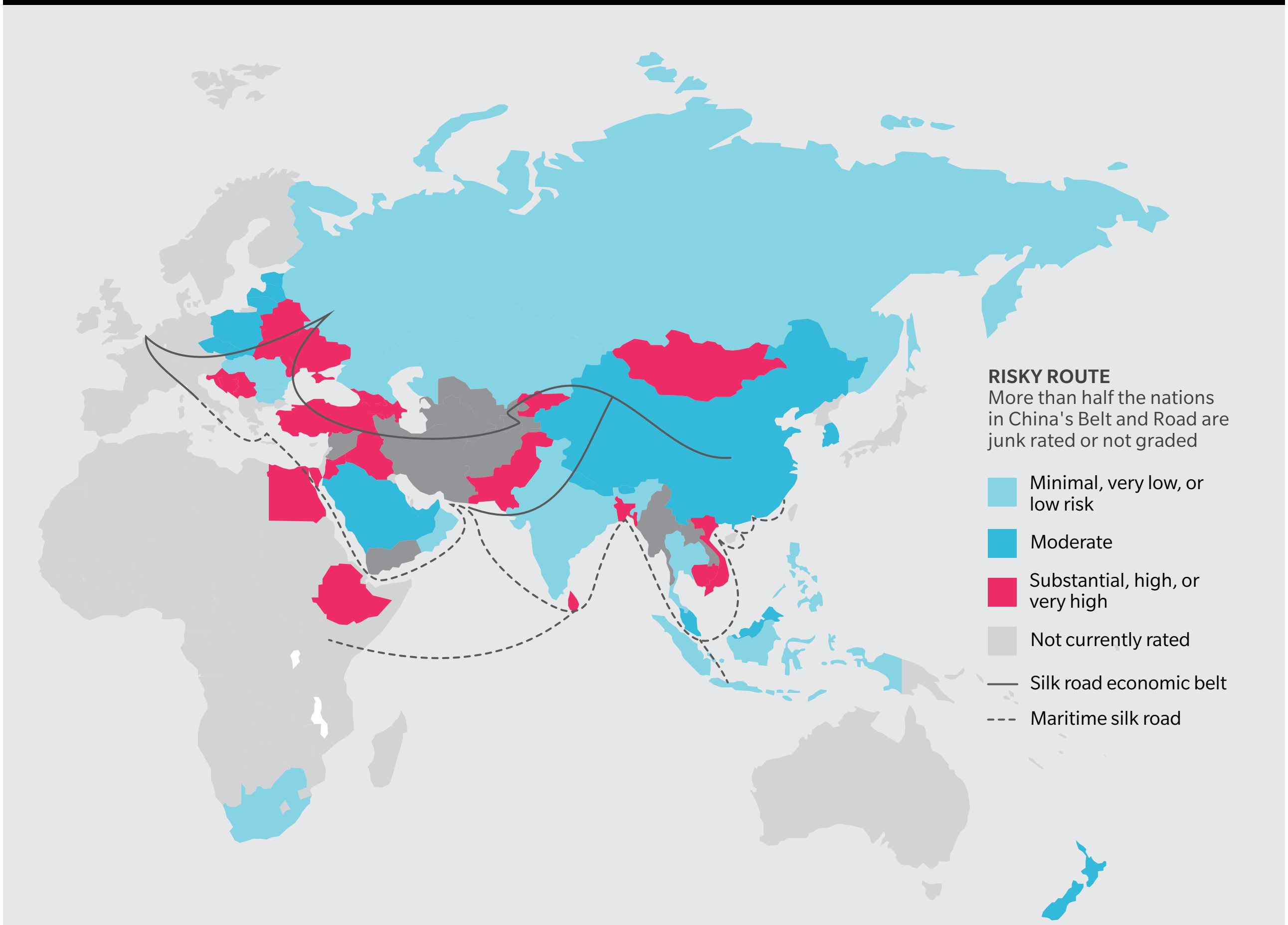
Moreover, some of these risks can be offset. For financing, for instance, China could turn to international organizations such as the World Bank, International Monetary Fund and the Asian Development Bank for support. Separately, the political risk in BRI participant countries could be partially reduced by well-designed insurance products.

Once basic infrastructure has been supplied and institutional and market environments significantly improved, the risks mentioned above could be mitigated and actively managed, which could encourage more foreign investors to join projects.

This article first appeared on BRINK Asia on May 8, 2018.

EXHIBIT 2: SOVEREIGN RATINGS ALONG THE BELT AND ROAD

Source: Bloomberg and Nomura Global Economics



Note: Based on best sovereign long-term foreign currency debt rating by Moody's Corp., Standard & Poor's Financial Services LLC and Fitch Ratings Ltd. on Oct. 24.

DIFFERENT STANDARDS FOR JUDGING THE BRI?

An interview with Mahamoud Islam
Senior Asia Economist at Euler Hermes

China's Belt and Road Initiative has, in recent times, come in for a fair bit of criticism, with some likening it to a political lever for use by Beijing, others unhappy with the debt burdens it places on partner countries, and still others questioning China's motives and the economic benefits that partner countries can potentially derive from the initiative. The criticism notwithstanding, the BRI has grown in scale like few other economic initiatives ever before, with more than 80 countries participating.

In this interview, Mahamoud Islam, senior Asia economist at Euler Hermes, speaks to BRINK Asia about the birth of the BRI, its importance for China and partner countries, the question of mounting debt in partner countries, and whether the criticism of the BRI is well-founded.

BRINK Asia: From a Chinese perspective, why is the BRI important?

Mahamoud Islam: First we have to put things in context. In the early 2000s, the Chinese economy grew rapidly, and one of the key growth drivers was exports—strong export growth supported strong economic growth. During the global financial crisis, the authorities implemented a massive stimulus to boost economic growth. This led to a strong recovery but also to a significant rise of macroeconomic imbalances: the rise of indebtedness and a rise in overcapacity, especially. With these experiences in mind, the Chinese authorities started to rethink their economic growth model. One, exports should remain a growth driver, but domestic consumption should play a greater role. Two, authorities should find long-term growth drivers to create a sustainable growth environment.

The BRI was born in that context. It was designed to find new growth drivers. On trade, the objectives were to support export diversification as China increased trade partnerships with other economies and to find new clients for corporates that are in sectors with overcapacity. Domestically, the BRI could be a key driver for economic development as a rise in infrastructure investment in the western part of China helps to reduce regional disparities. So, economically, it is important because it is expected to help China find and build new growth drivers.

Last, it is also important from a political perspective, as it serves as a branding strategy for Chinese foreign policy. The BRI is more than an infrastructure strategy. The objective is to promote development through greater cooperation on matters such as trade, financing, investment and culture along Belt and Road routes.

BRINK Asia: What are its implications on trade and investment in China?

Mr. Islam: As stated earlier, we expect the BRI to help diversify Chinese exports. One of the key implications of the initiative is that it will provide China more outlets for its growth through more customers along the Belt and Road. The second implication is that it provides an outlet for China's substantial savings (about 45-50 percent GDP). By investing in BRI markets for instance, China could expect some return on investment in the longer term or technology transfers if Chinese companies invest in high-tech companies abroad. Last, it can help internationalize the yuan and build financial links with partner countries. This could become more important as the project gets traction. Note that while in its beginning, the project included just over 60 countries; it now includes more than 80 countries.

BRINK Asia: What are the trade and investment implications on partner countries?

Mr. Islam: There are three implications. First, there is a rise of capital inflows to BRI markets. Second, there is a rise of trade between BRI markets and China. Third, in the longer term, this should lead to improved BRI market competitiveness as countries get better trade infrastructure and easier access to the markets.

It is true that it can be a source of financing difficulties for some markets that are already vulnerable, such as Pakistan or Sri Lanka. Yet, there are also many positives. Concretely, trade between BRI markets and China is increasing. Trade costs, namely transport costs and time of delivery, are expected to decrease with countries getting better transport infrastructure and ultimately a boost in trade.

BRINK Asia: Is debt emerging as a major issue for partner countries?

Mr. Islam: For sure—this is a problem. However, it isn't a problem just for the recipient countries, but also for China. If BRI partner countries have trouble repaying China, it will pose problems for China as well.

So yes, there are problems of financial sustainability behind the BRI. This is especially true for partner members that have fragile public finances—Sri Lanka, Pakistan, or Mongolia, for example. But it is also true for China. If China does not get paid, it loses money. And this is all the more important because China is also in a difficult financial situation. It is true that savings are high, but let's not forget that debt in China, especially in the corporate sector, is high (164 percent of GDP).

A boost in infrastructure spending could unlock growth potential further without endangering public-finance sustainability.

This configuration has three implications. One, there are countries where it will be more difficult to implement Belt and Road initiatives, because these markets do not have strong financial capabilities. Two, it will likely be important to expand the pool of financing for the project, as China cannot finance it alone. Three, improving the risk assessment of BRI projects will be key to limiting financial losses.

There are markets for which the BRI could be a source of opportunities more than risks. Markets such as Thailand, Indonesia or Philippines, for example, have large infrastructure needs, and their financial capabilities are relatively strong. Economic growth is already solid in these countries; a boost in infrastructure spending could unlock growth potential further without endangering public-finance sustainability.

BRINK Asia: You touched upon criticism of the BRI—how do you perceive the BRI?

Mr. Islam: I think that the BRI is an ambitious and very broad development strategy. It is a project designed by China that can benefit its domestic market but can also benefit partner countries through trade flows. Do not forget that China contributes to 1 percentage point of global economic growth (out of 3 percent). This is important in the current context when there is a growing skepticism about trade and global economic growth is slowing.

That said, as most ambitious and large-scale financial projects, it brings considerable risks, and thus it needs fine tuning. Involving more partner countries and the private sector, and with a better structure—a clear regulatory framework that, for example, clarifies the targets and the role of the members—the initiative will be critical for China to get more financial resources and reduce risk of losses in the longer term.

This article first appeared on BRINK Asia on January 23, 2019.

RMB INTERNATIONALIZATION: PROSPECTS AND CHALLENGES

Craig Chan
Global Head of Emerging Markets Strategy at Nomura

Wee Choon Teo
Northeast Asia FX Strategist at Nomura

The internationalization of the renminbi (RMB), China's official currency, has been a key policy focus for the Chinese government, particularly over the last half-decade. Given that China seeks to boost trade and investment and to establish its influence as a global economic power, more widespread use of the RMB is an understandable objective.

However, this has not been an easy undertaking, as the authorities have had to walk a fine line between the internationalization of the RMB and continuing to exercise a high degree of control over capital flows in and out of the country.

THE BELT AND ROAD INITIATIVE TO SUPPORT RMB INTERNATIONALIZATION

In the years to come, BRI-related trade and financing settlements will likely boost the demand for RMB in the international market. Moreover, the Chinese government is also encouraging domestic financial institutions to conduct overseas funding business in RMB when providing financial services to BRI-related projects in an attempt to boost its currency.

To facilitate the use of RMB in cross-border trade settlement and investment, China has signed bilateral currency-swap agreements with some BRI countries including Thailand, Malaysia and Singapore. Additionally, the People's Bank of China (PBoC) has named RMB-clearing banks in an increasing number of countries, and certain countries such as Malaysia, Thailand and Cambodia have adopted RMB as an official reserve currency. These efforts signal China's strong desire to push forward with RMB internationalization.

Nomura's Asia foreign exchange strategy team maintains that the BRI will be beneficial for China's push toward RMB internationalization (yuan financing for projects) and will allow China to offload some of its excess manufacturing capacity. Moreover, the BRI should support China's medium-term growth sustainability prospects and bolster the view of longer-term RMB appreciation. Overall, beyond the recent signs of a stabilization of China capital flows, the long-term internationalization or demand for RMB is recovering again.

The balance between structural outflows and inflows

After the surprise RMB foreign exchange devaluation on August 11, 2015, we noted that structural outflows—led by the Chinese domestic private sector diversification into foreign assets—were a medium-term risk for RMB and its internationalization prospects, as the authorities implemented capital controls to stem outflows.

Although local outflows continued in the second half of 2017, the pace slowed. In particular, net FDI inflow into China increased to $66.3 billion in 2017, up from a deficit of $41.7 billion in 2016, partly due to tightening regulations on outward direct investment over the past couple of years.

Overall, while we expect consistent local demand for foreign assets, the pace is likely to remain contained if China is able to sustain a stable growth environment and avoid significant local market volatility amid its financial deleveraging efforts. This is a challenging task, but one that China has managed to achieve so far, as reflected by the improvement in net capital flows, with headline FX reserves rising by $129 billion in 2017 as compared with the decline of $320 billion in 2016, albeit partly due to valuation effect.

Indeed, in our view, the ability of the government to sustain relatively stable growth is leading to renewed foreign interest in owning RMB-denominated assets, supporting its internationalization drive. This is reflected by the rise in foreign purchases of bonds and equities, signs of a bottoming of offshore renminbi (CNH) deposits and an increase in RMB trade settlements.

The risks of trade protectionism and financial market volatility are likely to be only temporary setbacks to what looks like an inevitable positive RMB outlook.

Foreign ownership of China equities and bonds accelerating

The foreign ownership of Chinese equities and bonds has been increasing—this too is boosting the RMB. Based on PBoC data, foreign investors cumulatively purchased $58.5 billion in RMB bonds in 2017, which resulted in a 47.5 percent increase in foreign bond holdings from end-2016. Of this, IMF COFER data shows that reserve managers bought $32 billion in 2017. Therefore, most of the remaining $26.5 billion was likely bought by foreign asset managers.

Separately, other factors that will cause strong bond inflows in the future include central banks' or sovereign wealth funds' portfolio diversification and the inclusion of China in large global bond indices.

Indeed, this is already happening. The Bank of France and Bundesbank (Germany) have recently highlighted their diversification into RMB, and we believe this is just the start of a medium- to long-term trend among global central banks. The announcement that RMB-denominated government and policy bank securities will be included in the Bloomberg Barclays Global Aggregate Index from April 2019 should also lead to passive fund inflows from real money investors. There is also a likelihood for the inclusion of RMB-denominated assets in the JPMorgan EM GBI index this year, which will also translate into passive inflows, while scope for China's inclusion in the Citibank World Government Bond Index has also increased.

Foreign equity inflows have also been strong, with net inflows of $64.8 billion in 2017, although ownership remains low at around 2.1 percent of total market capitalization (or $178 billion) and a broadening of index inclusions beyond the MSCI's initial partial A-share inclusion would imply additional equity inflows over the medium term.

Demand and use of RMB is on the rise

Other signs of broadening demand for RMB internationalization are reflected in the stabilization of CNH deposits as well as the increase in trade settlement in RMB.

RMB trade settlements have been rising after hitting a low of 12.5 percent of China's total trade in December 2016 to 14.6 percent in April 2018. This figure is expected to rise further with numerous Chinese organizations highlighting that they plan to conduct more trade transactions in RMB, instead of U.S. dollars. In addition, China is also pushing for RMB oil trade settlement (possibly with Russia and Angola, initially), which could further increase RMB internationalization.

RISKS TO A POSITIVE OUTLOOK ON RMB

From an RMB internationalization perspective, the risks stem from the possibility of severe trade protectionism. The Chinese government's deleveraging drive could also lead to financial market volatility and an acceleration of local capital outflows. In such a scenario, the authorities would likely enact measures to reverse the sources of instability and enforce measures to limit capital outflows.

However, this would likely only be a temporary setback to a positive RMB outlook, as a stronger RMB is likely to be an eventual result of the government's long-term goals of internationalization.

Another risk stems from the likely gradual liberalization of the capital account to allow for outflows—such as the Qualified Domestic Limited Partnership. Other measures that allow for greater outward direct investments, such as a further increase in the Qualified Domestic Institutional Investor quota, could also emerge, although these are only likely in an environment of an appreciating or stable RMB.

This article first appeared on BRINK Asia on June 12, 2018.

SINGAPORE AND THE BELT AND ROAD INITIATIVE

Blair Chalmers
Director, Marsh & McLennan Insights

Abhimanyu Bhuchar
Partner and Head of Energy & Transport Practice – Asia, Oliver Wyman

The Belt and Road Initiative (BRI) was unveiled by Chinese President Xi Jinping in 2013 as a trade development strategy that aims to better connect China with countries in the region, as well as Europe, the Middle East, and parts of Africa. It comprises a land-based Silk Road Economic Belt and an ocean-going Maritime Silk Road. It will involve more than 70 countries and will cover 65 per cent of the world's population and 40 per cent of global gross domestic product (GDP).

The idea was initially introduced as the One Belt, One Road (OBOR) plan, but China subsequently amended the name to BRI to reflect the idea's far-reaching ambitions. While many media outlets still retain the term OBOR, the concept has evolved from an infrastructure development project linking a fixed set of countries to an open invitation to the global community to foster greater connectivity and prosperity.

This has wide-ranging connotations with respect to Chinese foreign investment in infrastructure-related arenas. Countries including Australia, Brazil, and Ecuador may not have formally signed up to be BRI partners but reports of Chinese investment in infrastructure in these countries make reference to the BRI.

The BRI's ever-increasing portfolio of potential projects and country partners has generated interest from governments and private firms the world over. Singapore's existing strong relationship with China, her role as a major offshore renminbi destination and ability to act as a one-stop shop for infrastructure financing and development have given firms in the country a head start in taking part in the BRI. The Singapore government will no doubt seek to maintain the delicate balance between Singapore's own economic prospects and those of the broader region.

The ASEAN Master Plan for Connectivity may share similar strategic goals to the BRI on some levels, but that does not mean that there will not be challenges and potential cross-border political tensions which must be accounted for on a project-by-project basis.

SINGAPORE'S KEY SUPPORTING ROLE

Singapore is well known as a hub for trade and connectivity and has also enjoyed long-standing positive ties with China. When the BRI was first announced, the Singapore government moved quickly to position the country as a key supporting player in the scheme.

This was a move borne out of expectations of the potential opportunities, and out of concerns for the potential risks. After all, many of the BRI projects initially proposed may provide direct competition to the Port of Singapore.

To this end, Enterprise Singapore (an agency formed by the merger of IE Singapore and SPRING) signed a number of key BRI Memorandums of Understanding (MOUs) with various major Chinese financial institutions. The Singapore Business Federation (SBF) has also promoted Singapore's potential in the context of the BRI. One such initiative is the SBF-organised BRI Business Dialogue, which brought together over 80 business leaders from China, Singapore and the US to discuss the progress of BRI and explore potential partnerships with one another.

The sheer scale of the BRI and its associated investment values (some estimates expect projects to total US$4 trillion) mean that competition is high among nations to be part of the BRI project ecosystem. Beyond the enabling environment that the Singapore government has created, Singaporean firms have also leveraged two key strengths of the city state.

The first is Singapore's status as a global and regional financial hub. Robust financial institutions and markets, coupled with quality legal and insurance frameworks, position Singapore as a key player in the financing of BRI projects. To date, 33 per cent of all outward investments and 85 per cent of inbound investments related to the BRI now flow through Singapore. The Singapore Exchange (SGX) also serves as an important platform for the issuing of BRI bonds. In 2016, China Construction Bank listed its first RMB 1 billion (S$209 million) BRI infrastructure bond on the SGX.

The second strength centres on Singapore's Engineering, Procurement and Construction (EPC) expertise combined with operational excellence. The completion and operation of highly complex infrastructure such as Changi Airport is testament to the high standards of local firms. Singapore has also successfully exported its operational excellence. For example, Changi Airport Group has been growing its footprint globally, investing in and managing foreign airports through its subsidiary Changi Airports International. Singaporean firms, given their experience in operating infrastructure in and across foreign settings, can contribute their expertise to BRI projects. For instance, Sembcorp Industries and Chongqing Energy Investment Group have agreed to explore a strategic partnership on a broad range of development areas in line with the BRI.

HOPES AND FEARS FOR TRADE

Most contemporary discussion of the BRI focuses on infrastructure financing and construction and less so on the opportunities the infrastructure will bring once completed. China's stated end goal is to promote trade and economic integration with the destination countries, but the potential benefits are more likely to be multilateral than bilateral.

The BRI also carries with it risks and uncertainties that Singaporean firms need to consider:

- How might China's increasingly strong economic relationships disintermediate Singapore from future trade?
- How disruptive will some of the BRI projects, such as the East Coast Rail Line and Melaka Gateway Port in Malaysia, be to Singapore when completed? The same goes for mooted projects like the Kra Canal in Thailand.
- How will China's drive to export its technology and technical standards affect Singapore in its role as a world-class asset operator?

Beyond the implications the BRI has on Singapore's role in future trade flows, there are broader concerns that Singaporean firms need to address. These include the expected impact that 3D printing will have

EXHIBIT 1: SINGAPORE AND THE BELT AND ROAD INITIATIVE (BRI)

68 countries involved[1]

US$4 trillion in investment est.[2]

CHINA AND SINGAPORE BILATERAL INITIATIVES FOR BRI DEVELOPMENT[3]

3 Memorandum of Understanding between Enterprise Singapore and top Chinese banks

US$9 billion committed

The Chongqing Connectivity Initiative to drive the development of Belt and Road connectivity

WORLD LEADING FINANCIAL HUB: PROJECT FINANCING EXPERTISE[5]

60% of project finance transaction in SEA led/managed by Singapore based banks

33% of outward + **85%** of inward

BRI investment flows through Singapore

EXISTING PARTNERSHIPS BETWEEN CHINA AND SINGAPORE[4]

>6,500 Chinese firms operating in Singapore

2nd leading offshore hub for renminbi trading

ENGINEERING, PROCUREMENT AND CONSTRUCTION EXPERTISE[6]

Digital infrastructure development experiences

Operational excellence: Changi's involvement in Rio de Janeiro's airport management

1. ISCA journal; 2. The Belt and Road Initiative (BRI): Reshaping the Global Value Chain Conference; 3. Enterprise Singapore: Channel News Asia; 4. Asiaone: The Straits Times; 5. Enterprise Singapore: The New Paper; 6. Changi Airport Business & Operation Review

on global trade and supply chains as product manufacturing is brought closer to customers, and the increase in protectionist trade measures put in place by many countries.

By necessity, Singapore has long had an open economy and enjoys friendly relations with other countries. The proactive governmental response in putting in place BRI-linked MOUs and other agreements with China must now be replicated with other countries involved in the BRI. The onus is on Singaporean firms to identify the countries that possess greater trade and economic potential and to start expanding relationships and local expertise. The government can then provide support by pursuing relevant trade agreements to bolster this potential.

SECURING A BRIGHT FUTURE FOR SINGAPORE

A combination of government initiatives and private sector expertise has, to date, allowed Singapore to play an outsized role in this epic connection of infrastructure and economies.

The ever-increasing geographic scope of the BRI will provide local firms with opportunities to provide financial, legal, and technical expertise that will help turn ambitions into reality. At some stage, however, the tipping point will be reached between the construction phase and the new world of increased trade flows and economic integration. There will be no formal demarcation between these phases and firms can and must start preparing for this organically-evolved shift now if they are to differentiate themselves in a world that will be even more competitive than the one today.

A version of this article originally appeared here in the Singapore Institute of Directors Bulletin Q3 2018.

THE BELT AND ROAD INITIATIVE: WIDER IMPLICATIONS FOR ASIA

An interview with Parag Khanna
Senior Research Fellow at the Centre on Asia and Globalisation at the Lee Kuan Yew School of Public Policy in Singapore

China's Belt and Road Initiative is among the defining, prominent geopolitical and geoeconomic developments of our time, with major implications for international trade, infrastructure development, physical connectivity, poverty reduction and economic growth.

In this interview, the first of a two-part conversation, Parag Khanna, senior research fellow at the Centre on Asia and Globalisation at the Lee Kuan Yew School of Public Policy in Singapore, best-selling author and leading global affairs strategist, speaks to BRINK Asia about the BRI's impact on the Asia-Pacific region, particularly in light of China's vision, the internationalization of the RMB, evolving trade routes and the rise of Asian cities (and associated challenges).

BRINK Asia: How do you see the Belt and Road Initiative in the context of the supply chain nodes that you describe in your book Connectography?

Parag Khanna: We have to remember that the BRI isn't just a bottle of wine, but a "magnum," larger and maturing. China's vision behind the initiative has been in place for a long time, and we see a clearer manifestation of this vision in the last two decades. At the time of dismantling of the Soviet bloc and the coming together of the European Union, China was establishing trade routes to Central Asia and Europe. So, in that sense, the BRI is a declaration of this vision and China's intent to engage with the broader global economy in its pursuit.

The BRI is therefore also the "multilateralization" of the vision. The Asian Infrastructure Investment Bank, Chinese private equity funds (often government-backed), [and] the BRI are all initiatives undertaken for a deeper engagement between China and other countries and are designed to drive integration of supply chains and resulting regional trade. The highest market principle will always be supply and demand, and robust infrastructure facilitates and supports that principle. With improving macro fundamentals in Asia and resulting increase in demand for goods and services, infrastructure development as part of BRI is mostly welcomed. And that is why I believe that regardless of immediate popular backlash against BRI you see unfolding—whether in Central Asia or Southeast Asia—the projects will carry on because there is a fundamental demand for better infrastructure as a way to facilitate movement of goods and services in countries across this region.

BRINK Asia: The BRI will probably help with the internationalization of the RMB, especially with the AIIB at the forefront. Could you comment on the implications on the trade balance of other countries in Asia?

Mr. Khanna: Making a sweeping generalization around increased internationalization of the RMB is difficult. However, there is evidence of the growing use of RMB in trade, without a doubt given that most Asian countries run a growing trade deficit with China. People are now even talking about the "petro yuan"— say if China invests in the much-awaited Aramco IPO next year, will OPEC crude be traded in RMB? While China would prefer this increased use of the RMB, its trading partners will struggle unless they hold sufficient RMB reserves.

If we examine countries in terms of their share of total outstanding debt and what their cost of capital is, and in what currency, we find that much of that is still in U.S. dollars, but now we are going to make similar calculations in terms of the cost of borrowing to see how these countries can fulfill their RMB debt obligations.

BRINK Asia: You emphasize the growing importance of cities as centers of economic activity. How do you think the major city centers in Asia will evolve with BRI?

Mr. Khanna: We are already seeing so much development in the "city centers" across Southeast Asia—the BRI may not directly accelerate the rapid urbanization that we have seen in the region, but it does reinforce the trend. For instance, we are seeing more investments in countries such as Indonesia and Thailand with the increasing realization among governments that urban infrastructure is quintessential to attracting investments. To fully understand the second-order effect of infrastructure investment, you have to look at the follow-on effects, and it is very clear that there is going to be a significant impact on mobility, employment, and growth in the region as a result of this widespread urban infrastructure development.

The economic value of infrastructure investments cannot be accurately calculated as the benefit accrues over long periods of time. Urban centers across the region act as strong nodes in facilitating the increased mobility of labor and also of movement of goods and services, especially in countries where we see an increasing drift towards services and large populations. Lower costs of mobility as a result of increased urbanization have been known to have a very strong positive net effect on communities.

With improving macro fundamentals in Asia and resulting increase in demand for goods and services, infrastructure development as part of the Belt and Road Initiative is mostly welcomed.

Central Asia is different though—these countries have smaller populations, and BRI can be a strong impetus of further development of urban centers. There are countries such as Pakistan, Bangladesh and Nepal where much development is still sought. Thanks to BRI, we see a strong push in Pakistan. In countries such as Iran which are already urbanized, the focus will be on improving connectivity both within and with the external trade routes.

We will see an increased focus on the development of what are popularly referred to as “Tier-two” and “Tier-three” cities due to BRI as these cities present a lot of opportunity by way of potential for development.

BRINK Asia: As Asia urbanizes, it is faced with several infrastructure-related challenges in its cities. Do you think these are being addressed?

Mr. Khanna: This is a question that is far more fundamental than just the BRI. The answer is mixed—not enough is being done in some critical areas such as public housing. In terms of soft infrastructure, health care and education need a lot more attention in many parts of Asia.

Then if you look at transportation, there are large-scale problems, such as poor infrastructure, and traffic congestion remains a sore sign in many Asian cities. Fortunately, governments across the region mostly recognize the need to address these challenges and stronger policies are being introduced.

Separately, much of Asia’s existing water infrastructure needs to be upgraded, and a lot of new infrastructure needs to be built both for the provision of potable water and for the development of inland waterways. Addressing water inadequacy should be a priority, and not enough is happening in this area. On a related note, there is a need to come up with new pricing mechanisms for infrastructure utilities as the current models are driven by affirmative action and subsidies and therefore do not provide revenue collections in the order of what is needed for beefing-up the utilities infrastructure in line with the growing demand. We will see a lot more privatization of utilities and infrastructure companies, but that is a convergence of economic and political issues that is still evasive in certain countries.

The Philippines, for example, has led quite a strong focus on infrastructure and is pushing very hard on municipal planning around greener infrastructure and also trying to develop public-private partnerships models around the delivery of public services. Elsewhere, India is a strong test case where much has been promised, but execution there can be daunting given the largesse of the population that requires massive scale for any new initiative to result in broader change.

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THE COMPLEX INTERDEPENDENCE OF CHINA'S BRI IN THE PHILIPPINES

Aaron Rabena
Program Convener at Asia Pacific Pathways to Progress and Associate Fellow at the Philippine Council for Foreign Relations

In international relations, "complex interdependence" refers to the multiple channels of interaction and agendas in interstate relations, which involve domestic stakeholders—public and private—on nonmilitary issues. Since the Belt and Road Initiative came into being, most analyses have largely focused on infrastructure development. The BRI not only has the potential to impact a host government's socioeconomic agenda, but also its overall bilateral relationship with China.

The case of the Philippines demonstrates that to examine the progress of the BRI, it is imperative that it not only be measured through hard infrastructure, but also against the four other major areas of cooperation—policy coordination, trade and investment facilitation, financial coordination and integration, and people-to-people ties and connectivity.

BEYOND INFRASTRUCTURE

The 2017 Belt and Road Big Data Report clearly emphasizes on the non-hard infrastructure achievements of the BRI in terms of the following: signed cooperation agreements, established direct air routes, number of trains put into service, investments of Chinese enterprises in BRI countries (and vice-versa), economic and trade zones setup, signed bilateral currency swap deals, availability of the China Unionpay, sister-cities forged, increase in tourist exchanges, number of enrolled foreign students in China and implemented visa-free policies toward China.

Against this backdrop, the BRI should not be interpreted as an initiative that only involves the Chinese government or its state-owned enterprises, but also private Chinese companies. In the Belt and Road Big Data Report, of the top 50 most involved and influential Chinese enterprises, 42 percent are private, 56 percent are SOEs, and 2 percent are joint ventures. Apart from manufacturing and construction, these companies also operate in the areas of financing and IT, for example, Alibaba, Huawei, Lenovo, Tencent and JD. The report also mentions that the "participation [of private enterprises] into the initiative enhances the reputation and influence of the Chinese brands and products.".

FIVE KEY AREAS OF COOPERATION

Policy coordination: Beijing and Manila signed a Six-Year Development Program for Trade and Economic Cooperation in March 2017, which aims to gradually harmonize mutual development goals and interests within the BRI framework. This move is also indicative that China will increase its meager investments in the Philippines, which lags behind the U.S. and Japan. Complementing the program is the agreement of the Board of Investments and the Bank of China on the 2017-2019 Investment Priorities Plan for Chinese Companies, which is meant to facilitate business-matching activities and industrial linkages.

Infrastructure development and connectivity: In this second area of cooperation, China has pledged $7.34 billion in soft loans or official development assistance and grants for large-scale Philippine infrastructure projects and flagship programs. This amount forms part of $24 billion worth of agreements Beijing committed to President Rodrigo Duterte on his first visit to China in 2016. Interestingly, from 2016, when President Duterte took office, to 2017, loans and grants from China registered an astronomical 5,862 percent increase, according to Bloomberg. The basket of loans through official development assistance programs in two tranches ($7.19 billion) includes dam and irrigation, railways, expressways and bridge projects, among others.

Trade and investment: China became the Philippines' largest trading partner in early 2017, marking an increase of $15.04 billion (16 percent) from 2016. Furthermore, investments approved by the Philippine Economic Zone Authority and the Board of Investments more than tripled for the first three quarters of 2017 to around $40 million (from $10.9 million in 2016). Remarkably, private Chinese firms are also making headways in penetrating the Philippine consumer market through mobile firms such as Huawei, Xiaomi, Oppo, and Vivo—enterprises that last year ranked among the top 10 selling brands in the world, according to the World Intellectual Property Organization.

Even Alibaba Group is making its presence felt in promoting financial inclusion and digital payment services through strategic partnerships with local firms, such as Globe Fintech Innovations Inc. or Mint. Moreover, Alibaba's Alipay and Tencent's WeChat Pay have also signed licensing agreements with Asia United Bank, which favorably enables Chinese tourists to drive

The BRI in the Philippines is indicative that the China-led regime is not only a government venture, but is a "whole-of-country" approach.

the growth of cashless payment systems in the Philippines. In the area of telecommunications, President Duterte even endorsed the participation of a Chinese state-run company to be the third telecom carrier in the country in order to break the long-standing duopoly and improve the quality of Internet service in the Philippines.

Financial integration and connectivity: The Philippine Central Bank last year officially added the renminbi as part of its international reserves, joining more than half of BRI countries that have already done so. Early this year, the Central Bank additionally approved the Peso-Yuan spot market, which will lower the transaction costs for Philippine and Chinese banks and businesses by reducing reliance on the dollar as the intermediate peg. Around the same time, the issuance of "panda bonds" or renminbi-denominated bonds worth $200 million began, which could pave the way for more access to Chinese assistance in Philippine financial requirements. Furthermore, the Philippine government has announced plans of partnering with the Alibaba Group to create a more inclusive financial system to help rural communities and SMEs. Their plans would also cut transaction costs for overseas Filipino workers when remitting money to the Philippines through online banking services.

People–to–people exchanges and connectivity: China has become the Philippines' second-largest tourism market. As of November 2017, 14 new flights connect China and the Philippines, and the Philippine Bureau of Immigration initiated a Visa Upon Arrival scheme for Chinese tourists. Separately, in the area of media and communications, China Central Television and the Presidential Communications Operations Office have signed an MOU for the rebroadcasting of China Global Television Network programs, which are part of the Belt and Road News Alliance of China Central Television.

WIN-WIN FOR BOTH

The significant progress in the BRI's five key areas of cooperation in the Philippines underscores the rising stakes in and deepening complex interdependence of Sino-Philippine relations.

The BRI in the Philippines is also indicative that the China-led regime is not only a government venture, but is a "whole-of-country" approach, which includes the active participation of China's private sector.

While it is true that the success of China's BRI would depend on the political environment in each country, China may err on the side of caution by ensuring that proposed projects are transparent, commercially viable, and that participating companies are of good standing. Should Chinese projects flounder, there is a risk of legal action and nationalist backlash, and China, the BRI, and President Duterte would all accrue reputational costs.

Going forward, deepened Sino-Philippine economic cooperation will shift the bilateral dynamics from confrontation to cooperation and create an environment conducive to advancing the overall ties. But sustaining the BRI momentum, apart from risk mitigation strategies, policy guidance or institutionalization—just as what China has done with other countries—may be done through an MOU on Belt and Road cooperation. A joint BRI working committee or BRI action plan may also be formed so that planned projects can outlive brief six-year stints of Philippine presidencies.

This article is based on a paper that the author wrote, which can be accessed here.

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BRI: TIME FOR THE WEST TO ENGAGE

Andrew Cainey
Associate Fellow at Chatham House Asia-Pacific Programme and Co-Founder of Asiability

On the fifth anniversary of China's Belt and Road Initiative, many in the U.S. and Europe are still grappling with how best to react. While the largest multinationals such as HSBC and Siemens pursue business by forming their own BRI teams, many others active in infrastructure investment remain unclear about whether and how to engage.

G-7 governments are mostly reluctant to offer full support to the BRI, citing concerns about standards, sustainability and potential security implications. Among them, only Italy is seeking to sign a memorandum of understanding with China by the end of the year. However, much more can be done by the West to shape the development of the BRI.

VIEWS FROM THE WEST

For the West, the very nature of the BRI makes engagement a challenge—the BRI is inherently amorphous and multifaceted. In Chinese terms, this is a strength. It is a design feature, not a bug. It accords well with the approach of the Chinese leadership in setting fuzzy aspirations and direction for economic development, while letting individual local governments and companies figure out the way to realize this locally. The lack of detail allows space for experimentation and avoids setting hard targets against which progress can be measured.

Outside of China, however, such ambiguity makes it more difficult for others to know where they can engage and on what terms—and, indeed, what they will be engaging with. Many complain about a lack of detail and contact information. Others fear that giving endorsement amounts to writing a blank check to support activities that potentially run counter to their principles and interests. These two different perspectives represent a fundamental divide between the West and China on how they conceptualize and implement efforts such as the BRI.

The large gap between the broader aspirations articulated for the BRI and the nature of the projects so far underway also makes the picture more confusing. Chinese leaders speak of the BRI as an opportunity for all, as an open, "sunshine initiative," drawing on private finance and capabilities of foreign companies alongside Chinese state financing. This is an appealing proposition in a world buffeted by protectionist trade pressures and with unmet infrastructure needs. It complements China's continued, gradual progress in reform and opening to foreign companies. It is, however, a long way from the nature of projects to date—where Chinese state bank lending predominates, linked to the use of Chinese state-owned enterprises, often with the deployment of mainly Chinese workers.

This ambiguity and difference leaves space for Western countries and companies to project their own best hopes and worst fears about China's intentions from the BRI. Some overestimate the scale of the initiative and make overly optimistic assumptions about the role foreign companies can play. Others see contracts only for Chinese companies or emphasize potential security and defense implications over economic priorities, fearing a primarily security-driven initiative that threatens Western interests.

HOW SHOULD THE WEST RESPOND?

One strategy gaining ground is, in fact, competition rather than engagement. In response to China's focus on infrastructure investment, others are increasing their own funding and focus, with Japan, the U.S. and the EU announcing new connectivity initiatives and funding. This brings increased resourcing and choice for recipient countries—and the resulting competition will no doubt work to the benefit of these countries. It does not, however, remove the benefits of more active engagement with the BRI itself. China is pursuing a parallel strategy of engaging with existing multilateral institutions and creating its own new ones, such as the Asian Infrastructure Investment Bank. The West should take a similar approach.

The opportunity is to take China at its word—to identify practical opportunities to work on together and create more sustainable and transparent BRI projects, with diversified funding and implementation.

Many Western companies are already pursuing BRI-related contracts, selling equipment and helping Chinese enterprises expand into new countries. Leading Chinese lenders and state-owned enterprises already recognize the benefits that come from drawing on Western expertise in areas and countries that are unfamiliar to them. While positive, this is a natural part of doing business and, on its own, will not fundamentally shift the nature of BRI projects. That will take government focus and involvement as well.

The biggest stumbling block is standards. China acknowledges the benefits of improving standards, but takes a situational approach.

DOWN THE ROAD, EAST AND WEST NEED TO UNITE

The biggest stumbling block is standards: Western institutions place high value on internationally accepted standards of governance, environmental impact, anti-corruption, transparency and open procurement. China acknowledges the benefits of improving standards over time, but takes a more situational approach: It argues that pragmatic implementation is more important and that it abides by the standards of the countries in which it operates, even as it raises its own standards at home. In emerging markets, many government leaders prefer the new roads and bridges to be built now rather than focusing first on standards. China offers faster financing and faster construction. But this can also store up problems in badly executed projects and allegations of corruption.

Rather than battling to make project financing contingent on accepting either the Western or Chinese view of standards as a matter of principle, it is more effective to identify what brings the most sustainable benefits for the third-country recipient. Taken alone, the current model of Chinese financing and use of Chinese contractors is inherently self-limiting in size and can be risky—both for the borrower and the lender. Countries will be in a better position if they are able to bring together the best of Chinese pragmatism, execution and financing volumes with the expertise, access to financial markets and improved risk management that Western institutions can bring. This means a role for Western governments in helping recipient countries strengthen their own decision-making processes and improve transparency. It means a focus on anti-corruption measures, recognizing that this is consistent with China's own anti-corruption efforts at home and overseas. Scandals in Malaysia and elsewhere make addressing this an even higher priority for all parties.

Co-financing structures are critical to shaping the terms of BRI projects. This additional financing can come mostly from global financial markets, rather than relying solely on G-7-led development financing being added to Chinese state lending. Chinese lenders are keen to seek co-financing in this way: It frees up capital on their balance sheet for further projects and so enables a larger scale of activity. It is also the route to improving transparency, compliance, governance and economic sustainability on these projects. There are already well-established standards that determine which projects are investable and with what credit rating. Chinese banks and state-owned enterprises are keen to get advice from Western companies on this.

The scale and amorphous nature of BRI make it hard to do any of this at the overall level. The way to make this feasible is by selecting individual projects and countries to work with, in partnership with the relevant country governments and China. This allows focus and experimentation, while reducing the impact of any failure. It could start, for example, by working together on a new model alongside China in one or two countries in Eastern Europe that have an eye on EU accession. Or, it could mean looking to countries in Africa and Asia with historical, colonial ties and continued positive relationships with G-7 members.

In any event, others are already pursuing this approach. Following pressures on the financing of the China-Pakistan Economic Corridor (CPEC), Pakistan has now invited Saudi Arabia into CPEC as a partner alongside China, with China's explicit agreement. A similar invitation was reportedly extended to the U.S. but was not taken up. Where some choose not to act, the void is soon filled. It is time for Western governments to choose where they want to get involved and help create new realities on the ground for the BRI that are not driven by China alone.

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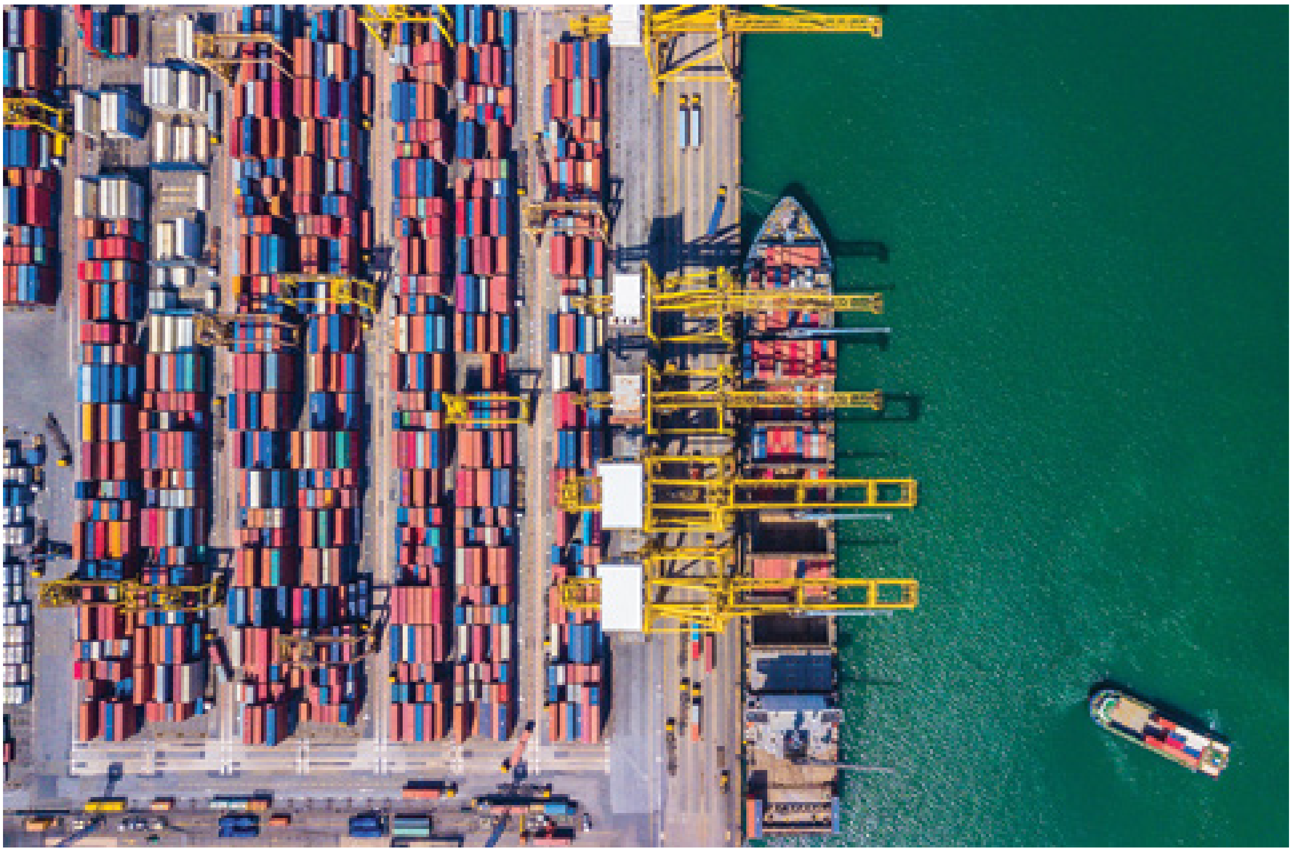
CAN SINGAPORE'S SHIPPING HUB SURVIVE CHINA'S MARITIME SILK ROAD?

Shen Yiming
Senior Vice President and Head of China Client Services, Asia for Marsh



There are arguments that China's Belt and Road Initiative poses more challenges and threats than opportunities for Singapore.

First of all, BRI aims to enhance inland transportation, mostly by train, from China to mid-Asia and Europe, as well as enlarge the scale of pipeline networks. This will divert a significant amount of seaborne trading volume, originally transported via the Strait of Malacca, indirectly hurting the interests of Singapore.

THE MARITIME SILK ROAD

One geoeconomic rationale behind the "Maritime Silk Road" (MSR) relates to China's Malacca dilemma. The term refers to China's over-reliance on energy imports transiting the Strait of Malacca. Over 80 percent of Chinese maritime oil imports and 30 percent of natural gas imports have to pass through the Strait of Malacca. To buttress its energy security, China is determined to circumvent this route by developing more reliable alternative land and maritime routes for energy imports along the Belt and Road.

For example, China is again seeking influence in Malaysia as it spreads its economic clout through Southeast Asia. It is investing $7.2 billion in a redevelopment project that will see Malacca become a new deep sea port.

The MSR initiative allows China to explore alternatives for its seaborne trade stop, currently located in Singapore. With the MSR initiative, Singapore is in a vulnerable position where it risks getting sidelined, after enjoying decades of being a key node in many of the regional sea routes. The alternative ports that may emerge from the MSR initiative include:

- Tanjung Priok Port, Indonesia
- Malacca, Port Klang, Malaysia
- Gwadar Port, Pakistan
- Hambantota Port, Sri Lanka
- Darwin Port, Australia

SINGAPORE HOLDS FIRM ITS MARITIME POSITION

Some analysts believe that Malaysia may overtake Singapore as the largest port in the region. Singapore has long enjoyed the benefit of its geographic advantage due to the Strait of Malacca. Using its port and terminal facilities, Singapore has become the most important container transshipment hub in Asia-Pacific since the '90s. Singapore's government has initiated various tax incentives and financial subsidiary plans that attracted lots of MNCs to designate Singapore as their regional hub or global headquarters.

In the maritime industry, Singapore is tremendously successful, continually ranked the number one maritime capital city in the Asia-Pacific region, surpassing even Hong Kong for the past decade. Singapore leads as the shipping hub for port terminal operations, bunkering, offshore building, ship brokering, ship financing, forward freight agreement trading, marine insurance and maritime lawsuit jurisdiction. In the context of the BRI, including the MSR initiative, Singapore has the potential to continue its leading role in the maritime industry.

As a sovereign country, Singapore's position remains unbiased, and it may possess more diplomatic flexibility than Hong Kong. Also, as many of the countries involved in BRI are relatively less developed and may be weaker in terms of governance—whether in terms of transparency or in possessing a credible legal and judiciary system—Singapore maintains an advantage on these counts.

According to Menon's Leading Maritime Capitals of the World report published in 2017, Singapore again clinched the top position. Singapore was also ranked first in 2015 and 2012. Singapore's continued dominance is due in part to its continued innovation and its strong maritime services environment, which includes legal, insurance, and shipbroking.

Singapore's maritime ecosystem comprises over 5,000 establishments employing more than 170,000 people and contributing about 7 percent to the republic's GDP. Home to more than 140 of the world's top shipping groups, a rich diversity of maritime products and services can be found in Singapore. It is the ideal Asian gateway for global leaders in shipping finance, shipbroking, risk management and maritime insurance. Singapore is also fast becoming Asia's hub for maritime law and arbitration.

Singapore's offering as an international maritime center continues to grow. While more than 140 shipping companies are already represented in Singapore, new companies continue to join—with the West of England P&I Club as an example. At the same time, the Singapore Registry of Ships is still

China will invest heavily in ports and terminals overseas, bringing in about $1.3 billion premium in revenue in marine insurance alone.

among the world's top five largest ship registries in the world.

Additionally, in making predictions about the world's leading maritime capitals five years ahead, the majority of industry experts surveyed shared a consensus that Singapore will remain the most important city, with many believing that the country has strong capabilities to handle digital transformation in the maritime industry.

CHINA CATCHING UP TO SINGAPORE

The Menon report cited expert consensus that Singapore would remain the "most important city" come 2022, but it also noted that Shanghai would become the second most important maritime hub. "The fact that Singapore and Shanghai are expected to become the most important centers for the industry tells something about the changing center of gravity in both the world economy and the maritime industry."

Shanghai has been moving up the ranks in tandem with China's continued development. It has been the world's busiest port by container volumes since 2010, and the momentum is expected to continue. Seven of the world's 10 largest ports are in China, and they're all experiencing an unprecedented boom in the movement of goods.

OPPORTUNITY FOR MARINE INSURANCE

During the phase of rapid economic growth in the country since 2004, the Chinese marine insurance market had already expanded to become the world's second-largest market for cargo insurance and the world's largest market for marine hull insurance. However, the majority of this exponential premium growth comes from domestic seaborne trading, including inland water and coastal shipping.

To boost international shipping and logistics, China will invest heavily in ports and terminals overseas, leveling up the port transshipment ability and terminal efficiency alongside the MSR trade routes. This is forecasted to bring in about $1.3 billion premium in revenue in marine insurance alone.

Since the initiative is largely focused on the infrastructure sector, especially for port and terminal facilities, there will be more heavy machinery and project cargo being shipped to support the implementation of the plan. From an insurance perspective, one single unit has a total weight of 200-300 metric tons and their sales value would easily exceed $10 million each. These types of project cargo normally have higher insured values and require high limits in terms of liability insurance cover.

Furthermore, handling these project cargoes, for example, transporting, installation, fixing and testing, is more complicated, thus raising the complexity and uncertainty for insurance claims handling. More importantly, since the deal is transacted across different countries, involving different laws and jurisdiction zones, the assureds will always prefer to pursue their disputes for arbitration outside the contracting countries, where the jurisdiction will not be biased.

SINGAPORE'S ROLE IN MARINE INSURANCE

Being Asia's insurance hub, Singapore is the ideal place for marine insurance placement for the following reasons:

- As the top maritime business center, Singapore leads the marine insurance industry in the Asia-Pacific region. Serving as the base for Lloyd's Asia, several other international insurers and eight marine P&I clubs, Singapore's insurance market has sufficient capacity to absorb the growth arising from the MSR initiative.
- The international insurance markets possess superior claims resources, such as claims experts, correspondents, marine surveyors and maritime lawyers. Such professional services maintain the highest quality of service and are easily accepted by other overseas markets. A distinct example is that co-insurance is the common practice for marine hull insurance over time, and the Chinese insurers prefer to follow the leaders in the international markets based in Singapore—in terms of rating and claims handling, for example.
- The free flow of foreign currency in Singapore clears the barriers for claims payments to overseas clients, which is still one of the main concerns for Chinese insurance companies when dealing with transactions in U.S. dollar.

Singaporean firms have also been able to support these high-frequency financing activities with quality insurance coverage for BRI projects and have participated in regional insurance pools to expand coverage to a wider range of risks. A recent notable development is the establishment of the Belt and Road Insurance consortium of Singapore in December 2017, which brings together insurers, reinsurers and brokers from Singapore and China to improve capacity and provide more holistic, all-in-one solutions for protection and risk management across a wide range of risks to BRI projects in the region.

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THE FUTURE OF BELT AND ROAD: DEBT AND DELAYS, OR HUGE GROWTH?

Sonal Varma
Chief India Economist at Nomura

Euben Paracuelles
Chief ASEAN Economist at Nomura

The Belt and Road Initiative is China's attempt to improve global trade connectivity by filling the infrastructure deficit experienced by poorer recipient economies. It is doing so by investing in infrastructure such as road, rail, pipelines, energy, fiber optic links and ports.

While there are undoubtedly risks associated with these BRI investments, there are many ways in which partner countries can benefit and, indeed, have already started benefitting.

KEY BENEFITS FOR PARTNER ECONOMIES

With over 80 countries and international organizations as its members, the BRI is expected to have a profound impact on global geoeconomics. This is because of both the scale and the ambition of this project.

An infrastructure stimulus

Infrastructure deficits due to stretched government finances and lack of technical capabilities have impeded growth in a number of recipient countries. Given these gaps, BRI investments will be a reprieve for member states. This is especially true for smaller economies: The proposed BRI investments make up 20 percent of 2017 GDP for Pakistan and about 15 percent for Bangladesh, for instance.

These large infrastructure investments can boost productivity and growth, and better connectivity and quality transport infrastructure should enable Asia's poorer economies to become integral parts of the global value chain—especially as rising labor costs force Chinese firms to invest in other lower-cost destinations, such as garment manufacturing in Bangladesh. Improved infrastructure will also support regional development in general.

The BRI also presents an opportunity for more developed economies. For instance, Singapore could partner with China in building these BRI projects, and Malaysia could benefit from increased Chinese FDI in solar power.

A mega boost to regional trade integration

The BRI will also promote connectivity through elements such as more harmonized cross-border administrative procedures, which should promote greater regional trade integration. China's bilateral trade with BRI countries stood at $962 billion in 2016 (25 percent of total), and Chinese President Xi Jinping stated back in 2015 that he hoped China's annual trade with BRI countries would surpass $2.5 trillion in a decade. The benefit to recipient countries will flow through due to reduced transport costs and better trade facilitation.

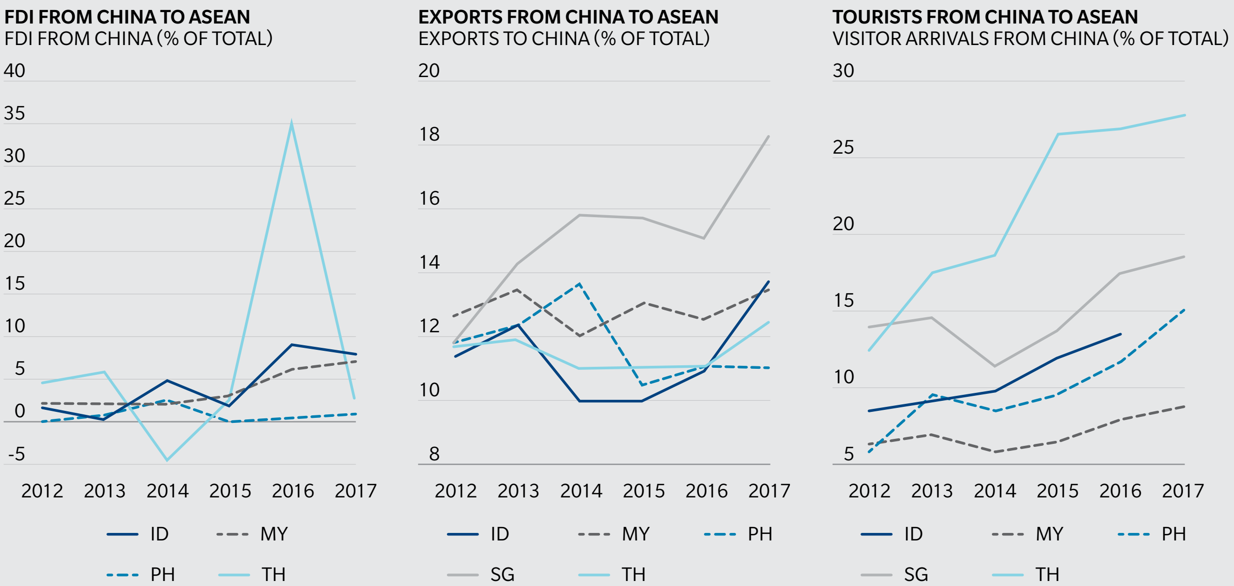
Development of the services sector

The BRI will promote the development of the services sector, especially in areas that cater to transit trade. This will be a particular boon for places such as Pakistan, which expects up to 4 percent of global trade to pass through the Gwadar-Xinjiang corridor by 2020, and Sri Lanka, which is likely to be integrated into a China-backed global trading route. Cross-border e-commerce and real estate investments are other areas expected to receive a boost. Additionally, tourism in most BRI countries will benefit, as better infrastructure will help attract tourists from both China and elsewhere.

Financial sector integration is another likely outcome, as the banking sector in partner countries

EXHIBIT 1: IMPACT ON ASEAN AS A RESULT OF THE BRI

Source: CEIC, Nomura Global Economics



Note: We use FDI inflows for Malaysia, equity FDI for the Philippines and net FDI for Thailand.

Note: We use non-oil domestic exports for Singapore.

Note: Malaysia includes China, HK and Macau.

will need to cooperate in on-lending and trade finance, in turn leading to growth in legal and professional services. Singapore stands to benefit the most: first, as a stopover for Chinese tourists en route to other destinations; second, as a logistics and transshipment hub; and third, as an international financial center.

Rising FDI inflows

FDI inflows could boost productivity growth in BRI partner countries and help lift potential growth. We see scope for higher FDI inflows from China, which, despite recent increases, still has a relatively small share of total FDI (Exhibit 1). Partner countries' FDI prospects look fairly positive as a result of the BRI.

For example, the electronics and tourism sectors could be an attractive destination for more Chinese FDI in Thailand under its flagship Eastern Economic Corridor. Similarly, FDI is also likely to flow into the manufacturing sector in Indonesia, which is trying to reduce its dependence on the commodity sector.

RISKS TO RECIPIENT COUNTRIES

Hand in hand with the many potential advantages that partner countries will derive from the BRI, there exist some risks.

Debt sustainability

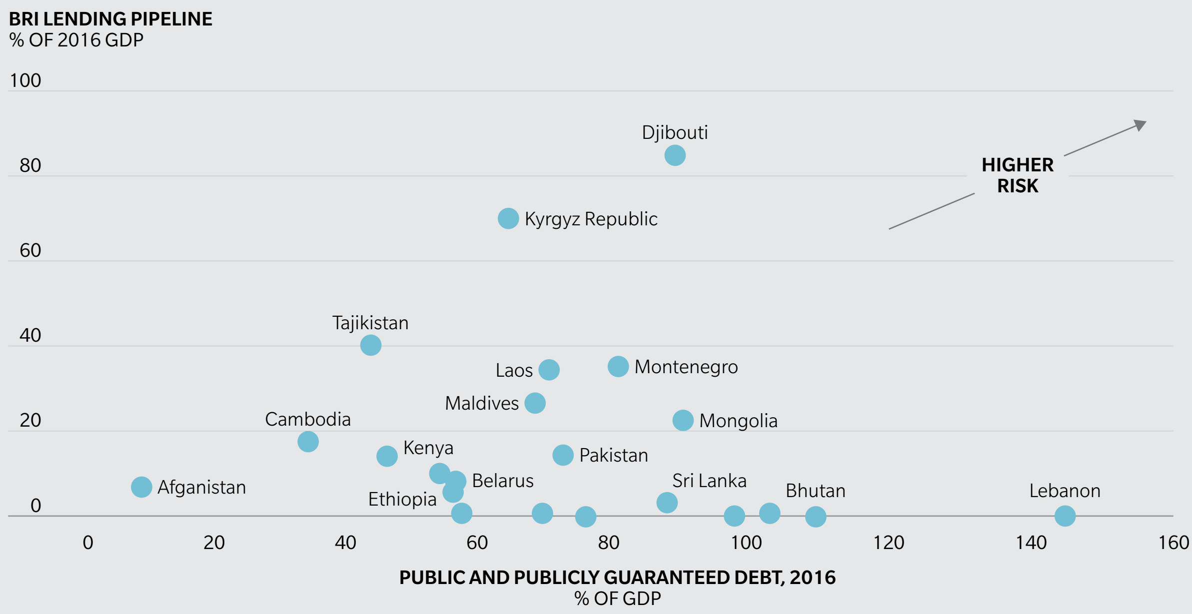
The biggest concern with the BRI is the risk posed by an increased debt burden. Certain smaller economies, such as Pakistan and Bangladesh, are likely to receive substantial lending from China. The exact terms of the funding are not all publicly available, but they cover both concessional and commercial loans. Loans taken at a commercial rate for a project that does not generate sufficient returns would hurt the debt-servicing capacity of borrowers and result in debt distress. A Center for Global Development paper identifies eight countries, including Pakistan, that could suffer from debt distress due to future BRI-related financing (Exhibit 2).

Sovereignty

In cases of debt distress, sovereignty issues could come to the fore. Sri Lanka's inability to service debt taken to finance construction of the Hambantota Port resulted in China receiving a 99-year lease for managing the port. This, in turn, has raised concerns in India that the

EXHIBIT 2: PUBLIC DEBT AND BRI LENDING PIPELINE

Source: John Hurley, Scott Morris, and Gailyn Portelance. 2018. "Examining the Debt Implications of the Belt and Road Initiative from a Policy Perspective." CGD Policy Paper. Washington, DC. Center for Global Department.



port could serve as a Chinese naval base. Smaller developing countries are more at risk as they do not have substantial bargaining power. Already, there are concerns that China's use of Chinese construction materials and workers for BRI projects limits multiplier effects for recipient economies.

Balance-of-payment risks

The BRI will increase trade between China and partner countries, but given the competitiveness of Chinese goods and the import of Chinese machinery under BRI projects, lower trade barriers could result in a sharper rise in imports from China than exports to China, ultimately widening trade deficits. Debt repayments and repatriation of profit could add further pressure, deteriorating the balance-of-payments position and exerting pressure on currencies. External indicators already show Pakistan and Kazakhstan as starting from a weak position.

Legal risks and implementation delays

Delays are not uncommon for big-ticket projects, but one benefit of the BRI is supposed to be an improved execution of such infrastructure projects, with Chinese funding support and technical capabilities.

However, thus far, this is not playing out as expected in some ASEAN countries. Across host countries, there is a range of execution problems, from land acquisition delays to cost overruns, among other constraints. And the high-speed rail projects in Thailand and Indonesia are experiencing significant delays as well the risk of reduced or minimal support from China. These problems may preclude other BRI projects, which have yet to be included in the pipeline, and may affect other channels such as non-BRI-related FDI inflows and stronger linkages in trade and tourism.

Moreover, most frontier economies have varied and less-developed legal systems. Resolving disputes in international contracts could result in complexities for companies involved in BRI projects.

OVERCOMING THE CHALLENGES

Over time, there has been greater recognition of these associated risks and challenges and the need to address them. China has taken steps to improve the perception of the BRI after questions were raised over its real motives, especially by emphasizing the importance of greater connectivity and more investment in both hard and soft infrastructure. The BRI is evolving to show that it is flexible enough to accommodate the growth strategies of recipient countries. Also, more multilateral financing mechanisms such as the Asian Infrastructure Investment Bank should increase transparency.

Overall, the BRI can be a win-win initiative for both China and the recipient economies. China has the financial muscle and the technical infrastructure expertise, while many BRI countries are fiscally constrained and lack infrastructure funding. The BRI allows China to export its own manufacturing overcapacity, while better infrastructure in recipient countries will enable local industrialization and business creation. This should ultimately allow the significant, long-term benefits of the BRI to materialize.

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CHINA'S ARCTIC POLICY AND BELT AND ROAD INITIATIVE: SYNERGY OR CONFLICT?

Nengye Liu
Senior Lecturer at Adelaide Law School, University of Adelaide

China has been an active player in the Arctic region over the past decade. It built its first Arctic research station, Yellow River, in the Norwegian archipelago of Svalbard in 1999, and Chinese icebreaker Xue Long (Snow Dragon) sailed across the Northern Sea route along the Russian coastline in the summer of 2012.

Last October, Xue Long returned to base in Shanghai after 83 days on the Arctic rim, having completed its eighth Arctic expedition. This marked China's first circumnavigation of the Arctic rim.

THE TWIN FOCUS

On Jan. 26, 2018, China published its first ever official Arctic Policy. This marks a milestone for China's engagement with the Arctic region, which is undergoing significant, rapid ice-melting due to global warming. China's Arctic Policy draws a clear picture about objectives, guiding principles and actions of Chinese participation in Arctic affairs. It is stated by the Chinese government that China is an important Arctic stakeholder and is a near-Arctic-state geographically.

At the same time, China has been promoting the Belt and Road Initiative, which covers nearly 70 countries, since 2013. The BRI is Chinese President Xi Jinping's signature foreign investment plan, first announced in Kazakhstan. After the first phase (2013-2017), the BRI was even incorporated into the Constitution of the Communist Party of China (CPC) during the

CPC's 19th National Congress, held from Oct. 18 to 23, 2017. This was a strong signal that China is going to continue pursuing the BRI in the years to come.

One of the BRI's aims is to connect the Eurasian continent, which does have an Arctic component. China's National Development and Reform Commission and the State Oceanic Administration published the Vision for Maritime Cooperation under the Belt and Road Initiative, "the Vision," in May 2017, which includes the Arctic as one of the cooperation priorities. According to China's Arctic Policy, China is planning to build a "Polar Silk Road" together with Arctic coastal states, in particular Russia, as part of China's BRI. The Polar Silk Road is supposed to connect with the Russia-dominant Eurasian Economic Union.

WHY FOCUS ON THE ARCTIC?

The Arctic is a highly environmentally vulnerable and sensitive region. Development projects backed by foreign investment might be tempting but need to ensure the protection of the Arctic environment. It is therefore worth examining how the BRI, as an extensive investment plan, interacts with China's policy objectives to understand, protect and use the Arctic.

On the one hand, Arctic shipping routes, particularly the Northern Sea route, would potentially save time and costs for connecting China with both the resources-rich Russian Arctic and the Western European market—the so-called blue economy corridor. In the meantime, an infrastructure deficit is a pressing problem for prosperous shipping along this sea route. Russia is motivated to look to China as a potential investor, technology partner and consumer market. It is therefore an economic opportunity for China's BRI.

Indeed, China's Arctic Policy has identified the development of Arctic shipping routes as the first priority to use the Arctic, saying: "China encourages its enterprises to participate in the infrastructure construction for these routes and conduct commercial trial voyages in accordance with the law to pave the way for their commercial and regularized operation." In the summer of 2017, COSCO Shipping Specialized Carriers, a member of the COSCO Group, China's largest shipping company, had already started regularly using the Northern Sea route as a commercial shipping route to Europe. China does not show interest in challenging Russian jurisdiction in the Northern Sea route and is willing to follow Russian law. Further, Chinese vessels are generally responsible and are not known to cause environmental disasters. The BRI, therefore, seems to be in perfect synergy with China's Arctic Policy when it comes to Arctic shipping.

CHINA'S ROLE

Activities taking place outside the Arctic region are the main contributors to climate change

To ensure that the Belt and Road Initiative is not in conflict with its Arctic Policy, China will have to pay more attention to building a green belt and road.

effects and pollution in the Arctic. China's BRI covers six of the ten most climate-vulnerable countries, and it had been involved in 240 coal power plant projects in 25 BRI countries by the end of 2016. The fear is that China might help lock developing countries into coal-power assets that will last decades and contribute to climate change. In turn, the BRI's contributions to climate change would cause further damage to Arctic environment. This would be contradictory to China's Arctic policy objective to address climate change so as to protect the Arctic.

However, China has ratified the Paris Agreement and included measures to deal with climate change such as Nationally Determined Contributions in its overall national development agenda and planning. To make sure that the BRI is not in conflict with its Arctic Policy, China will have to pay more attention to fulfill its vision of building a green belt and road, as indicated by China's Ministry of Environmental Protection in its 2017 Guidance on Promoting Green Belt and Road.

In particular, strict environmental and climate standards should be integrated into domestic Chinese law as criteria for approving overseas investment along the Belt and Road.

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CAN THE BELT AND ROAD INITIATIVE BE GREEN?

Ruediger Geis
Head of Trade Affairs at Commerzbank AG

China's Belt and Road Initiative is foremost the country's bid to improve economic integration with economies across Eurasia and into Africa. But, the project—while extraordinary in scale and reach—poses many questions, particularly around its commitment to the environment. Notably, can China successfully dovetail its BRI-related investments with its Paris Agreement targets? Or, instead, are these efforts mutually exclusive?

China's growth since the turn of the millennium has been largely predicated on its use of fossil fuels. Yet, a repetition of this carbon-rich growth model across 72 countries along the Belt and Road would, of course, be at odds with worldwide commitment to carbon emission reduction. Though China has, in recent years, changed its trajectory by becoming a global leader in renewable technologies, discrepancies remain in China's definition of what constitutes "green."

"GREEN" CHINA

This is partly due to the country's use of fossil fuels, which amounts to nearly 88 percent of its annual energy consumption. It comes as little surprise, then, that since 2007, China has been the largest emitter of greenhouse gases.

But is the tide beginning to turn? As well as being the largest consumer of coal, China is now also home to one-third of the world's wind power, a quarter of its solar panels and the largest electric car market—all part of an effort to increase China's non-fossil fuel capacity from 13 percent to 20 percent by 2030.

And, to fund this vision, China plays a critical role in the development of green financing tools, including green bonds, climate bonds and green loans. China's green bond issuance, for instance, accounted for 39 percent of global totals in 2016—enough to dominate this growing market. And while 82 percent of China's green bonds were issued domestically in 2016, the transition toward green financing is certainly not limited to China's domestic endeavors.

GREEN FINANCE AND THE BRI

By 2049, it is estimated that $8 trillion will have been invested into the BRI—making it near impossible for China to rely solely on public finance. As a result, the deputy governor of the People's Bank of China believes that green financing will be a "key pillar" of the BRI's success, a trend already discernible in the financing markets.

For instance, in November 2017, Commerzbank—acting as joint lead manager and joint book runner on the deal's European tranche—assisted the China Development Bank with the successful issuance of the first green BRI bond. The proceeds from the five-year $500 million and four-year 1 billion euro tranches ($1.1 billion) will contribute to renewable energy, clean transportation and water resource management projects located in strategically significant locations along the BRI, including China, Kazakhstan, Pakistan and Sri Lanka. In the same month, the Bank of China sold a climate bond in three currencies.

A month earlier, the Industrial and Commercial Bank of China listed its inaugural green bonds, comprising three tranches totaling 1.1 billion euros, $450 million and $400 million.

WHAT'S GREEN?

China's expansion into green financing has not been without complication, however. Currently there are various metrics used to measure whether a bond is green, creating a mismatch between Chinese and international definitions. For a bond to be internationally recognized as green by a body such as the Climate Bonds Initiative (CBI), at least 95 percent of the proceeds must be invested into green projects.

Crucially, the CBI's definition excludes fossil fuel retrofits that, while cleaner and low-carbon, are incongruent with international climate goals. Of all coal plants going online in the next decade, China's energy companies are involved in almost half, either at home or around the world. The result is that, in 2017, 38 percent—or $14.2 billion—of China's green bond issuance did not meet international green definitions.

So, what is being done? To better harmonize standards, the CBI has been looking to launch Green Bond Connect, in partnership with the Hong Kong Stock Exchange, which would allow investors to identify which bonds are certified green by the CBI and thus meet international standards.

China, too, is beginning to address the issue. In December 2018, China announced its plans to exclude "clean coal" from its green bond. The decision represents a big step toward the global adoption of green definitions. In tandem, China is working alongside international banks to implement more intelligent, tailor-made hedging tools that may help offset some of the risks inherent in the BRI. What China is rapidly learning is that sustainable investment is becoming the international standard.

Numerous standards promise fair incomes for commodity producers—but distinguishing those that are reliable, compared to those that are "greenwashing," is difficult.

SUSTAINABLE TRADE

Assessing sustainability in such detail is also important when it comes to trade. Environmental risks associated with climate change are worsening, which, in many cases, can lead to material effects on supply chains. In addition to protecting our ecosystem, increasing corporate longevity is another clear rationale for adapting behaviors.

Again, clearer certification could help. Numerous standards and labels promise fair incomes for commodity producers—but distinguishing those that are reliable, compared to those that are effectively "greenwashing," is becoming more difficult.

In close cooperation with major bodies, those active in the trade finance industry are looking at determining what a trustworthy certificate should contain and how it should be constructed. This should drive more reliable certificates that guarantee a fair deal for producers at the start of a supply chain, promise safe and secure labor conditions for those working across it and offer protection for the environment.

By collaborating with international banks and organizations, China can fully embrace internationally accepted green definitions and technologies, allowing the huge and laudable ambition of the BRI to be matched by, and complementary to, the climate and sustainability goals of the international financing community.

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CAN INVESTORS DRIVE SUSTAINABILITY ALONG THE BELT AND ROAD?

Alison Hoare
Senior Research Fellow in Chatham House's Energy, Environment and Resources Programme

The Belt and Road Initiative is aimed at increasing links between China and the rest of the world, in large part through encouraging investment in transport, energy and communications infrastructure. This will create significant opportunities for trade and business, and some impacts have already been seen.

In 2017, for instance, China's trade with countries along the Belt and Road increased to over a quarter of the country's total foreign trade by value. One objective of the BRI is that it will "promote ecological progress in conducting investment and trade," and given its scale and ambition, there is huge potential for this initiative to help drive more sustainable business practices in all BRI partner countries.

INTEGRATING SUSTAINABILITY

Ensuring that investments are made in sustainable infrastructure is key. Large-scale infrastructure projects bring the risk of significant negative environmental and social impacts, but they can also be an agent of positive change. Because of their scale, they are a major source of contracts and business opportunities, offering the potential to drive a shift toward more sustainable modes of life and business practices. For example, the construction sector uses an estimated 50 percent of the world's raw materials production and 80 percent of mineral raw materials production. Therefore, if only sustainable products are used to build infrastructure, this creates a huge market for these products and can result in significant changes to business practices across the sector. Similarly, if contractors and service providers are required to implement environmental-management systems, or if sustainable construction methods and technologies are used, significant demand for sustainable businesses is created.

The potential impact of integrating sustainability into the design and construction of infrastructure projects can be seen from some recent examples. For example, the 2012 London Olympics sought to be the "greenest games" to date, and a sustainable procurement strategy was developed to help achieve this. This resulted in a reduction in the water, energy and materials used for construction as well as improved environmental performance of the site, including high levels of energy efficiency. Furthermore, this had a long-term legacy for many of the sectors involved. For example, implementation of the policy to source 100 percent legal and sustainable timber resulted in several contractors of the games revising their own chain-of-custody systems and procurement policies. In addition, through working closely with industry and sending a clear signal that innovative and sustainable products were a priority for the games, a number of new, more sustainable products and processes (for example, concrete, lighting and plastics) were developed or brought to the market sooner than anticipated.

Another example comes from the Netherlands, where the government includes sustainability criteria in the tendering process for infrastructure projects as part of its efforts to reduce carbon emissions. This includes assessment of the sustainability performance of both the company as well as of the proposed project design. The use of this approach in tendering for the reconstruction of one motorway resulted in the selection of a design with expected energy consumption and carbon emissions reduced by 50 percent. This was achieved through ensuring the efficient use of construction materials and increasing their recycled content, as well as through adopting a design that reduced the forecast vehicle use of the motorway.

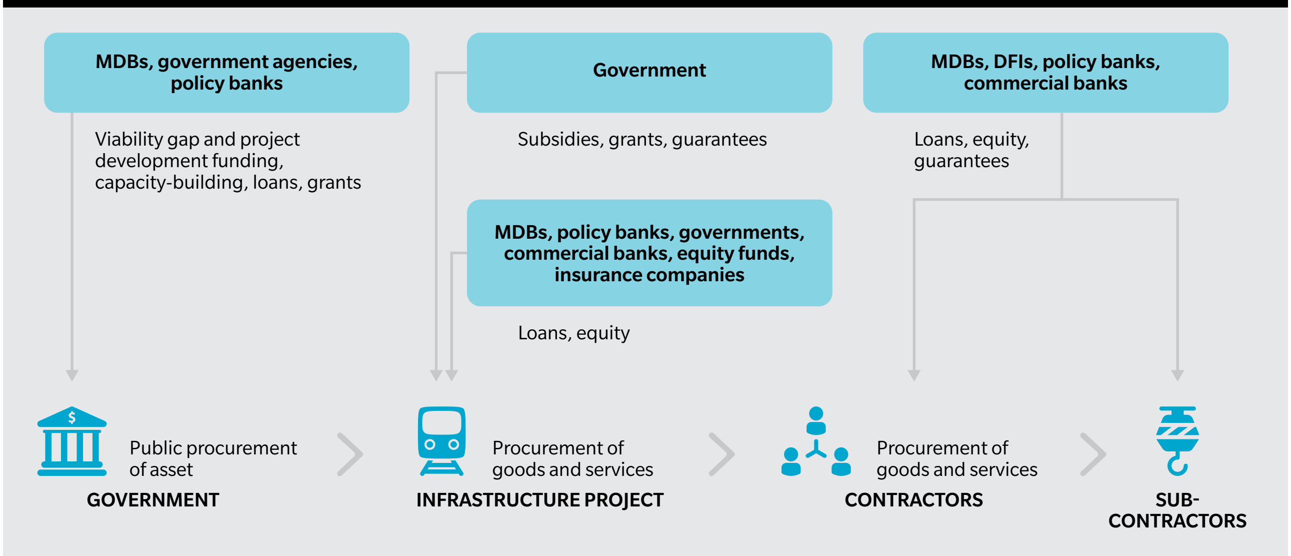
REALIZING THE POTENTIAL

These examples illustrate the potential for sustainable infrastructure projects to help shift businesses and the wider economy toward more sustainable practices. If ambitious sustainability targets could be implemented for BRI projects, the impact could be huge. There will be challenges to achieving this, however. Perhaps most important is the limited capacity in many of the BRI countries to develop or implement sustainable projects. This is where investors need to step in, particularly the multilateral development banks (MDBs) and China's policy banks, as explained in a recent report from Chatham House. They should be doing far more, both to increase the level of ambition of governments and to encourage innovation from the private sector.

One way this can be achieved is if the banks give greater priority to

EXHIBIT 1: PROCUREMENT IN INFRASTRUCTURE PROJECTS AND THE ROLE OF INVESTORS

Source: Compiled by the author



sustainable projects. Many of the banks have set up project preparation funds, and these play an important role in helping governments to develop bankable projects. However, the majority of these funds give little attention to sustainability. They should be prioritizing transformative projects or, at the very least, ensuring that sustainability issues are integrated into the project preparation process.

It is also important to increase the scale of capacity building both for governments and the private sector. The MDBs and, to a lesser extent, China's policy banks currently do provide advice as well as technical and financial support to borrowers. However, given the severely limited capacity in many countries, such activities need to be scaled up.

The banks also need to strengthen the sustainability targets for their entire investment portfolios. Considerable attention is being given to increasing the amount of green finance, which is very positive. However, the impact risks being undermined if further action is not taken by banks to ensure that all their investments are in line with the global climate agenda and the Sustainable Development Goals.

Increased cooperation between investors will be important to support progress in all these areas. This should include sharing best practice on sustainable procurement, agreeing on standards for sustainable infrastructure and developing methodologies to monitor the environmental footprint of investment portfolios. Perhaps most important of all is the need for far greater ambition from investors—only then will the BRI succeed in its goal of promoting ecological progress.

This article first appeared on BRINK Asia on May 11, 2018.

HOW TO MANAGE M&A RISK ALONG THE BRI

Agnes Vargas
Director, Asia, Commerzbank

The Belt and Road Initiative (BRI) is creating ample investment opportunities along its route, while also reshaping the scope of outbound Chinese investment. Such transformations, however, also come with material financial risks—for China, and for corporates and financial institutions worldwide.

The BRI embodies the broader story of China's economic transformation, which has now been three decades in the making. Driving the change is China's search for foreign investment and its push to open its industries to the world, particularly as the country continues to demonstrate that its reputation as a low-cost manufacturing center belongs in the distant past.

To cement this transformation the BRI has multiple objectives: Among them are improving infrastructure links across the old Silk Road to better integrate China within global supply chains, as well as reforming China's state-owned corporate giants to reduce their corporate debt and to stabilize the economy.

These governmental efforts dovetail with enormous opportunities for China's companies. Many are increasingly leveraging their (often unrivalled) expertise to secure BRI-related merger and acquisition (M&A) deals across Central Asia, the Middle East, Africa and Europe in numerous sectors such as technology, real estate, leisure and healthcare.

This raises concern, however. Many of these M&A deals boast astronomical ticket prices, while corporate debts and defaults are on the rise. Managing these risks will be one key determinant of BRI's success in the years ahead and will necessitate a more sophisticated approach to risk and cash management.

GROWING INVESTMENT

Nonetheless, the BRI is making inroads along its intended destinations. In 2007, China accounted for only 1 percent of global cross-border M&A in terms of value. By 2016, this figure had risen to 14 percent. As the volume of deals has increased, so too have sizes. For instance, ChemChina's recent $43 billion purchase of Syngenta, a Swiss pesticides and seeds group, was a major deal that might not have been expected a decade ago.

Perhaps the most important trend, however, has been geographical. Throughout 2016 and 2017, the value of acquisitions in Western Europe remained higher than acquisitions in BRI countries: at $120 billion and $60 billion, respectively, according to Commerzbank estimates. That said, the number of deals declined by 18 percent in Western Europe, while deal volumes have increased by 8 percent in BRI countries, marking a shift in geographical concentration. Foreign direct investment (FDI), too, has continued to increase along the Belt and Road. As such, we estimate that Chinese FDI along BRI corridors could reach $25 billion by 2020—double the 2014 figure.

RISKS ABOUND?

With such expansion comes new risk. The patchwork of investment projects, FDI and M&A has resulted in rising corporate debt. China's corporate debt ratio today stands at 159 percent of GDP. Meanwhile, some analysts forecast that corporate defaults are expected to reach their highest levels this year.

As a result, the implicit government support for companies—which has led to concerns that the true health of companies was being masked—is also changing. Larger companies considered core to Beijing's strategic goals—including BRI-related projects—will increasingly face fewer restrictions than non-core sectors in terms of raising debt and investing. This will become increasingly important as debt needs to be refinanced.

The risks are not only domestic, but also in target markets. Many countries along the route are underdeveloped: At least 27 BRI countries have sub-investment grade or "junk" ratings, for instance. Among the largest stumbling blocks in these markets, where financial institutions and robust regulatory frameworks are lacking, are developing sound due diligence practices and securing trade risk mitigation. The rub, here, is that when such protections are more difficult to obtain, this invariably means they are more necessary to have.

RISK PERCEPTIONS CHANGING

The picture isn't all gloom for outbound M&A, particularly in the European market. As the "Made in China" label increasingly carries a reputation of sophisticated product, Chinese corporates are seeking to add value to well-established brands. In Europe alone, we've seen outbound M&A toward companies such as KUKA, a German robotics company, and Pirelli, an Italian tire manufacturer.

In turn, corporates along the BRI are increasingly seeing that investment from China is neither a foregone conclusion to losing jobs to Chinese production lines nor a means to handing over intellectual property. Instead, it's often seen as an exercise in adding value. With this, corporate China is increasingly seen as a manager of people, not only assets: a trend that is steadily mitigating Chinese risk profiles.

Larger companies considered core to Beijing's strategic goals will increasingly face fewer restrictions than non-core sectors.

The changing perceptions surrounding China, and by extension, the BRI, are already paying dividends. With the help and guidance of external partners, associated risks could be better mitigated.

External partners are ready to join this effort: Germany, France and Italy are looking to create a joint European framework to help China vet its investments. The experience of foreign banks, too, can help tackle the challenges of increased risk by, for example, providing broader hedging options and granting access to a wider range of cross-border solutions.

Also, for corporates who lack the experience and size for public finance, international banks will have a role in securing private funding. For instance, Commerzbank recently signed a memorandum with the Industrial and Commercial Bank of China—pledging to lend $5 billion to BRI projects over the next five years.

Looking forward, with more than $3 trillion in capital reserves and a hunger for foreign investment, China must take caution in its approach. The unprecedented scale of investment in the BRI comes with new risks that will only increase in size and complexity as it advances. Yett, with multiple partners on its side, the BRI might yet turn a corner.

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NOTES

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