

# Foresight

A global infrastructure perspective

36<sup>th</sup> Edition – November 2015

## Treading softly along China's "One Belt, One Road"

By Julian Vella, Asia Pacific Head of Global Infrastructure

**China's bold vision can make a significant contribution to bridging the Asian infrastructure investment gap. But Chinese investors should be aware of the heightened expectations that come with selecting and managing projects in new markets.**

Over 2000 years ago, the Silk Road was established as a trade route connecting China with Eurasia and the mighty Roman Empire. The road, in various forms, lasted over 1500 years before a decline in political powers ended its influence. Fast-forward half a millennium, and China's plan to rebuild its old trade links with Europe and Asia has aroused renewed excitement.

The "One Belt, One Road" initiative envisages a path by land from China through Central Asia to Europe, with the maritime route flowing through Southeast Asia, the Indian Ocean, the Middle East, and Africa to Southern Europe.

By building essential infrastructure and boosting financial and trade links, the belt and road aims to enhance commerce and spread prosperity across 60-plus countries with a combined population well in excess of 4 billion. Financing comes from a number of sources, such as the Asian Infrastructure Investment Bank (AIIB), the Bank of China, The China International Trust & Investment Corporation, (Citic), and the Silk Road infrastructure fund. To date, approximately 250 billion dollars (US\$) of related projects have been contracted, much of them involving Chinese machinery, raw materials and construction firms.<sup>1</sup>

### Choosing the right projects

Given its huge domestic development in recent decades, China is hardly a newcomer to managing major projects. However, taking its infrastructure show on the road, across such a diverse range of countries, raises a number of fresh challenges.

Firstly there is the sensitive issue of sovereignty. With China emphasizing that it will respect sovereign rights, project selection will in many cases be at the discretion of each of the nations along the route – whose priorities may or may not align with those of China. A proposed railway line that stretches through to Thailand, for example, could support the latter's ambitions to become a regional logistics hub, and the former's need to access key export markets, offering a win-win for both countries. On the other hand, some prospective projects could potentially be viewed as primarily benefiting either China (e.g. by securing its energy resources) or the country in question (e.g. building local infrastructure unrelated to the One Belt route).

Under any circumstances, choosing the right projects to prioritize can be quite a challenge. When dealing with governments inexperienced in infrastructure development this is compounded, particularly as project selection can often become highly politicized. When you factor in concerns over lack of transparency, corruption, an uncertain legal and regulatory environment, unpredictable financial systems and foreign exchange exposure risks, then decisions become even more complex.

China's domestic infrastructure program has been largely government financed, and carried out at breathtaking pace to accelerate economic growth. Conducting projects outside of its borders, in emerging markets, is a far more complex and prolonged affair, with the involvement of an array of stakeholders, which can slow the pace considerably.

<sup>1</sup> China's 'One Belt, One Road' looks to take construction binge offshore, Reuters, 6 September 2015.

## Chinese businesses have relatively less experience in managing overseas projects, except where they are directly tied to China's economic and trade objectives.

These issues make it doubly difficult to please financiers (either banks or funds), who expect a good return on their investment through carefully chosen, efficient and well-managed projects. Project leaders, must, therefore, show a high level of understanding of the unique regulatory, political, legal, financial and project risks associated with potential projects, such as resource nationalism, transparency and labor unrest. It's especially important to earn a 'social license to operate' by creating a good working environment, contributing to communities and minimizing the carbon footprint.

Amidst this complexity, China should, therefore, exert 'soft' power through comprehensive and early engagement with all governments along the route, to ensure that every project is positioned as a collaborative venture that brings rewards to all parties. This may involve investment in areas of infrastructure that do not directly benefit China, such as healthcare, education and housing.

### A new game with different rules

Chinese businesses have relatively less experience in managing overseas projects, except where they are directly tied to China's economic and trade objectives. This opens up opportunities for players from more mature infrastructure markets such as Australia, UK and Canada, to offer new ideas and technical knowledge as part of their project development and project management support. With its recent US\$880 million acquisition of Australian construction giant John Holland, The China Communications Construction Company (CCCC) has gained access to invaluable technical expertise; a move that could be replicated.

Hong Kong also has a significant role to play in supporting infrastructure development as well as facilitating trade and investment along the belt and road given its location, its connectivity with mainland China, and its strength in financial services, transport and logistics, and professional services.

In addition, Chinese investors must also acknowledge that some of the countries in the proposed route have traditionally strong links to other nations with a vested interest in the region, and may resist China's overtures. Equally these powers, namely Japan, India and especially Russia (which has a big influence in central Asia) may not support China's efforts, and could seek alternative trade routes and blocs.

Japan has not signed up to the AIIB, having nailed its colors to the mast of the established Asian Development Bank (ADB) as one of the largest shareholders. Since the One Belt announcement, Japan has stepped up its game, pledging to increase its investment in the ADB by US\$110 billion over 5 years, with an expressed intent to build infrastructure such as roads and railways while reducing pollution.<sup>2</sup>

India, meanwhile, has its own programs, namely the Spice Route between Asia and Europe, and the 'Mausam' project that revives ties with its ancient trade partners via the Indian Ocean, stretching from east Africa, along the Arabian Peninsula, past southern Iran to South Asia, Sri Lanka and Southeast Asia.

While commentators have sought to describe the "One Belt, One Road" in various ways, it is clear that the initiative does reflect the Chinese government's recognition that its own prospects are inextricably linked with those of its trading partners, and that it must take a more global role to further these ambitions.

With an annual Asian infrastructure gap estimated to be US\$800 billion,<sup>3</sup> there is plenty of room at the table for the AIIB, the ADB, and, indeed, other interested investors from around the world. The ADB has said that it is prepared to cooperate with China and has welcomed the entry to the region of new institutions for funding and supporting development projects. Despite fears that the main players are trying to assert an unhealthy influence, their combined efforts can make a real contribution to sustainable, inclusive growth for dozens of emerging economies.

### Talking points

- How effectively can Chinese investors and infrastructure players evaluate, select and implement complex overseas projects?
- How can China convince sovereign governments that its intentions are win-win?
- What opportunities exist for players from other markets to participate in One Belt, One Road?
- To what extent must China focus on 'soft' infrastructure such as agriculture, healthcare, education and housing?

2 Japan unveils US\$110 billion plan to fund Asia infrastructure, eye on AIIB, Reuters, 21 May 2015.

3 Building China's "One Belt, One Road," Center for Strategic & International Studies, 3 April 2015.

### Contact us

**Dane Wolfe**  
Marketing Manager  
Global Infrastructure  
KPMG International  
T: +1 416 777 3740  
E: dmwolfe@kpmg.ca

**Pranya Yamin**  
Marketing Manager  
Global Infrastructure  
KPMG International  
T: +1 416 777 8094  
E: pyamin@kpmg.ca

kpmg.com  
kpmg.com/socialmedia



kpmg.com/app



The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2015 KPMG International Cooperative ("KPMG International"), a Swiss entity. Member firms of the KPMG network of independent firms are affiliated with KPMG International. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

Designed by Evalueserve.  
Publication name: Foresight.  
Publication number: 132938-G  
Publication date: November 2015