

C hinese Infrastructure Initiatives, the AIIB & “One Belt, One Road” — Roundtable on the Global Implications

By Japan SPOTLIGHT

China is taking a significant initiative in promoting infrastructures for developing countries all over the world by establishing the Asian Infrastructure Investment Bank (AIIB) and pursuing the large-scale idea of “One Belt, One Road”. What will the economic and political consequences be of Chinese leadership in stimulating global growth by developing such infrastructures? We introduce a discussion on this issue between two experts on Chinese economy and politics — Prof. Akio Takahara, a leading political scientist and professor at the Graduate Schools for Law and Politics at The University of Tokyo, and Long Ke, a senior fellow at Fujitsu Research Institute and one of our distinguished Editorial Committee members at Japan SPOTLIGHT. Naoyuki Haraoka, editor-in-chief of Japan SPOTLIGHT, moderated the roundtable discussion.

(Roundtable on Aug. 23, 2017)

Participants



Akio Takahara



Long Ke



Naoyuki Haraoka

Introduction

Haraoka: In my personal view, the core concept to be developed and preserved by global governance was free trade, but it is now growth strategy. Development of infrastructures certainly contributes to economic growth anywhere in the world. Free trade is assumed to produce winners and losers, which makes it difficult today to achieve a worldwide consensus, but developing infrastructures will clearly be instrumental in achieving global growth and producing benefits for everybody. So this would be a unanimously acceptable objective in global governance and a key to achieving growth strategy all over the world. I would like to start our discussion by talking about the role and economic implications of infrastructure investment for the global economy in this regard.

Takahara: There are still many countries in the world which will need further economic development to reduce the income gap between

rich countries and poor ones, though the current trend of decreasing poverty is to be highly appreciated. To encourage economic growth in poor countries in Asia, Africa, Latin America or wherever, building social infrastructures is inevitable. In my understanding, in reality the supply of social infrastructures is not catching up with the need for them.

Ke: I understand the importance of reducing the income gap for the global economy, as Prof. Takahara mentioned with regard to infrastructure development. But I would like to add another policy implication of the development of infrastructures, and that is capacity building, which was discussed at the World Bank in the 1990s. At that time we mainly observed a lack of electric power-related infrastructures which created an impediment to economic development in poor countries. At this moment, we see sufficient supply of electric power in Asia and Latin America, though not Africa. However even now, the lack of sufficient port facilities or

transportation infrastructures among those nations is an impediment to international trade. China's initiative in infrastructure investment seems aimed at trying to fix it, as a strategy in the second stage of social infrastructure building.

Chinese President Xi Jinping has been using the phrase "Chinese dream" all the time in his speeches ever since his inauguration. One of these "dreams" is probably to realize the "One Belt, One Road" idea of building infrastructures all over the world under Chinese leadership. Thus, China wants to take the leadership among the international community to achieve effective global governance in promoting a global growth strategy. In particular, it wants to do so in order to fill the perceived vacuum of leadership in global society given that US President Donald Trump is saying the United States should not pay any cost in taking such leadership but put a higher priority on preserving US domestic interests. This is the background to the initiatives in establishing the AIIB and pushing the idea of "One Belt, One Road".

Haraoka: We all agree that infrastructure investment will be necessary to achieve inclusive growth. We are, however, getting into the second stage of globalization, which is one dominated by IT. In this new phase we see emerging countries like China among the developing nations starting to increase its presence by taking advantage of IT and reaping the benefits of new ideas and technologies transferred from developed nations. In this process, globalization is being transformed from a G7-oriented one into a BRICS-oriented one, I believe. How do you assess the economic implications of infrastructure investment in this globalization phase where poor countries are acquiring more power?

Takahara: While developed nations' economic growth is not expected to be so high, even though they expect IT to lead to high growth, developing countries are expected to get the benefits of being latecomers to IT. It is certainly a blessing for them.

Ke: China has achieved dynamic growth during these four decades by opening up to the globalized world instead of promoting democracy. "One Belt, One Road" is certainly one of those policies for taking full advantage of globalization. However, it is thinking about developing cross-border e-commerce not only for promoting imports but also for promoting exports after infrastructure investment through the "One Belt, One Road" initiative. Alibaba, Tencent, WeChat, those Chinese IT companies will be in this e-commerce network.

Chinese Initiatives

Haraoka: Shall we start discussing these Chinese initiatives? First, on the AIIB, there was an argument that China was promoting it for the transfer of its excessive manufacturing facilities to developing Asian nations. Based on current developments, do you think this argument is still valid?

Takahara: Even if this is one of the true motivations for promoting the AIIB, I do not think it is wrong. However, whether it is wrong or not is not relevant in assessing the AIIB initiative. Regarding Chinese economic development, we notice the strong power of Chinese construction companies that have completed so many infrastructure projects like the Three Gorges Dam or railways and roads, supported by a 4 trillion yuan domestic demand expansion program to mitigate the deflationary impact caused by the Lehman Shock in 2008. Thus the domestic need for infrastructure became naturally saturated and then China started looking for more investment targets out of the country. Its China Development Bank and the EXIM Bank have been engaged in promoting such investment projects outside the nation. Chinese leaders created the new concept of "One Belt, One Road" which could cover these projects. So we must be careful to distinguish between the concept and the content of this initiative. The concept of "One Belt, One Road" is political and diplomatic, while the content consists of specific projects. It's like the constellation and the stars. The Chinese leaders are interested in impressing the people by drawing a constellation, while our interest lies in the stars that are real and tangible.

Haraoka: What would be a distinction between the AIIB and "One Belt, One Road"?

Ke: First of all, concerning your point about excessive manufacturing facilities, I think there are two kinds of such facilities. One is the existing kind and the other is one that would be excessive in the future due to the Chinese government's sloppy planning. Most Japanese would consider excessive facilities negative in terms of their experience during the 1990s and 2000s, the so-called "two lost decades". However, while during the Japanese lost decades the growth rate has been almost zero and occasionally negative, in the case of China the growth rate has been positive, though it has been slowing down. Thus, the existing excessive facilities would be gradually utilized under this positive growth. We should be careful about newly emerging excessive facilities, as they are emerging due to their poor management under the nationalized enterprise system.

The distinction between the AIIB and "One Belt, One Road" is clear. While the AIIB was founded as an international financial institution, "One Belt, One Road" is just an idea floating in the air. The two could be partly linked in terms of funding, though. The AIIB was recently given the highest credit rating by two well-known ratings corporations, Moody's and Fitch. This was possible because they got those ratings automatically from equations where the variables were inputted. Since there were not so many funding projects yet and high risks were avoided, the equations automatically brought a positive rating.

The "One Belt, One Road" initiative assumes robust Chinese economic growth as a prerequisite. As the Chinese economy is now slowing down, there is a possibility of downsizing the idea. It is also true that this initiative is not fully supported by the Chinese people. So I guess this initiative could turn out to be merely Xi's face-saving



project.

Haraoka: What is the definition of “One Belt, One Road”? Does it assume a Eurasian Corridor area or a Silk Road area as its target?

Takahara: In my understanding, they were originally attempting to connect the East Asian Economy Zone and the European Economy Zone by this initiative. However, the original idea seems to have greatly changed, as Latin American nations got interested in getting more finance from China and China is positive about having them included in the initiative. So the scope of the initiative has become unclear and the whole idea itself more difficult to define.

Ke: When the initiative was envisaged by Chinese leaders, they had in mind the concept of a new Silk Road, but it expanded later to other places such as Latin America. As you know, the Chinese like expansionism.

Takahara: “One Belt, One Road” is a political concept and not to be precisely defined in terms of geography. It does not have a contour.

Haraoka: Assuming that the AIIB is established with more concrete targets, its projects are now managed by clear standard criteria for financing and objective assessments of each project, aren't they? If there is no economic rationale behind the financing of the projects, how can we expect economic benefits from them?

Takahara: As Mr. Ke said, the major rating agencies gave them AAA rating. That means the AIIB is run by authentic international finance experts with long working experience at the Asian Development Bank (ADB) or some other international financial institutions. They know what a possible failure in financing big projects would mean to China and the other investing nations.

Ke: The AIIB consists of a Research Section, Investigation Section and Board of Directors. The organizational structure of each section

differs very little between the AIIB and the World Bank or ADB. The concern is about the governance of the Board of Directors. This would deserve further examination, as AIIB operations are in progress. There is uncertainty over power games at the Board, while the financial experts of the Chinese National Development Bank with deep experience of financing overseas development projects support the AIIB's practical activities in selection of projects for financing.

Geopolitical Issues

Haraoka: The Trump administration is prioritizing the restoration of the US domestic economy and its industrial competitiveness rather than taking leadership in global rule-making such as international trade rules or rules on global climate change. It has officially declared that the US will withdraw from the Trans-Pacific Partnership (TPP) agreement, one of the mega-regional free trade agreements, and the Paris climate accord to determine the principles for member nations to tackle the global environmental challenge. US reluctance to take the lead in global governance would create a vacuum in global leadership. The Chinese initiative in building infrastructures in developing nations could be interpreted as an attempt to fill this vacuum. On the other hand, G7 countries must welcome Chinese interest in joining the global rule-making process, since that would encourage China to engage in more responsible activities in the international community. How can we understand the Chinese initiative in this context?

Ke: I think it is up to China whether or not to try to be a leader. But it needs to be aware of the cost of leadership, if it tries to take this initiative. Trump may be saying the US is no longer ready to pay this cost. It is still uncertain that China is ready to pay it either. Another uncertainty is whether the Chinese initiative is well accepted by other nations. Unless it is supported by the international community, the initiative will not lead to any productive outcome, no matter how enthusiastic China may be to take a leadership role.

Takahara: I guess originally there may have been some Chinese leaders thinking about promoting a China-centered regime on the western side of China when they envisaged the AIIB or “One Belt, One Road”. But they soon realized they will need to observe global rules in formulating and financing profitable infrastructure projects. As China's national power increases, it naturally will find its responsibilities to the global economy increasing. At this moment, though, it would be difficult for China to take a leadership role in rule making for the global economy. In the domain of national security, it is not abiding by a decision by the international arbitral tribunal at The Hague on its claims and actions in the South China Sea. This is a clear violation of international law. But, in the economic domain, it cannot be as aggressive as on national security. It knows it is benefitting from the WTO by being a member. The Chinese are very pragmatic.

Ke: On the question of Chinese leadership in building infrastructures, we should not forget the “Silk Road Fund” supposed to finance the projects of “One Belt, One Road”. The AIIB will need the approval of its Board to finance each project and thus arbitrary Chinese decisions could be avoided. However, the Silk Road Fund could provide supplementary finance for the projects of “One Belt, One Road”, if necessary. This fund was established by China and it can make its own decisions without consulting anybody else.

Takahara: There can be projects that are not economically feasible but are done for geopolitical or political interests. In that sense, China would have a geopolitical strategy in financing those projects, even if the borrowing countries cannot return the costs.

Haraoka: Would China be interested in promoting rules on free trade, replacing the original role of the US? It seems to be keen now on promoting mega-regional FTAs, like the Regional Comprehensive Economic Partnership (RCEP) or China, Japan, Korea (CJK) FTA.

Takahara: For China, trade is crucial. It must continue to import massive amounts of energy and export massive amounts of goods in order to maintain its economic growth. Expansion of protectionism would be disastrous for its economy. Therefore, it strongly advocates for free trade in favor of its own economic interests, not for the sake of global governance. But yes, it was a big diplomatic gain in Davos earlier this year when Xi presented himself as the champion of free trade while the Trump administration is retreating to protectionism.

Ke: At the Davos Conference 2017, Xi certainly made a remark in support of free trade. This can be interpreted as a message to support Europe against Trump, since a conflict between the US and Europe would be a big opportunity for China. China has been attempting to be closer to Europe, as it is eager to import arms from Europe, which has been opposed by the US. Trump’s anti-globalization comments could make the US unpopular among European nations and thus Chinese support for European pro-globalization policies would favor its arms strategy.

Haraoka: On the question of global climate change, while the US president declared the US withdrawal from the Paris accord on international commitments to reduce CO2 emissions, China seems to have started to advocate for this international rule.

Ke: I think that is merely a pretense to support it in order to improve relations with Europe. Seeing the US reluctance to promote global environmental protection, China is again trying to win European friendship by pretending to support a pro-environmental policy. But China cannot earnestly promote environmental protection since strengthened environmental regulation would seriously hamper its economic development, a more vital policy concern.

Takahara: China is always so good in the presentation of its policy.

China does not want to be seen as reluctant and negative in promoting global environment protection. It is now behaving as if it were one of the leaders of global environmental protection.

Another example of skillful Chinese presentation is that there is a perception in the US of the RCEP being initiated and led by China, though that is not the case. Even the US and European media share this perception. I think Japan should learn from China about such presentation skills and promote its foreign policy more adroitly.

Haraoka: “One Belt, One Road” has certainly started to fascinate Europeans.

Takahara: It is not only Europeans but also other nations are taken by this mirage or constellation, which in fact cannot be clearly grasped by anybody. I am very impressed by this Chinese diplomatic genius.

Ke: On specific infrastructure projects, according to Chinese authorities, land transportation, railways and roads are almost done. Though there is still some work to do like standardizing the width of railway tracks among nations, a railway towards Russia has already been completed and it could go to Europe from China. But they will need to create many more backyards for handling and classification of freight, what we call distribution centers.

On transportation by sea, they still need to build so many port facilities. Since these will be constructed under Chinese leadership, small nations along the coasts are happy but vigilant about them. There is uncertainty about the operators of those facilities, apart from the ownership. Fishermen active on these seas may oppose their operation. On the question of the backyards I mentioned, if farmers grow vegetables they will resist land confiscation. I think that is one of the reasons why China cannot clarify a specific proposal yet and only provide a vague concept, like a mirage. China would like to achieve whatever it can and is not rash in providing a clear picture of the whole idea.

Besides, it is certainly true that completion of distribution centers would improve the whole distribution system of the region of “One Belt, One Road” significantly. With much lower distribution costs, trade between Europe and China would be dramatically expanded. Japanese businessmen in trading companies are also highly interested in this merit.

Haraoka: The next question is how much this Chinese initiative is appreciated by other countries. In addition to Japan and the US, could India be categorized into a group of nations which do not necessarily appreciate it?

Ke: Yes. India and China have a complicated and serious territorial conflict. In addition, Chinese cannot eat Indian curry and there is no Chinatown in India. Thus Chinese cannot stay in India. In the 7th century, a Chinese Buddhist priest Xuanzang went to India to get the Buddhist codes, but he could not stay there. Chinese and Indians

have a great cultural conflict.

Takahara: For India, however, increasing trade with China would bring great benefits. There are also infrastructure projects in India to be financed by the AIIB. They must want to get the economic benefits from expanded economic relations with China, while competing against China in terms of geopolitical strategy. This is a paradoxical situation between economy and politics, as in the case of many other countries. The issue must be how to balance the two.

Japan's Reaction to the AIIB or "One Belt, One Road"

Haraoka: What do you think would be the possible benefits of these Chinese initiatives for Japan? Could Japan strengthen its economic relations with Europe by taking advantage of "One Belt, One Road", based upon the Japan-EU FTA?

Ke: At maximum, around 25,000 Japanese companies have established factories or branch offices or subsidiaries in China. Due to a rise in labor costs in China, some of them such as apparel factories left and now around 21,000 Japanese firms are still active in China. Those must stay there since they are a part of the supply chain in Asia and the Chinese market will grow in the future. Against this background, as the Chinese government promotes cross-border e-commerce after the distribution network is completed under the "One Belt, One Road" initiative and this cross-border e-commerce needs bonded areas, Japanese firms will be great beneficiaries of the easy customs declarations in the bonded areas. Japanese firms can also enjoy the merits of "One Belt, One Road" by bringing key components from Japan into the industrial clusters established in China which will be fully utilized for "One Belt, One Road". I think the economic merits for Japan could be enormous.

Takahara: Assuming that connectivity by a consolidated distribution system is well developed and the intermediary region between Asia and Europe is developed as well by this initiative and thus Asian and European economies are both enjoying growth, it would certainly be beneficial for Japanese business as well. Though it may be difficult for Japanese business to be directly involved in a specific infrastructure building project, I guess the merits would exceed the demerits for Japanese business since with infrastructure construction in progress, economic development is encouraged and thus the market expands as a result of the rising standards of living for consumers.

The AIIB will need to be successful as well. It will be good news to see that infrastructure building projects are successful in Asia and the economy is developing well by Chinese funds. But there could be some worries about the possibility of the Chinese monopolizing these benefits and it will certainly be necessary for all of us to see that each project is promoted in accordance with existing rules and that China observes these rules.

Haraoka: In order to maintain good governance of these Chinese initiatives, do you think Japan should join the AIIB?

Takahara: Yes, I think it would be better for Japan to join it in many senses. Japan should have access to the information of the AIIB.

Ke: The chairman of the AIIB, Dr. Jin Li Qun, came to Japan and asked the Japanese Ministry of Finance to join it and said he would leave the post of vice chairman for a Japanese. Prof. Takahara is right in saying that Japan will not be able to access any information unless it joins it. So I think it would be better for Japan to join. The worst case for Japan would be that the US joins as an observer, and Japan is left behind and unable to see what is going on in the globalized world.

Haraoka: Do you think the US will join the AIIB?

Takahara: At this moment, it seems unlikely that the US will become a member of the AIIB, but it could possibly be an observer. Unless the US maintains a keen interest in Asia, Chinese money and people will continue to flow into Asia and the US will lose its presence. US leaders must be aware of this.

Ke: Though it is unlikely that the US will be an official member of the AIIB, as the US Congress would not approve it, it would still be meaningful for the US to have observer status. It could have a certain influence on AIIB management. Trump's actions are a bit unpredictable and I guess depending upon the development of the North Korean security situation, there would be a possibility of US commitment to the AIIB. That would put Japan in a difficult situation.

Haraoka: What do you think about the role of APEC in discussing the AIIB or "One Belt, One Road"?

Ke: APEC could be a good venue for such discussions and this would be a good place for the US to show its leadership. However, at this time, we are seeing some strong anti-US sentiments in Asia since Trump was elected as president because of his "America first" policies. I think the US should do its best to restore its image among Asian nations first.

Outlook for the AIIB & "One Belt, One Road"

Haraoka: Could you talk about the prospects for these two Chinese initiatives?

Takahara: China will steadily promote infrastructure projects with an economic rationale in mind. But there likely will be geopolitical considerations affecting their decisions occasionally, and in these cases we cannot deny the possibility of friction with the US, India, Russia and probably Japan.

In the long term, two things could happen. First, Chinese money

could become exhausted and the initiative could run out of steam. Second, as I said, the “One Belt, One Road” initiative is a political symbol and as such it may disappear with Xi’s retirement, though of course its specific projects will remain.

Ke: In terms of global development finance, the World Bank, ADB and AIIB are complementary to each other rather than competitors. At least, China believes in their complementarity. This could encourage the smooth operation of the AIIB, making a distinction from “One Belt, One Road”, a mirage. Another role we expect the AIIB to achieve is to finance infrastructure development projects in North Korea after a possible regime change together with the ADB. In such a long-term perspective, we will need to consider the AIIB as a positive initiative for Asian prosperity. It is up to business how to take advantage of the infrastructure projects envisaged in “One Belt, One Road”. You do not have to react immediately to the whole concept negatively.

Haraoka: Political and economic stability in China must be a crucial prerequisite for the success of the AIIB and “One Belt, One Road”. What do you think about the outlook for Chinese economy and politics?

Takahara: There are pessimistic views and optimistic views, and the difference between the two will depend on how the concentration of power to Xi will work for the Chinese economy. The optimism comes from the view that concentration of power would work well in promoting economic structural reforms effectively to let China get out of the “middle-income trap” and continue robust economic growth. The pessimism comes from the view that a dictator will certainly make mistakes, and that his dictatorial rule will dampen the morale of the cadres.

Ke: The Chinese economy on the whole is gradually slowing down. This is my observation. The manufacturing sector, led by national enterprises, has lost the momentum of growth and this decline was somewhat compensated for by IT enterprises’ strong growth. But overall the speed of growth of the whole economy is decelerating. Whether China can achieve stable economic growth or not is up to political stability. Social stability is a key to achieving economic stability and at this moment income inequality between the rich and the poor is not narrowing, and society is now aging. This is bad news for the economy.

Another vital concern is whether Xi can maintain sufficient power to control all of his possible political rivals or not. Without authentic power, Chinese political stability cannot be assured.

Haraoka: What do you think about the increasing impact of e-commerce upon the Chinese economy? Would it be effective in transforming the economic growth of China from an investment-led one to a consumption-led one?

Ke: Chinese Internet users are mostly in their twenties, thirties and forties. Wealthy Chinese people in their sixties are not using e-commerce. So I think that increasing e-commerce in China will not have such strong power to lead the whole economy. In addition, those Internet users in the younger generation are mostly working couples and they do not have time to go shopping in a supermarket but buy goods for daily life over the Internet, which could make many supermarkets go bankrupt. Thus, e-commerce would have both positive and negative impacts upon the economy. E-commerce itself would not raise Chinese economic growth as claimed by the media.

Final Remarks

Haraoka: Do you have any final remarks?

Takahara: We should keep a watchful eye on the reality of “One Belt, One Road”, and should neither overestimate nor underestimate it. There is a Chinese maxim: “Judge a person by his deeds, and not just by his words.” It’s good that the Chinese are talking big about regional cooperation, free trade, anti-protectionism, etc., and we are expecting their implementation processes to be fair, transparent and rules-based. That is, abiding by international standards and not “with Chinese characteristics”.

Ke: We should also watch the overall flow of goods, money and human resources between China and the rest of the world. China decided to promote “One Belt, One Road” by using its cumulated foreign reserves, resulting from increased exports until a few years ago. But Chinese exports have decreased in both 2015 and 2016, largely due to rising labor costs. That resulted in a decrease of foreign reserves.

As for the movement of human resources, since 2010 the number of Chinese students going to study at universities abroad has been increasing, following the preceding period of a significant increase in students studying abroad, the 1980s. But different from in the 1980s, students today are mostly determined to stay abroad and not come back to China anymore. So China is now losing much of its invaluable human resources.

“One Belt, One Road” is a mirage to be dreamt of only by trusting in China. We should keep watching the long-term impact of the two factors behind this trust — the decrease in foreign reserves and the increase in young Chinese with the strong potential to leave China permanently.

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