POLICY INSIGHT

Making the BRI more inclusive†

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ABSTRACT

In this policy insight, the author lays out the context of the BRI and its role in global development. He also explains why the US should consider working with China on the BRI. The author opines on China’s possible approach and strategy to get global private investors to come on board for the massive BRI projects. He suggests that the global players can establish a third-party market cooperation and coordination mechanism to turn the BRI into a platform for win-win global collaboration

Keywords: Belt and Road Initiative (BRI); China-US cooperation; private investors; third-party markets

1. Why the world needs the BRI

Infrastructure may not be the only thing countries need to grow, but it is a necessity. Of the many reasons countries fall behind in their development, the lack of infrastructure comes on top. Insufficient infrastructure impedes industrial and urban growth and prevents countries from accessing the benefits of regional and global trade. This is particularly true for landlocked countries, which face huge logistical costs in development and trade, such that they are limited to trading with their neighbours, which puts them at an economic disadvantage (Purkovic, 2014). The United Nations Conference on Trade and Development (UNCTAD) notes that currently 80% of global trade is done by sea, with an even higher proportion of developing countries being dependent on maritime freight (UNCTAD, 2019). This means few international trades are carried out by land, and countries with no seaports are placed at the losing end. The history of globalisation also supports the fact that countries with access to sea freight grow more quickly. So, breaking the infrastructure barrier is key to helping developing countries to progress quickly and get out of poverty in order to join the ranks of the globalised economy.

The question is, since insufficient infrastructure has been a perennial problem for developing countries, why can’t these nations quickly build their own? Regarded mostly as quasi-public goods, infrastructure lacks

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exclusivity, hence the private sector either does not build it or builds very few of it because the returns are just not attractive. However, there are strong positive externalities or third-party benefits in infrastructure, and substantial development cannot take place without ample infrastructure. Due to its unique nature, the government has to take the lead in infrastructure development—try as we might to find innovative ways to bring in the private sector, the role of the government cannot be replaced.

Unfortunately, the governments of most developing countries face major problems in gathering resources and getting sufficient funding, which makes it difficult for them to take on the above-mentioned responsibilities. The Asian Development Bank (ADB) estimates that the governments of most Asia-Pacific countries can only provide about 40% of infrastructure funding needs (ADB, 2017a). The establishment of various multilateral development banks following World War II provided some relief for developing countries, but the total funds and operational efficiency of these development banks are far from sufficient to meet the needs of the developing world.

China has been quite successful in infrastructure development. With groundbreaking infrastructure projects such as industrial parks and special economic zones, as well as energy and transport projects, China’s economy has grown rapidly. Furthermore, China has built up large funds and also expertise in infrastructure construction in various environments. More importantly, China’s unique economic system and its government’s ability to deploy resources have given it a special edge in infrastructure development, especially in large-scale and cross-border projects. Through the Belt and Road Initiative (BRI), China has joined the ranks of global infrastructure construction, which provides a rare opportunity for global development. In this aspect, China’s financial model is unique: while infrastructure is being built, it drives the export of facilities and trade. The profits from the latter make up for the low returns of infrastructure construction, so that, overall, the projects are financially feasible. This model of looking at combined benefits solves the previous problem of low returns on individual infrastructure projects.

China’s BRI has also revitalised the globalised economy. Previously, globalisation mainly involved the flow of resources between the north and south of the globe. To elaborate: most developed countries are located in the northern hemisphere. With their technology, funds, and management edge, these countries made purchases from the developing countries in the southern hemisphere, who in turn, based on their low cost advantage, started production and processing and then sent the consumables back up north. However, the 2008 global financial crisis seriously affected the purchasing power of developed countries, and coupled with the rise of trade protectionism, the north-south cycle was also affected.

The BRI, especially the Silk Road, will improve developing countries’ ability to provide energy and logistics and encourage economic growth and higher income (Maliszewska and Van Der Mensbrugghe, 2019). Trade between developing countries (i.e., the south-south trade) will go up in tandem (De Soyres et al., 2018). This horizontal south-south flow of resources will give a new direction to economic globalisation and complement the previous vertical north-south cycle, enrich globalisation, and help to balance global trade. There will be more high-quality goods and technical exports from developed countries, creating a win-win global situation (Lin and Wang, 2017).

Of course, there will be many difficulties in implementing the BRI. Some of these points include maintaining a feasible international geopolitical balance; boosting communication and strategic
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coordination between global stakeholders; attracting developed countries, especially the US, to participate in the BRI; bringing in more private enterprises and funding; creating sustainable financial and environmental development; and providing appropriate and sufficient infrastructure according to the diverse needs of developing countries. These are all key as to whether or not the BRI succeeds.

Currently, the discussion on the BRI is mostly focused on international geopolitical competition. Undeniably, as China positions the BRI as a platform for mutually beneficial economic development, China’s soft power and influence will increase as the BRI is pushed through. But why should this natural growth in China’s influence be criticised if its initiative can contribute to global development? After World War II, the US contributed to the recovery of West Europe through the Marshall Plan, and it also got something out of it. In the same spirit, we should also acknowledge China’s contributions. Taking another perspective: can we find a better solution in place of the BRI? The top global challenge now is growth, and all efforts to contribute to global development should be given priority. The competition between major powers and regions should give way in the face of global development. That should be the main principle in improving the global governance system.

2. Why the BRI needs the US

The BRI seeks to provide infrastructure-centred public goods to encourage the global flow of resources and pave a new way towards global development. The problem is that most BRI projects are long-term ones that involve large capital investments and entail major non-traditional risks such as geopolitical conflicts, power shifts, war and unrest, and a global economy in flux. It is hard for any one country to resolve these challenges on its own. All involved nations must work together closely and step up the coordination of interests and policies to face these challenges together.

China is the proponent and the main driver of the BRI, and how it communicates to others is of extreme importance. So far, China has worked well with developing countries, other than India. Most developing countries face domestic growth challenges and readily accept the BRI. China’s collaboration with Japan and developed countries in Europe is also improving. It has signed a memorandum of understanding on the BRI with Italy, one of the world’s seven largest industrial countries, signalling that some developed countries within Europe are starting to consider the BRI. Japanese Prime Minister Shinzo Abe’s visit to China in October 2018 similarly led to a bilateral agreement to cooperate on joint infrastructure development in third-party countries, which opens up a new way for businesses in developed countries to indirectly participate in the BRI. Even if these countries are not yet officially part of the BRI, businesses operating in their borders can partner with Chinese businesses in third-party countries.

The greatest resistance to China’s efforts to drive international cooperation on the BRI comes from the United States. While US enterprises are interested, the US government has always gotten in the way of the BRI because of geopolitical competition (United Nations, 2019). Following Trump’s election, suppressing the China-led BRI has become part of America’s overall strategy to stop China’s rise (U.S.-China Economic and Security Review Commission, 2019). This trend is growing, with no sign of easing in the near future. It is the biggest risk and challenge to the development of the BRI.
Even if the US can stop the BRI and force China to cut its foreign investments, the question arises: who can fill the gap? In terms of infrastructure funding and construction capabilities, no country can replace China in the international market, including the US. One only has to look at the slow infrastructure growth in the US and its mostly empty international commitments to know that the US lacks competence in this aspect. And since the US cannot take China’s place, its interference removes a rare opportunity for global growth. After all, organisations such as the Asian Development Bank and the World Bank have given countless warnings that the continued lack of infrastructure is seriously hampering global development. The investments that developing countries put towards realising the United Nations’ 2030 Agenda for Sustainable Development are far from sufficient (United Nations, 2019), and it is expected that half the development goals will not be met by 2030. Also, poverty makes low-income countries hotbeds for armed conflicts and terrorism. Only with unity and cooperation can there be sustainable global development.

Another choice that might be hard for the US to accept, but which may be the only good choice, is to work with China on building the BRI. Both countries could complement each other in infrastructure construction, and cooperation would be a perfect solution that would allow the US to better play its role as a world leader.

China’s edge is in hard power in infrastructure construction, but its soft power remains weak. It lacks speaking rights in global regulation, has little global coordination capabilities, and is ineffectual in global cross-cultural management. By contrast, the US enjoys strong soft power but lacks infrastructure construction capabilities, and it is only a matter of time before China overtakes the US in terms of overall economic power. China and the US each has its own comparative edge, making it essential that they work together.

This mutual dependence dictates that the long-term growth of both countries has to be centred around cooperation. “Decoupling” and the “New Cold War” are just threats and the delusions of a short-term dispute. Since China-US cooperation is the way to handle new global challenges, why not leverage the BRI as a platform to combine China’s hard power in infrastructure construction with America’s soft power to give a complete system of global public goods? Aiming to counter China’s BRI, in recent years the US has rolled out infrastructure projects in the Asia-Pacific and Indo-Pacific regions, which overlap with the BRI geographically. The US can consider establishing platforms for complementary cooperation with China in these overlapping regions in an effort to fully capitalise on each country’s strengths.

The US objects to the BRI, saying that the initiative lacks transparency and sufficient private sector participation and neglects sustainable environmental development. These points are valid, but it has been less than ten years since China’s large-scale outbound investment in the world economy, and the BRI has only been introduced over the past five or six years, so there will inevitably be problems. China is still inexperienced when it comes to going international. It needs to learn from the world and needs help through cooperation. Instead of opposing and criticising China or trying to establish its own exclusive system, the US could participate in the construction of the BRI and use its soft power to make the BRI a platform for world cooperation and guide the development of the BRI with international best practices.

The biggest difficulty in China-US cooperation on the BRI is the suspicion and wariness in the US towards China’s rapid rise (Tellis, 2020). But if China’s rise is a given, then attacking it and
blocking it would at most slow the process, but not derail it. The US should accept this fact and cooperate with China to build the BRI, which would revitalise the US economy and help maintain its status as a global leader.

Previously, the US mainly relied on its dominance and strength for global governance, exerting its influence through military intervention and economic sanctions, with little direct contribution to global development. However, this concept is long out of date. It has been 75 years since the last world war. Peaceful development and mutually beneficial cooperation are the current themes, and stimulating growth has to be the focus of global governance. If the US does not take part in pushing for global growth, its global leadership abilities will be questioned and challenged. Besides, most countries agree that the BRI reflects the urgent demand for global growth and would help solve the bottleneck (García-Herrero and Xu, 2019). By working with China, the US would make up for its lack of participation in global growth and strengthen its global leadership. The US should take a more integrated and longer-term view of its strategic relationship with China and work with China to give the world a new governance model centred on development and cooperation. Advocating geopolitical competition might attract attention in the short term, but in the long term, only efforts that really promote global development will gain the sustained support of the international community.

Of course, China should also be more proactive in creating and providing platforms for cooperation with the US and other developed countries, leave more room for companies from these countries to earn profits, and roll out more targeted policies to encourage foreign companies to play a role in BRI projects. At the same time, China should improve in terms of transparency, fair competition, localisation management, funding sustainability, and environmental protection. It should also avoid getting drawn into international geopolitical tussles and be more prudent in investing in sensitive regions as a means of creating better conditions for building multilateral cooperation platforms.

In short, the BRI needs the cooperation of the world and, especially, of the US. Only with global cooperation can the BRI be a catalyst for global development. Getting mired in geopolitical tussles would make cooperation practically impossible, but from the view of world growth, cooperation is a feasible option.

3. Why the BRI needs global private investors

A country’s infrastructure is a public asset and thus cannot be best provided by the private sector (Helm and Mayer, 2016). The government and public capital must play the key leading role, but this does not mean that reliance on government and state-owned enterprises alone will produce satisfactory results.

Infrastructure development requires a huge outlay of funds, which can expose the limitations of government resources, even for China. The main challenge, however, lies in the public sector’s inefficiency rather than in the lack of government funding. Unlike private enterprises, state-owned enterprises often do not face hard budget constraints. In addition, because BRI infrastructure projects are largely driven by political factors, economic efficiency often becomes a secondary objective.
Since BRI projects also involve national interests and international geopolitical competition, exclusive investments from the Chinese government and state-owned enterprises will be questioned, especially when the projects encounter difficulties (He, 2020). In the initial years of the BRI, some construction projects led by the Chinese government and state-owned enterprises invited criticisms due in part to the lack of diversity in the sources of investment.

One solution is the introduction of private capital investment, especially through global private capital and the participation of multinational companies, which will bring in more capital to alleviate funding shortages and ensure that project selection is more responsive to market demand and aligned with the cost-benefit relationship. When public and private capital are combined in public-private partnerships (PPPs), the overall project capital increases and the project’s operability improves, leading to enhanced economic efficiency (Wagner, 2019).

At the same time, participation from the private sector introduces new technology and advanced management experience to the projects. With years of experience in the global market, many multinational companies have acquired a wealth of experience in cross-border and cross-cultural management, which will help the BRI build top-quality infrastructure as it adopts global best practices.

Through the participation of private enterprises from all around the world and the benefits they bring to the table, the BRI will become more inclusive, and this shared global ownership will gain wider acceptance for the initiative. Through this platform, companies from China and other countries can learn from each other on how best to improve their international operations.

Private capital is significant to a project, but an Asian Development Bank report indicates that only 0.8% of the USD50 trillion in private capital managed by global pension funds, sovereign wealth funds, insurance companies, and other institutional investors is spent on infrastructure. Although the level of savings in Asia is high, there are still considerable obstacles blocking the channelling of private capital investment into infrastructure funds for BRI projects (ADB, 2017b).

The issue is multifaceted. The most immediate challenge is that most BRI projects are located in developing countries where risks are relatively high. Elevated risks have long prevented developing countries from receiving effective external investment, creating a vicious circle. The most prominent, tenacious risks include non-traditional issues such as international and geopolitical conflicts, terrorist threats, environmental and social risks, and uncertainties growing out of political instability. To attract private investment, it is critical that these risks be addressed through international cooperation and coordination, supported by guarantee mechanisms to mitigate the various risks involved.

Since the return on investment in infrastructure is generally only seen many years later, the flexibility of entry and exit strategies for private investment is an important consideration. It is necessary to effectively segment a construction project and tailor different financing instruments, such as asset securitisation through REITs, for different investment cycles. These require corresponding financial innovations to help private investors manage risks.

The lower financial return on infrastructure projects presents another major obstacle to attracting private investment. Infrastructure projects have significant positive externalities and spillover effects, but their financial return does not fully reflect positive outcomes such as industrial
development, urbanisation, and poverty alleviation. It is worth exploring ways to measure these broad spillover effects as a basis for formulating effective incentives for private investment.

One spillover effect is the increased taxation levied by the government as a result of economic development brought about by infrastructure projects. It would be reasonable, then, to use a portion of the increased tax revenue to provide risk guarantees for private investment or additional investment subsidies, which are highly effective institutional arrangements that encourage private investment. Instead of fully investing limited public capital in projects, the focus should be on using it as a leverage to unlock and maximise private investment (Yoshino and Abidhadjaev, 2017). China’s Silk Road Fund, various policy banks, and the Asian Infrastructure Investment Bank should play this critical incentivising role.

The participation of multilateral development banks in BRI projects is likewise essential for attracting private investors. In addition to direct funding, guarantees, risk management, and technical support, these banks play an indispensable role in crafting policy recommendations and coordinating government actions. Because many BRI projects and their impacts transcend borders, effective coordination among various countries and interest groups is essential. Multilateral development banks, including the World Bank, the International Monetary Fund, the Asian Development Bank, and the European Bank for Reconstruction and Development, have great experience in cross-border investment. Through their established standards, norms, and best practices that mitigate investment risks and increase returns on investment, they can boost proactive private sector participation.

Though the public sectors of both investing and recipient countries play a vital leading role in the BRI, private sector participation is also essential. Private investment will diversify the sources of capital, reduce the debt burden of governments in the recipient countries, and improve the operational mechanisms and efficiency of the BRI projects, which will, in turn, introduce market forces into the BRI. Only when ownership and operations are diversified can the BRI become a true economic initiative and a platform for global cooperation and thus extricate itself from endless international and geopolitical disruptions. Private capital investment can only be encouraged by removing various obstacles through institutional mechanisms, global cooperation, and financial innovation.

4. Global players should build third-party markets together

We now find ourselves in a unique era. Since the current American administration came to power, the world economy has undergone tremendous changes with broad, far-reaching implications. The international political and economic order that was established after the end of World War II has been altered. The global economy has been greatly impacted, and international trade has declined substantially. Those most noticeably affected by this shift are advanced economies and other emerging export-oriented economies that rely heavily on international trade, finance, and investment.

The rise of trade protectionism, and multilateralism giving way to unilateral sanctions, have created unprecedented hurdles for economic globalisation. In an effort to generate new solutions for global collaboration, the BRI has made a constructive attempt to serve as a driving force for a new wave of globalisation.
But how can the BRI be turned into a platform for win-win global collaboration? How can the power of the market be introduced? And how can infrastructure construction be extended to encompass industrial development and urbanisation? All these will become the focal point of development in the next growth stage, where the implementation of the BRI needs to arrive at a new turning point. China’s first attempt to cooperate with France in a third-party market came in 2015 and was concretised in 2019, marking a significant step forward in this direction.

Third-party market cooperation can effectively integrate China’s production capacity, the advanced technology and management expertise of developed countries, and the development needs of developing countries. In this way, it can achieve “all-win” progress through the principle that “one plus one plus one is bigger than three”. Private enterprises and multinational corporations will have an opportunity to participate in BRI projects. They bring with them expertise in project governance and the backing of private funding sources.

Third-party market cooperation emphasises the importance of market principles. National sovereignty should be parked in the background, while enterprises conduct business collaborations based on market principles, in an effort to highlight the role of enterprises and markets as the main agents for international economic cooperation. This approach helps avoid international geopolitical strife and get the BRI back on track for promoting economic growth.

In the field of infrastructure construction, China has distinct strengths in capital and engineering capacities, but it is weak in areas such as project management, risk management, financing platforms, environmental protection, and cross-cultural management. Third-party market cooperation will allow China and enterprises from developed countries with considerable overseas experience to exercise their complementary advantages. It will also benefit local enterprises, as participation in native projects will offer them the full advantage play in the field.

This three-party synergy will reduce total investment cost and facilitate the acceptance of the project in both the local and international communities. In this way, developing countries where BRI projects are carried out can have more autonomy in shaping the projects to better serve the needs of local development and livelihoods. Such a cooperation platform in third-party markets is also conducive for avoiding vicious competitions among countries competing in the same field or region and encourage complementary cooperation between China and other countries in the third-party markets. This is not confined to cooperation in infrastructure construction but extends to industrial development and urban construction as well.

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