

China's new Silk Road: A win-win for Asia?

As China's growth engine slows, policymakers are seeking new ways to ensure long-term economic growth, recently announcing several initiatives to aid in the creation of a new trans-Asian trade network under its One Belt One Road policy. Manulife Asset Management's Portfolio Advisory Group examines recent developments and concludes that if successful, the project could provide an outlet for the Chinese economy's overcapacity while building long needed infrastructure in the region.

The history of the Silk Road can be dated back to the Western Han Dynasty (206 BC–220 AD), named for the trade in silk carried out along its 6,437 kilometer length. Trade along the route was a significant factor in the cultural and economic development of China, Asia, Europe and the Middle-East, opening up a trade corridor that connected east with west.

In 2013, President Xi Jinping announced plans for a revival of the 2,000-year-old road and for the establishment of a sea-based silk route, under the "One Belt, One Road" (OBOR) plan. The OBOR is a combination of two development proposals – the Silk Economic Corridor and the 21st Century Maritime Silk Road – whose purpose is to establish new trade and transport links between China, Central Asia and Europe. As of today, 60 countries have expressed interest in partnering in the program. It is an ambitious plan by the Xi government to bind surrounding regions more closely through pipelines, roads, railways and ports. Scholars compare the OBOR initiative to the US Marshall Plan that helped Europe rebuild after WWII. The United States gave approximately US\$160 billion (current value) in economic support to that initiative.

Upon completion, the OBOR will benefit 60 countries with exposure to 4.4 billion people or 60% of the global population. The OBOR initiative will link countries totaling US\$2.1 trillion of GDP or one third of the world's output. According to some estimates, the total value of China's OBOR initiative could reach US\$21 trillion. If successful, China could extend the initiative to the whole world as long as other countries are interested in development and trade with China.

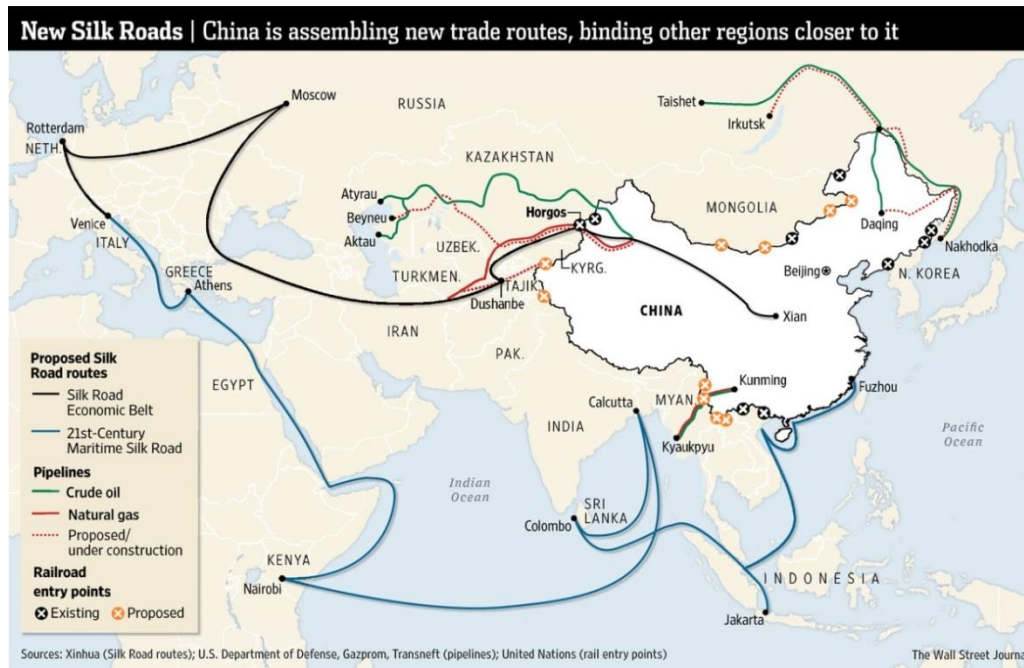
How expansive of a network?

There are two networks, spanning land and sea. Initial maps of the project illustrate land routes snaking across Central Asia into Turkey and up into Europe as far as Rotterdam.

Xi'an, home to the well-known Terracotta warriors, is where the ancient Silk Road began and that is where the new Silk Road is expected to begin. From there, it stretches to Northwest China and west through central Asia. It progresses through northern Iran before swinging west through Iraq, Syria and Turkey. From Istanbul (the gateway between Asia and Europe), it heads northwest through Europe (including Bulgaria, Romania, Czech Republic and Germany) before entering Rotterdam (Europe's largest container port). From Rotterdam, the path runs south to Venice before it hits Greece, where it meets up with the equally ambitious Maritime Silk Road.

The maritime route goes from southern China with way points into south-east Asia along the Malacca Strait (one of the busiest maritime routes in the world). From there, it heads to India and then crosses the rest of the Indian Ocean to Nairobi, Kenya. From Nairobi, the Maritime Silk Road goes north around the Horn of Africa and moves through the Red Sea into the Mediterranean where it meets the land based Silk Road in Venice.

This is the most expansive infrastructure project we have seen to date.



Source: The Wall Street Journal, 14 November 2014.

How serious is China - how will they make it work?

According to sources, the OBOR policy is discussed at almost every major affairs forum or conference in China. At the annual central conference on economic affairs in December 2014, the OBOR was highlighted as one of the priorities for China in 2015.

The Asian Infrastructure Investment Bank (AIIB) was proposed by China and is regarded as the rival to IMF, World Bank and Asian Development Bank which are all regarded as influenced heavily by the United States. The purpose of the AIIB is to provide finance to infrastructure projects in the Asia Pacific area and as of writing, it has 32 member countries. Among other priorities, one of its main missions is to help fund the OBOR. In addition to the AIIB, Chinese president Xi Jinping announced the creation of the US\$40 billion Silk Road Fund. The Silk Road Fund, which will be overseen by Chinese Banks, will be used to expand railways, roadways and other infrastructure.

Why the One Belt One Road policy?

The goal of the One Belt One Road policy varies based on whom you ask. It is certain that a key goal for the OBOR is to export the country's capital, technology and industrial and labour capacity. Historically, China has been more focused on domestic policy and Chinese officials are adamant that they do not want to become an overbearing influence in Asia. Instead, they believe the OBOR is a "win-win" where China gains access to strategic resources while exporting spare capacity and where other countries build up their infrastructure (especially railways and ports). Beijing expects that the economic contact along the Silk Road will boost productivity in all countries along the route.

Senior Chinese officials have envisioned the Silk Road as a region of "more capital convergence and currency integration". No doubt, Chinese officials hope that with currency integrations the renminbi would become more widely used. Over the past couple of years its reach has spread to Mongolia, Kazakhstan, Uzbekistan, Vietnam and Thailand.

Why are over 60 countries interested? Countries in need of financing to help grow their economies and related infrastructure would welcome a willing financial sponsor. China has become the single biggest foreign investor in the African continent by implementing a no-strings attached policy. This type of policy is popular with countries that have limited access to capital or technology, or to countries that face foreign sanctions or

stringent government requirements by the World Bank. As well, increased regional connectedness would boost trade as countries would have greater access to the enormous Chinese market with 1.3 billion consumers.

As the pace of China's domestic infrastructure spending slows, China is facing challenges with overproduction and overcapacity, particularly in their steel and construction material sectors. As labour costs rise, China is likely to move its labour-intensive and low value-added manufacturing facilities overseas. The One Belt One Road initiative will address both of these issues.

Challenges ahead

Environmental - The One Belt One Road could be easily dismissed as a grandiose pipedream were it not for China's transformation over the past two decades. Between the 2000 and 2012, China increased the number of cities with a population of greater than one million from 34 to 102! The build in China has been quick, but it has also raised challenges for the environment. For example, China has become the world's manufacturing hub, but this has come at a price as it burns approximately half of the world's coal consumption.

Approximately 70% of China's freshwater is polluted resulting in 700 million Chinese people drinking contaminated water. Similarly, cities along the Yangtze River Delta, Pearl River Delta and Beijing-Tianjin-Hebei region suffered over 100 haze days a year due to pollution, with pollutant concentration of two to four times above the World Health Organization limits.

Geopolitical - Over the past couple of years, China has been involved in disputes over maritime boundaries with several countries in the region. Some critics view the OBOR strategy as a long term goal of gaining geopolitical influence within the continent. The One Belt One Road will increase not only China's presence, but its economic influence on the surrounding countries which has the potential to result in further tensions in the region.

Despite the numerous challenges, more countries are likely to join the One Belt One Road policy, making it a potential win-win situation by solving China's over capacity issues while building long needed infrastructure in the region. If completed, the OBOR will be by far the largest infrastructure project in our civilisation's history – hundreds of years from now, it may be looked at in awe similar to the way we look at the Pyramids and the ancient Silk Road.

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