The Impact of China's One Belt One Road Initiative on Developing Countries

What is China's One Belt One Road initiative and will it bring prosperity or difficulties to the many developing countries along its route? Nathan Hayes, alumni from the department and Economist at Timetric's Construction Intelligence Centre, breaks it down for us.

In autumn 2013, President of the Peoples Republic of China (PRC), Xi Jinping, announced the One Belt, One Road (OBOR) initiative, comprising of the land-based "Silk Road Economic Belt" and the "Maritime Silk Road of the 21st Century".

OBOR will see the development of six major economic corridors. Building transport and information infrastructure will beget the development of energy and industrial clusters along these economic corridors.

China's OBOR initiative will boost the construction outlooks for many developing countries along the route through the development of substantial transportation and associated physical infrastructure. Crucially, OBOR will facilitate financing of such growth, providing alternative sources of funding to traditional public finance. The initiative will be driven largely through Public Private Partnerships (PPPs), with the standard OBOR financing model of Chinese loans paying for Chinese contractors.

The Chinese government is keen to emphasise that OBOR comes without any political strings attached. However, while this may strictly be the case, the investment is *de facto* building political and economic ties between China and the host government. OBOR will serve to facilitate greater market access to economies along the trade routes for Chinese companies, secure natural resources for China, expand and strengthen Chinese hegemony, and provide an outlet for China's investment-led growth model to continue.

Source: Xinhua News Agency

As China has developed economically, its global political strength has also increased. The Chinese government has facilitated outbound investment in the form of equity stakes in projects and physical assets across the globe, particularly to secure access to resources.

The massive inflow of investment across the construction industries will bring with it greater technical capacity for the less developed countries along the Silk Road as: transport infrastructure standards become harmonised, easing cross-border trade; higher technical standards improve the quality of buildings and other construction projects; and the latest technology and innovative building methodologies are utilised.

The initiative has already hugely boosted trade and investment. Trade between China and countries along the OBOR routes constitute a quarter of China's total trade value, exceeding US$1 trillion in 2015. Indeed, Chinese exports to these countries exceed those to the US and the European Union, China's top two export destinations. This trend will continue as ongoing investment in supporting infrastructure encourages trade flows.

Many countries along the OBOR need to improve their infrastructure stock. Pressures on the existing stock continue to mount as populations rise, urbanisation continues, and ongoing industrialisation and economic development requires supporting infrastructure. These factors, combined with the need to catalyse future economic growth with high quality infrastructure, necessitate ongoing investment. However, many countries along the OBOR lack the financial capacity to develop their infrastructure through public coffers, and the private sector is unable to meet the shortfall.

Better integrating the private sector into the construction industry, rather than relying predominantly on the public sector, can bring a number of benefits, including mitigating the financing burden placed on the government; increasing productivity and improving the quality of public services; and facilitating knowledge transfer and sharing of best-practice experience and expertise from the private to public sector.

A greater number of such financing arrangements can be expected for construction projects across the Silk Road. Indeed, the financing model employed will be particularly well suited to building capacity and undertaking the required infrastructure development.

The private sector across many of the developing countries along the Silk Road is relatively nascent, and many firms lack the capacity or resources to properly implement the large construction projects proposed. Relying on domestic companies may limit the participation of the private sector and hamper growth, but the OBOR financing model is for loans from Chinese banks that pay for Chinese contractors. Utilising such firms will: utilise excess capacity of Chinese companies; bring in expertise; utilise the high technical capacity of firms; facilitate greater Chinese control of projects; create economic benefit for China (sending money back to Chinese firms and suppliers); and develop the capacity of domestic private sector firms.

There are a number of necessary conditions for private sector financing to work alongside public money. These include transparency around the way the money is allocated, an appropriate balance between the public funding and the private funding, clear returns, a strong regulatory system that is able to work across borders, and conduct that everybody can recognize as being close to market principles. Without these conditions, the private sector may be reticent to invest, dampening the spill-over effects.

Many developing countries have a great deal to gain from such an initiative, but there are a number of risks in investing in such markets, including: foreign exchange volatility; risk of recession; price instability; 'crowding-out' of private sector investment; legal and regulatory issues; dearth of pre-existing basic infrastructure; corruption; bureaucratic issues; and poor transparency.

Among the various developing countries along OBOR routes, there are some with relatively strong governance (such as India, Indonesia, and Vietnam) which will be hard for China to unilaterally dictate to and control. Such countries will most likely not want to accept large numbers of Chinese workers or take on high levels of debt. Other countries along the OBOR (such as Cambodia and Pakistan), however, have relatively weak governance systems. China may be in a better position to dictate terms to these countries, but operating risks are higher in such environments, project management could be fraught, and the financial returns hampered.

Due to the OBOR funding arrangements, China benefits from both the financing and construction of infrastructure projects, while the recipient countries must bear the financial risk. When trade volumes are high the arrangement will be mutually beneficial, and that may not matter, but when it is not, it could become a source of concern for the recipient country.

The OBOR is positive for developing countries, and an opportunity to improve their physical infrastructure stock. The initiative will also serve to strengthen the private sector in many countries, create positive spill-over effects beyond the initial projects, and facilitate further investment. Risks abound, however, particularly if trade volumes decrease and the terms are no longer competitive.

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