

The Rise of China : How Global Infrastructure Connectivity Important to China

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China has undergone quite massive economic reform since 1970s. *Gaige Kaifang* (reform and opening-up policy), economic reform initiated by Deng Xiaoping became the momentum of gradual shifting from purely socialist economy to what it is claimed as “socialism with Chinese characteristic”. Since this reform, China has experienced remarkable economic growth among other Asian countries, which shown the highest GDP growth reached more than 15% in 1984 and the lowest 3,8% in 1990.¹

Globalization and free trade has brought vast opportunities to expand market and investment. China has succesfully utilize this opportunity to increase its economic expansion and leverage. On the other hand, China should encounter related domestic issues such as severe air pollution and slow economic growth in recent years (around 6-7%). This issues also becomes important factor to understand China’s economic policy for promoting foreign investment outflow as well as export expansion.

The economic growth has been mostly contributed by promising development in industrial sector which supported by cheap and large human resources as competitive advantage. China was well-known with its imitation strategy in the early stage of industrialization, and has succesfully developed innovation in various products, including clothing, electronic, and communication device, from low-end to high-end. Chinese products now ready to dominate the global market. Even the top export destinations of China today are among its greatest competitors, which comprising of the United States, Hong Kong, Japan, South Korea, and Germany.²

China is now keeping its pace for global expansion, not only through export but also foreign direct investment (FDI). In 1990 China produced only less than 3% of global manufacturing, but now the share continue to grow. Despite remains low compared to other developed countries in terms of FDI, the FDI outflows also significantly increase. According to World Investment Report 2017 released by UNCTAD, China becomes the most promising source of FDI, followed by

¹ Data from National Bureau of Statistic of China, “China’s GDP Growth Rate” , <http://www.bbc.com/news/business-36051327>

² The Observatory of Economic Complexity, “China Country Profile” , <https://atlas.media.mit.edu/en/profile /country/chn/>

the United States, Germany and the United Kingdom. China's FDI outflows in 2016 was 44% increased over previous year, which brought this country as the second largest in the world.³

The economic prospect is also followed by high-profile policy in terms of geopolitics and international relations. China has continued to engage on a bigger role in the global political economy, for instance through economic alliance : ASEAN+3 and BRICS, along with Brazil, Russia, India, and South Africa. China also engages in the leadership of several international forums. In 2016 China took presidency in G20 before replaced by Germany this year. China also took leading role in the establishment and management of Asian Infrastructure Investment Bank (AIIB).

China's Initiative For Global Infrastructure Connectivity

Globalization and free trade has brought the world into border-less states. Thus global infrastructure connectivity becomes one of important factors for integrated global economy. This is also in line with China's philosophy on the importance of promoting good infrastructure to sustain economic growth. China begun to take several initiatives to support the development of global infrastructure connectivity. Started with the Belt and Road Initiative (B&R Initiative), the establishment of AIIB, Global Infrastructure Connectivity Alliance (GICA) under G20 forum, and indeed through growing foreign direct investment.

Back to the ancient history of China's glory, when China's international trade mostly depended on the trade route across Asia well-known as Silk Road. This route had played significant part in China's culture expansion as well as economy and diplomacy. To bring back this prestige, in 2013, President Xi Jinping proposed one of China's most ambitious economic policy projects so-called "One Belt, One Road" initiative, which in 2016 changed to the B&R Initiative or Silk Road Economic Belt and Maritime Silk Road. The initiative basically aims to connect regions in China's neighborhood and to bridge infrastructure gap through massive program of infrastructure development, mainly to increase economic cooperation. B&R Initiative also stresses on people-to-people bond among countries along the B&R routes, in the area of education, culture, travel issue, and bilateral exchanges.

According to B&R Initiative Big Data Report 2017, which shows progress of B&R Initiative, cooperation between China and the Belt and Road countries as well as local participation is increasing.⁴ The top 5 countries in terms of B&R cooperation with China are Russia, Pakistan,

³ UNCTAD World Investment Report 2017, <http://unctad.org/en/pages/PublicationWebflyer.aspx?publicationid=1782>

⁴ Belt and Road Portal, "Big Data Report 2017", <https://eng.yidaiyilu.gov.cn>

Kazakhstan, Thailand, and Vietnam. As of September 2017, China had signed B&R cooperation documents with 74 countries and international organizations, mainly related to economic and trade cooperation, synergy of strategies and plans, and science and technology. China's trade with B&R countries has been rising, with total value of trade about \$953.59 billion in 2016 (0.4% increase compared to 2015), which takes 25.7% of the total amount of China's foreign trade.⁵

China's attempt to increase international cooperation was also conducted through Belt and Road Forum for International Cooperation held in May 2017, which attended by more than 130 countries and 70 international organizations. In the forum, country leaders agreed on the Joint Communique of the Leaders Roundtable of the Belt and Road Forum for International Cooperation, in which one of the statement is that the each country reaffirm the shared commitment to build open economy, ensure free and inclusive trade, oppose all forms of protectionism including in the framework of the Belt and Road Initiative.⁶

As financing platform, President Jinping established Silk Road Fund in 2014 separated with AIIB to support the B&R initiative with main focus on investment rather than as a lending source. By the end of June 2017, the Silk Road Fund had signed 16 contracts and committed to invest USD6.8 billion.⁷ The Karot Hydropower Project in Pakistan is the first investment project of the Silk Road Fund. Along with other BRICS countries, China also established New Development Bank (NDB) to finance infrastructure and sustainable development projects in BRICS and other emerging economies and developing countries.⁸

It was also in 2013 when China first proposed the idea of establishment of AIIB as a development bank to support infrastructure development in Asia-Pacific. The primary goals of AIIB are to address the expanding infrastructure needs across Asia, enhance regional integration, promote economic development and improve the public access to social services.⁹ AIIB started to operate on January 2016 after the agreement came into force on 25 December 2015. The membership currently grows to 80 approved members, in which many countries part of the B&R

⁵ Silk Road Chamber of International Commerce, "*Belt & Road Info: Big Data Report of Trade Cooperation under the Belt and Road Initiative 2017 Released*", March 28 2017, <http://www.srcic.com/news/big-data-report-of-trade-cooperation-under-the-belt-and-road-initiative/>

⁶ Belt and Road Forum for International Cooperation, "Joint Communique of the Leaders Roundtable of the Belt and Road Forum for International Cooperation", May 16, 2017, <http://www.beltandroadforum.org/english/n100/2017/0516/c22-423.html>

⁷ Chris Wright, "Making Sense of Belt and Road – The Chinese Driver: The Silk Road Fund", Euromoney: September 26 2017, <https://www.euromoney.com/article/b14t0s0j4ws7ql/making-sense-of-belt-and-road-the-chinese-driver-the-silk-road-fund>

⁸ NDB Website, "About Us", <https://www.ndb.int/about-us/essence/our-work/>

⁹ AIIB website, www.aiib.org

routes are also members of the AIIB. Japan and United States have not been joining the bank because of governance issues and project's environmental impact.

As founding country, China takes most of financial contribution around 32% among regional members with 27.5% of voting power, compared to the second largest contribution from Russia that takes only 7%. Presently, there are 21 approved projects and 9 proposed projects ready to be financed by AIIB. Several projects are co-financed with the Asian Development Bank (ADB) and World Bank. Both the ADB and World Bank had also signed Memorandum of Understanding (MoU) to strengthen cooperation and knowledge sharing between the institutions.¹⁰

Following China's G20 Presidency last year, China proposed another initiative called Global Infrastructure Connectivity Alliance (GICA). Almost similar to B&R Initiative, the objective of GICA is to promote cooperation, knowledge exchange, and meaningful progress in the field of global inter-connectivity. The Secretariat is hosted by the World Bank Hub for Infrastructure and Urban Development in Singapore. Some of key activities of GICA are accelerating knowledge sharing on global infrastructure connectivity across regions, developing solutions to close gaps in global infrastructure connectivity, and optimizing infrastructure financing for infrastructure connectivity programs. Claimed to complement Global Infrastructure Hub (GI Hub) initiated by Australia's Presidency in the previous year, GICA also aims to visually showcasing connectivity initiatives across the globe through an interactive mapping tool.¹¹ GI Hub and GICA has signed a MoU to work together. In 2017, GICA is ready to formalize the membership from interested countries and international organizations.

In fact, China recently has invested in many infrastructure projects in Asia, including in railway sector. Major rail network to be developed under the B&R Initiative are claimed to increase volume and efficiency of trade in the region and promote more efficient transportation. Despite some countries criticizing the initiative, the B&R will bring benefit to China's international trade by expanding markets which will consequently give positive impact to its industry and economic performance. The massive infrastructure development, in particular from the B&R Initiative or in the coming future of GICA will also promote participation and investment of Chinese banks.

¹⁰ World Bank Press Release, "World Bank and AIIB Sign Cooperation Framework", <http://www.worldbank.org/en/news/press-release/2017/04/23/world-bank-and-aiib-sign-cooperation-framework>, , April 23 2017, and ADB News Release, "ADB, AIIB Sign MOU to Strengthen Cooperation for Sustainable Growth", <https://www.adb.org/news/adb-aiib-sign-mou-strengthen-cooperation-sustainable-growth>, May 2 2016.

¹¹ Global Infrastructure Connectivity Alliance, <http://www.worldbank.org/en/topic/transport/brief/global-infrastructure-connectivity-alliance>

The increasing foreign trade and investment will also rise the flow of Renmimbi and therefore, it is ready for internalization to join US dollar and Euro as one of the world's top global currencies. Offshore renmimbi markets are developing with official renmimbi clearing banks now appointed in 20 countries across Asia, Europe, Middle East and the Americas. In 2016, International Monetary Fund also announced that renmimbi will be included in Special Drawing Rights reserve currencies aside with US Dollar, Euro, British Poundsterling, and Japanese Yen.¹²

In the geopolitical context, it is quite clear that China's rising leadership will extend its influence as well as political leverage, in spite of the statement from President Jinping that China will always emphasize about building partnership not political and/or security alliance. China tends to change its direction on international politics into high-profile and "political idealism", although still maintaining alliance with Russia and close relationship with North Korea. China will be potential to become great competitor for US and Japan, both in terms of economic power and politics. The existence of AIIB and its greater role will be also possible to undermine other similar aid institutions in which the US and Japan have dominant influence, although it is too ambitious to declare that AIIB will grow that fast.

However, China should face many obstacles to achieve its goals through all initiatives, including how complicated and wide the scope of B&R is. Since it is engaging many countries territories, there are many issues particularly related to cross-border issues and other legal and social issues that probably different from one country to another. It is also become such a big question whether the B&R Initiative or GICA will give explicit benefit to its member countries. The effectiveness as well as the future of GICA, as the legacy of China's presidency, will raise skepticism if it can not offer clear advantages and scheme of cooperation. But through President Xi Jinping's strong leadership and active diplomacy, the forthcoming prospect of those initiative will be more optimistic.

Challenges and Opportunities to Indonesia

China's investment in Indonesia is continue to grow and has been ranked as the 3rd largest investor after Japan and Singapore. One of the well-known projects is Jakarta-Bandung High-Speed Railway (HSR) project, which included as one of National Strategic Projects. This project is expected to connect and provide faster access between this two biggest business cities in Indonesia, while on the other hand will support the B&R Initiative. The HSR project is funded mostly by China Development Bank (CDB) and PT. Kereta Cepat Indonesia China, a consortium

¹² HSBC RMB Resource Center, "What is renminbi?", <http://www.rmb.hsbc.com/what-is-rmb>

between Indonesian state-owned enterprises (SOEs) and China Railway International. AIIB, which is led by China, also engages to finance two infrastructure projects in Indonesia. The two approved projects are Dam Operational Improvement and Safety Project Phase II (DOISP II) and Regional Infrastructure Development Fund Project (RIDFP).

The government of Indonesia has targeted hundreds of infrastructure projects development in 2015-2019, which certainly need large financing. As alternative source of financing to solve the limited capacity of state budget, the Government of Indonesia has encouraged participation of SOEs and private sector to develop public infrastructure. Therefore, the increasing investment flow from China will bring advantage to support the financing.

From bilateral relations perspective, the relationship between Indonesia and China obviously tends to be closer today. Beside the rising trade and investment between the two countries, Indonesia also support the B&R Initiative and became the co-initiative of GICA as part of Indonesia's role as co-chair in China G20's presidency last year. As a consequence, Indonesia should be much supportive to actualize the goals of GICA and formulate enthusiastic offer to prospective countries. This will also be a good opportunity for Indonesia's high-profile politics in terms of foreign relations if GICA can demonstrate its effectiveness to member countries.

On the other hand, Indonesia should face many controversies and negative issues regarding China's investment, such as anti-Chinese sentiment, issue of illegal Chinese workers expansion, and the Jakarta-Bandung HSR project. The Jakarta-Bandung HSR project has delayed from its target and has not shown significant progress mostly due to administration issue and land acquisition. It also becomes controversial issue and such a high risk project, in particular related to quality assurance, environmental issue and poor planning in terms of project design and location determination, that may lead to rising cost. Many criticizes this project as an "unnecessary project" because Jakarta and Bandung route already supported with well-developed infrastructure, i.e toll road and traditional railway. But according to Minister of SOEs, as of November 2017 the land acquisition progress has reached 54% and loan from CDB amounted USD1 billion will be disbursed on November.¹³

Apart from the controversies, China has offered more interesting and competitive scheme for Jakarta-Bandung HSR project compared to Japan in this project. China is ready to take bigger risk by offering fully business to business and do not request for state budget contribution as well

¹³ Tempo.co, "China to Disburse USD1bn for Jakarta - Bandung Train Project", October 6 2017, <https://en.tempo.co/read/news/2017/10/06/056912074/China-to-Disburse-USD1bn-for-Jakarta---Bandung-Train-Project>

as government guarantee. However according to some analysts, poorly managed infrastructure investments are one of the main causes of China's current economic problems. Fitch rating agency also highlighted that Chinese banks are considered to not have a track record of allocating resources efficiently at home, especially in relation to infrastructure projects.¹⁴

Therefore, China should reassure for providing higher quality of investment, not only to sustain its investment in Indonesia but also to relieve negative sentiment and to gain more confidence in Indonesia. Whilst the Government of Indonesia should also be aware on the risks and be attentive on any arrangements and agreement, particularly by stressing on economic calculation, concern on environmental issue, project completion timing and quality assurance. Considering the mutual interest between two countries, it will be important to ensure the success of this project nor investment in general.

**) The article is based on personal opinion and does not represent MOF policy.*

¹⁴ John West, Official Monetary and Financial Institutions Forum (OMFIF) Advisory Board, "China 'Belt' plans criticised", May 10 2017, <https://www.omfif.org/analysis/commentary/2017/may/china-belt-plans-criticised/>