Financing the Belt and Road Initiative: MDBs, SWFs, SOEs and the Long Wait for Private Investors[1]

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More than four years ago the Chinese leadership launched the Silk Road Economic Belt and the 21st Century Maritime Silk Road, the land and maritime dimensions that form the Belt and Road Initiative (BRI). The BRI builds upon the charm of the historic silk roads to create a long term, multi-dimensional and complex strategy that has greater attention on the development of western Chinese provinces, aims at the creation of new markets to address the overcapacity of Chinese enterprises, fosters trade, diversifies energy resources and energy routes pursuing energy security with more attention to the environment, enhance the internationalization of the RMB. In addition to the economic goals, the BRI also aims to strengthen connectivity and cultural bonds among people of more than sixty-five countries. The BRI converges with the "Made in China 2025"policy[3] that supports the expansion of Chinese enterprises in information technology, artificial intelligence and other advanced manufacturing technology[4], and with the State Owned Enterprise (SOE) reform that pursues the creation of more efficient national champions able to play a more important global role. The BRI aims at the improvement of China's role as a global actor and leader. The prominence and importance of the BRI is pivotal for the Chinese leadership and the pursue of the "construction of the Belt and Road Initiative" is now part of the Chinese Constitution.[5]

The BRI establishes six transnational economic corridors, namely: 1) New Eurasia Land Bridge Economic Corridor; 2) China-Mongolia-Russia Economic Corridor; 3) China-Central Asia-West Asia Economic Corridor; 4) China-Indochina Peninsula Economic Corridor; 5) China-Pakistan Economic Corridor; and 6) Bangladesh-China-India-Myanmar Economic Corridor[6]. The BRI involves more that sixty-five countries along which experts expect investment of around US$1 trillion of infrastructural investments, partially addressing Asia's infrastructure needs.[7] Along the corridors, investors are building highways, railways, ports, telecommunications, power plants, electric grids, and pipelines. The China-Pakistan Corridor alone counts US$62 billion of expected investments with the construction of the port of Gwadar, around twenty projects in the energy sector, and eight major infrastructural projects.[8]

The types of investments that are expected along the countries of the BRI are characterized by large upfront payments and long periods to generate returns on investments. Additionally, some of the projects are implemented in more than one jurisdiction which adds to the legal risk. Moreover, the unstable political frameworks of some of the countries that are part of the

BRI increases the related political risk.[9] The majority of bilateral investment agreements (BITs) between China and the BRI countries are characterized by weak protections such as lack of national treatment and narrow dispute settlement clauses that allow for claims only related to the amount of compensation in case of expropriation. This background is not very attractive to private investors.

The success of the BRI is pivotal for Chinese policies and is strictly connected with the success of the investments in the infrastructural project that underpin the BRI. Concurrently with the launch of the BRI, the Chinese government led the establishment of two new multilateral development banks (MDB) and a dedicated sovereign wealth fund (SWF). The Asian Infrastructure Investment Bank (AIIB) was established on 29 June 2015, with an initial subscription of US$100 billion by the 57 founding members.[10] The AIIB is operating alone or in collaboration with the World Bank, the Asian Development Bank, the European Bank of Reconstruction and Development, the International Bank for Reconstruction and Development, and other multilateral development institutions to finance the projects. The AIIB supports green development and sustainable infrastructure projects in the energy sector that aid its members to do their part as expressed in the Paris Agreement to, "hold the increase in the global average temperature to well below 2 degrees Celsius above pre-industrial levels and pursue efforts to limit the temperature increase to 1.5 degrees Celsius"[11] through specific schemes. The other MDB is the New Development Bank (NDB) established by Brazil, Russia, India, China, and South Africa (BRICS) on July 15, 2014 with an authorized capital of US$ 100 billion, also known as the BRICS bank.[12] The new MDBs have converging agendas with respect to the BRI projects. Even though AIIB and NDB do not have a specific mandate to support the BRI, both institutions are financing BRI projects. In the case of AIIB, the projects that so far have received financial support are all in countries that are part of the BRI.[13]

The Chinese policy banks are deeply involved in the financing of BRI's projects. China Development Bank and Export-Import Bank of China, two state-owned banks have received injection of capital from the foreign exchange reserve (US$32 billion and US$30 billion, respectively) to better support the financial needs B&R investors.[14] Also the four state-owed commercial banks are participating in the investments, and financing of the BRI by issuing overseas bonds[15] and providing loans.[16] In 2016, the Industrial and Commercial Bank of China Limited, the China Construction Bank Corporation, and the Bank of China signed memoranda of understanding with Investment Enterprise Singapore to support the participation of Singaporean companies to the BRI.[17] This important economic commitment, detached from the related geopolitics emphasise the potential of BRI projects to generate economic returns.

Despite the fact that Chinese development banks and international MBDs are supporting with loans and financing the projects, the Chinese SWFs and SOEs are directly involved with the infrastructure and energy investments. In late 2014, the Chinese government established the Silk Road Fund (SRF) a new dedicated sovereign wealth fund with a specific mandate to finance BRI projects.[18] The SRF is established with resources from the more notorious and richer China Investment Corporation (CIC), the State Administration of Foreign Exchange (SAFE) and other state-owned banks, with an initial capital of US$40 billion. The SRF, while pursuing economic returns on its investments, does not aim to maximize profits but invests in projects with sustainable and reasonable returns, and endeavours to promote coordination and integration of the development strategies between China and the host countries.[19] In order to better support the investments of the SRF, the Chinese government decided to add another tranche of 100 Billion RMB to the resources of the fund.[20] So far SRF has also made several major energy and infrastructure investments: a) 9.9 percent stake in Russia\'s key new liquefied natural gas (LNG) project based in South Tambeyskoye gas field from Novatek, Russia's largest independent natural gas producer, for 1,087 million EUR, 10 percent equity ownership interest in PJSC SIBUR Holding, a Russian vertically integrated gas processing and petrochemical company. SINOPEC has previously invested in SIBUR.[21]

The investment strategy of CIC, one of the biggest SWFs in the world, with more than 810 billion USD in assets under management, has changed in light of the BRI. CIC has increased its focus on direct investments and together with CIC Capital (a subsidiary) have led Chinese consortiums in several major deals in the infrastructure and real estate sectors[22]. Since CIC does not have deep knowhow, experience, and the necessary staff to supervise investments in different economic sectors, partnerships with the Chinese SOEs that are looking for acquisitions offshore is natural and based on a business rationale.[23] Last year CIC Capital was part of an international consortium that acquired a 50-year lease to operate the Port of Melbourne for 7.3 billion USD. CIC Capital contributed by $1,094,000,000 USD. The same subsidiary was also involved in the $920 million purchase of a 65 percent stake in Kumport, Turkey’s third-largest container port, in a consortium that involved COSCO and China Merchant.[24] As part of real estate investments CIC has acquired from CBRE Global Investors ten shopping malls in France and Belgium for $1.44 billion, and the purchase of nine office towers in Brisbane, Melbourne and Sydney from Australia’s Investa Property Trust, a Morgan Stanley subsidiary, for A$2.45 billion ($1.8 billion). In order to mitigate political risk related to the investments SWFs or SOEs cooperate with domestic partners. CIC and Russian Direct Investment Fund have established the Russia-China Investment Fund to support Chinese investments in Russia in different economic sectors, and together with SRF are investing in a major real estate project in former airfield Tushino in the North-West of Moscow. Also, the National Social Security Fund (NSSF) that has a mandate to supplement and adjust social security spending such as social insurance during the peak time period of the aging of population.[25] NSSF has kept a low profile and is also adjusting its investment strategy seeking higher returns while participating in the BRI projects.[26]

Based on information from the State-Owned Assets Supervision and Administration Commission of the State Council, forty-two central SOEs have participated in 1,676 BRI projects in different forms: by establishing joint ventures, making direct investments or becoming shareholders.[27] SOEs have often had the support of the SWFs or the development banks in order to take full advantage of their expertise in the specific economic sectors. COSCO Shipping, China Overseas Port Holding Company, and China Merchants Port Holdings have made major acquisition of port activities: Piraeus, Gwadar, Hambantota, Colombo, Djibouti. China National Petroleum Corporation and other state-owned companies are involved in the development of oil and gas fields and construction of pipelines that connect central Asia to China. State Grid Corporation of China have acquired grids in Italy and Australia and establishing ultra-high voltage transmission lines between China and Russia, China and Mongolia, and China and Kyrgyzstan. In the same fashion, the activities of SOEs have expanded in other sectors such as highway and railways etc. The implementation of the projects has positively affected multinational corporations such as General Electrics, Honeywell, and Caterpillar that have become suppliers to the SOEs that are implementing the projects.

The success of the BRI is based on the activities of the Chinese state controlled entities (SWFs, SOEs and state-owned banks) together with the financial support of the MBDs.

Private investors can also benefit from the support of the MDBs. The decision of more privately-owned investors to invest in the BRI projects would make full use of the untapped potentials that more than sixty-five countries can offer, and add important financial resources to address the infrastructural gap in Asia. While on one hand the BRI is providing much needed investments in infrastructure, on the other hand BRI is fostering the investments of Chinese SWFs and SOEs as global actors in strategic sectors. The investments of Chinese SWFs and SOEs are frequently intertwined with geopolitical objectives and occasionally the geopolitical motivation seems to eclipse the economic rationale of specific investments to the pursue of broader and not intelligible objectives triggering national security concerns in the host countries.[28]

The commitment of The State-owned Assets Supervision and Administration Commission of the State Council (SASAC) to encourage central SOEs to deepen their involvement in the countries along the BRI during the coming years, the pivotal role that SWFs and state-owned banks are playing in collaboration with other state controlled entities (IE Singapore, RDIF, etc), and the marginal role that private investors are playing, suggests that BRI is determining a great transformation serving as a springboard for the expansion of state capitalism.

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[4] Chinese Premier Li Keqiang said, "We will implement the 'Made in China 2025' strategy, seek innovation-driven development, apply smart technologies, strengthen foundations, pursue green development and redouble our efforts to upgrade China from a manufacturer of quantity to one of quality." See Made in China 2025: How Beijing is revamping its manufacturing sector, http://www.scmp.com/tech/innovation/article/1818381/made-china-2025-how-beijing-revamping-its-manufacturing-sector accessed 5 November 2017.

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[6] Part of the BRI is also the Cooperation between China and Central and Eastern European Countries that involves 11 EU Member States and 5 Balkan, see Cooperation between China and Central and Eastern European Countries available at http://www.china-ceec.org/eng/ accessed 5 November 2017.

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