Seafarer

One Belt, One Road – Many Motives

Stephanie Gan

February 2018

"The Belt and Road Initiative, rooted in the Silk Road spirit of peace, cooperation, openness, inclusiveness, mutual learning and mutual benefit, follows the principle of extensive consultation, joint contribution and shared benefits."

– China Daily[1]

"It is about connecting culture. It is about connecting communities. It is about enriching economies and improving the standard of living of people."

– Christine Lagarde[2]
Managing Director, International Monetary Fund

"Belt and Road is now seen as part of the China solution for the whole world, not just the developing world. The question is what is the cost of stepping up to play that role. If they step up to the mark, it is not cheap."

– David Kelly[3]
Research Director, China Policy

Cover Image: Port of Colombo, Sri Lanka

One Belt, One Road – Many Motives

The Belt and Road (B&R, or One Belt, One Road) is an ambitious vision for global trade, infrastructure development, and diplomacy. First articulated by Chinese President Xi Jinping in 2013, the initiative frames China as the geographic and financial center, with ties radiating toward Europe, Asia, and Africa.

Figure 1. Silk Road Routes

Source: © The Economist Group Limited, London (2 July 2016).[4]

As shown in Figure 1, the Belt and Road draws inspiration from the ancient Silk Road, and similarly features a series of physical routes that carry broader political and economic implications. Unlike the original Silk Road which arguably sprang up around the single motive of trade, today's Belt and Road addresses a dizzying array of objectives, as illustrated in Figure 2.

Figure 2. B&R – China's Many Motives

Trade	• Remove physical bottlenecks to trade in Eurasia • Foster new export markets for Chinese goods • Promote the renminbi's (RMB) internationalization through billions of RMB-denominated transactions related to project payments and loans
Economic	• Accelerate economic growth and state-owned enterprise (SOE) profits through new infrastructure contracts • Prepare domestic Chinese companies for global competition through exposure to international projects and management practices[3] • Pair ongoing SOE restructuring with a favorable business environment for completing contracts • Find new avenues for credit expansion and economic growth outside of China
Political	• Project a softer image to neighbors by demonstrating leadership, generosity, and a commitment to clean energy investment • Showcase China-led multilateral institutions, build credibility and standing among international agencies • Create a foreign policy legacy for Xi Jinping's presidency
Military	• Secure strategic access to ports and air facilities through commercial investments in poor but politically friendly countries. B&R investments such as Gwadar Port in Pakistan and Hambantota port in Sri Lanka have raised alarm in India that China plans to encircle the region[5] • In the course of securing projects and running supply lines, expand China's naval and military reach in Belt and Road geographies
Security	• Bring stability to China's poorer Central and Western provinces through accelerated economic development and physical connection to the rest of China • Open alternative routes for oil and gas imports. Roughly 80% of China's energy supplies today pass through the narrow Malacca Straits[6]

Through the execution of B&R, China can project a positive example of leadership and progressiveness by making much-needed infrastructure investments in the region. With the formation of the Silk Road Fund and Asian Infrastructure Investment Bank (AIIB), China presents nimbler, Asia-focused alternatives to the established multilateral institutions.

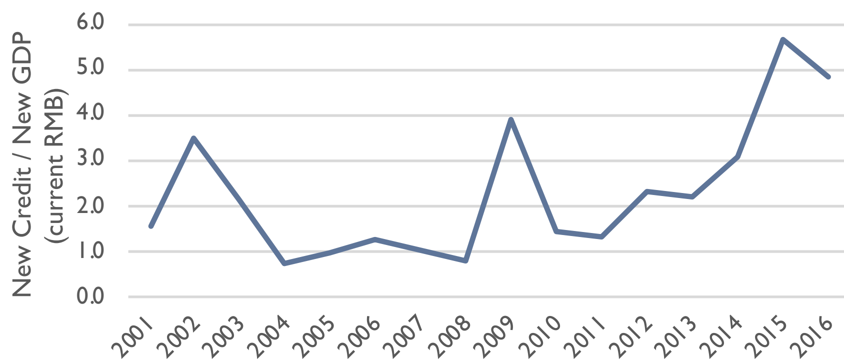
The timing and recent comments by the Communist Party leadership suggest that B&R is part of a larger national pivot as China seeks to exercise influence commensurate with its economic might. A more concerning view is that B&R provides channels for China to broaden and extend its military reach as it coordinates and protects its investments. China's plan to secure sea-lanes for its navy through a series of ports (the "String of Pearls") has been met by vociferous and sometimes violent opposition in India, Sri Lanka, the Philippines, and Thailand.

This paper will side-step geopolitical speculation and other interesting facets to focus on the more mundane: financial incentives and risks. Specifically, what are the financial origins of B&R? Where is the money coming from? What types of projects are getting funded? And how are investment rewards and risks being shared?

Economic Origins of Belt and Road

As China continues a multi-year transition toward a private investment-driven economy, it must simultaneously navigate a backdrop of stagnating global trade and alleviate excess capacity at its state-owned enterprises (SOEs). Compounding this struggle is the law of large numbers. World Bank statistics show that between 2005 and 2016, the ratio of credit growth to gross domestic product (GDP) growth had increased from 1x to approximately 5x (Figure 3). This implies a challenge with sustaining economic expansion: as China's economy has grown, the associated leverage has grown even faster. Put another way, the "debt intensity" of China's economic activity has increased meaningfully since 2007 and continues to trend upward.

Figure 3. New Credit to New GDP in China



Source: World Bank. Data as of 25 September 2017.

In an ideal world, the solution would involve sending excess labor and materials to less-developed neighbor countries that need more investment, while China's SOEs profit from lucrative new contracts. To that end, China has pledged to lead the $4 trillion of global investment that it envisions across a region spanning some 65 countries. As for the funding, the last three years have seen a flurry of capital injections, investment announcements, and several dedicated B&R-themed funds.

Project payments have substantial implications for China's position in the financial markets as well. While the renminbi (RMB) is progressing toward internationalization and has become a world reserve currency as of 2016, the currency is still a long way from global acceptance, and comprised less than 2% of global payment value as of June 2017.[7] International payments made to China are still primarily denominated in U.S. dollars, but RMB usage is growing rapidly in some Belt and Road countries.[7] As new projects emerge, they could entail billions of dollars in RMB-denominated transactions for contracting work as well as loan repayments. As more countries become comfortable transacting in and holding the RMB, the currency's status on the global stage should be meaningfully enhanced. To that end, China's central bankers are actively exploring ways to increase RMB usage in global commodities pricing.[8]

At least $900 billion in projects have been committed to date.[3] To put this number in context, President Truman's Marshall Plan was worth about $140 billion in current dollar terms, or just one-sixth the size.[9] China ultimately expects B&R spending to surpass $4 trillion. This is extremely ambitious, although the true project size will be extremely difficult to quantify. However, this also means that even if the initiative reaches a fraction of Xi's vision, it would still be sufficient to transform the face of development and politics in the region.

At least $900 billion projects have been committed to date. To put this in context, Truman's Marshall Plan was worth $140 billion in current dollar terms.

The main entities to watch are the policy banks, commercial banks, and development funds that supply the money, as well as the SOEs that provide materials and labor.

Banks and Funding Institutions: "The Money"

Commercial banks and development funds have been adamant that their B&R investments are driven by commercial and development imperatives, but as we have seen, there are many overlapping motivations. Funding entities with differing commercial motives and varying levels of autonomy have invested in one another and invest alongside one another in the same projects.

In the medium term, B&R's viability rests in the Chinese government's ability to manage credit risk, as well as enterprises' belief in this risk management. The implicit understanding is that China will not allow B&R loans and the issuing banks to fail. Whether or not this is realistic remains an open question. However, the Communist Party has many tools at its disposal, including the ability to limit capital outflows and direct inter-bank lending. Thinking for the long-term, China has also created various avenues for foreign investors to

Funding Highlights
Policy Banks[10]

June 2015: China's State Administration of Foreign Exchange ("SAFE") injected $48B into CDB and $45B into Exim.[11]

May 2017: CDB and Exim announced that they had extended $200B of loans in EMEA and Asia, with plans for an additional $55B.[12]

May 2017: President Xi pledged an additional $124B in funding to general B&R initiatives.[13]

Funding Highlights
Commercial Banks

To date, three state-owned commercial banks have committed over $225B in B&R-related loans.[15]

- ICBC is the largest of the four banks by assets, and cited participation in 212 B&R projects encompassing $67B of credit as of the end of 2016.
- In 2015, BOC announced that it had committed $68B for 300 major OBOR projects.
- CCB has reportedly lent $90B.

In August 2017, two of the Big Four banks began fundraising efforts for B&R-specific funds.[16]

- CCB has been conducting road shows to raise at least $15B from investors, while the smaller BOC announced that it aims to raise 20 billion RMB ($3.1B USD). Agriculture Bank of China and ICBC are reportedly also considering Belt and Road funds.
- In May 2017, President Xi also announced that China's financial institutions would expand their overseas RMB funding business to approximately 300 billion RMB.[18]

participate, and may even introduce opportunities to involve its private citizens.

Policy Banks

Policy banks have been behind some of the largest and riskiest B&R deals. Two policy banks that are closely associated with B&R, China Development Bank (CDB) and Export-Import Bank of China (Exim), have written low-interest infrastructure loans that are contingent on the recipient's purchase of Chinese equipment or construction services. These "concessionary loans" charge as little as 1-2% after a 10+ year grace period, and are often protected under policies written by the state-owned China Export & Credit Insurance Company.[12]

For policy banks, at least some of the seed capital comes from China's trove of over $3 trillion in foreign reserves – primarily U.S. dollar (USD)-denominated instruments that would otherwise be earning close to zero.[14] In 2015, China's policy banks received over $100 billion from reserve fund injections and the Ministry of Finance.[11]

As government-owned entities, policy banks are required to provide very little reporting detail, but receive favorable credit ratings due to their strong backing by the central government.

Commercial Banks

Commercial banks form the next line of funding. At the forefront of activity are a handful of large state-owned banks, including Bank of China (BOC), Industrial and Commercial Bank of China (ICBC), China Construction Bank (CCB) and CITIC Bank.

State-owned commercial banks need to balance their SOE status with the market's expectations of these publicly traded companies to pursue profitability. One retired senior executive responded impatiently to SOE complaints about the pressure to do B&R-deals: "A lot of SOEs are stuck on this idea that 'the country is making me do it, and I don't want to do it'. Well, do you want to be an SOE or don't you? Have you ever counted all the benefits you get from being an SOE?"[17]

Compared to policy banks, commercial banks extend shorter-term loans with higher financing costs.[12] Their support from the Communist Party is less explicit, and so they seek other forms of protection – for example, participating in syndicated lending blocks, investing alongside policy banks, and obtaining credit insurance from state-owned insurance companies. Commercial banks have also expanded into complementary financial services at the central government's encouragement, and provide renminbi settlement, cash management, and trade financing. Since 2013, at least nine Chinese banks have set up 62 branches in countries along the B&R route.[19]

Multilateral Funding

Multilateral development banks (MDBs) such as the World Bank and Asian Development Bank have been funding infrastructure projects for decades. However, their dispersed mandates and decision-making have often meant slower action. In part to address this issue, China initiated the Silk Road Fund (SRF) and Asian Infrastructure Investment Bank (AIIB) between 2014 and 2015. AIIB's leadership has taken care to emphasize the role of its infrastructure investments in driving social benefit, but China's political image also plays a part. As AIIB's president Jin Liqun explains: "China needs to do something which can help it be recognized as a responsible member of the international economic community and maybe in the future be recognized as a responsible leader."[21]

Funding Highlights

Multilateral Funding

The first $10B of SRF's capital was contributed by State Administration of Foreign Exchange ($6.5B), China Investment Corp ($1.5B), Exim ($1.5B), and China Development Bank ($0.5B).[20]

In May 2017, Xi announced SRF's capital would grow by additional 100 billion RMB.[13]

Compared to policy banks and commercial banks, these two entities are smaller in their relative investment scale. The AIIB is a multilateral bank that is authorized to lend up to $250 billion.[21] With a member base that includes 16 of the 20 largest economies in the world, the bank has many financing tools at its disposal: it can tap interbank credit, issue sovereign bonds, or absorb private capital under a public-private partnership program.[20]

"China needs to do something which can help it be recognized as a responsible member of the international economic community and maybe in the future be recognized as a responsible leader."

– Jin Liqun, AIIB President

Even though China has nearly 30% of votes in the AIIB (the next highest block belongs to India at 8%), it insists that it will willingly shed its veto power as more countries join, and is already working with the more than 60 other member countries.[20] Unlike existing MDBs that have a general aim of alleviating poverty, the AIIB only focuses on Asian infrastructure investment.[21]

China established the Silk Road Fund as an investment fund with a tighter B&R focus. The fund primarily uses direct equity investments rather than loans, and insists that its investments meet high commercial return hurdles.[20] While SRF's capital has primarily come from China's foreign exchange reserves and policy bank injections, other countries can participate at the sub-fund level.[20]

Other Sources

Private citizens could soon become yet another funding source. In April 2017, Hong Kong's Securities and Futures Commission announced plans to selectively relax listing conditions for infrastructure companies connected with B&R.[22] Separately, an executive at ICBC suggested an offshore stock exchange to allow B&R region companies to go public.[20] If this continues, Chinese banks may face a lighter financial burden, but leave retail investors directly bearing more of the risk.

State-owned Enterprises: "The Muscle"

With China's president providing the political will and its banks supplying the money, SOEs with materials and engineering capabilities provide the final leg of the B&R stool.

SOEs have less complicated economic incentives. According to China's State-owned Assets Supervision and Administration Commission, an estimated 1,700 B&R projects are lining the order books of at least 47 key SOEs.[23] SOE bids for multi-billion dollar rail and port projects are looked upon favorably because their services are tied to preferential funding terms from the policy banks. Stable funding and state-backed credit insurance also improve the chances that these SOE projects will be successful. As with their commercial bank counterparts, the presumption is that state-owned infrastructure firms will benefit from President Xi's interest in seeing B&R succeed.

If there is any risk, it may lie in SOEs being too eager to meet the supply of funding and associate themselves with projects that are even tenuously linked to B&R. Charles Parton, a former European Union (EU) diplomat in China summarized, "If you want to get projects or programmes approved, you say it's OBOR [One Belt, One Road], so everything becomes OBOR."[3]

> *"If you want to get projects or programmes approved, you say it's OBOR, so everything becomes OBOR."*
>
> *– Charles Parton, former EU diplomat*

The value of Chinese mergers and acquisitions (M&A) in B&R countries continued its growth through 2017, which appears at odds with China's efforts to rein in "excessive capital exports."[24] In Africa, where China has made some of its earliest investments, observers have pointed to a "chaotic" environment in which 54 African countries were rapidly originating project ideas, while numerous Chinese banks and contracting companies competed intensely for the new business.[25]

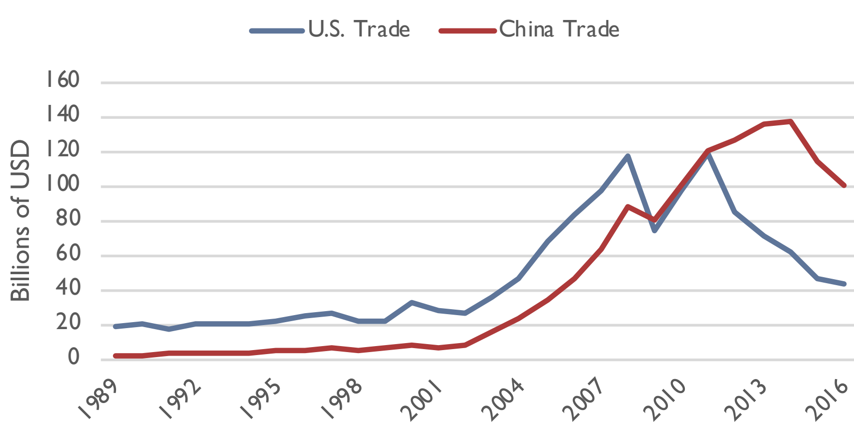
To that end, the Chinese government may already be preparing to re-assert itself. The last three years have seen $1 trillion of assets combined through government-directed SOE mergers, as part of an ongoing SOE reform.[26] An anecdotal but important trend involves many SOEs appointing Communist Party committee members to their boards, and combining the roles of company chairperson and party secretary. Taken together, these efforts can be read as a way for Xi's party to take control and perhaps rein in the bottom-up "chaos."

A Mixed Record of Project Implementation

China's Early Successes in Africa

Because of the long project timelines and B&R's relatively recent start in 2013, it may still be too early to point to definitive B&R success stories. While not technically a part of B&R (China's investment in Africa began some fifteen years earlier), investments in Africa can serve as a proxy for political and economic ramifications. Beginning in the early 2000s, Chinese banks began financing billions of dollars in infrastructure projects – dams, roads, universities, railways, and airports – in a series of transactions that have dovetailed with blossoming trade and diplomatic relations. As illustrated in Figure 4, between 2000 and 2016, trade between China and Africa multiplied to over $100 billion, overtaking the U.S. by a substantial margin.

Figure 4. Trade Value with African Countries



Source: International Monetary Fund. Data as of 25 September 2017.

Certainly, there have been complaints of poor labor and environmental protections, and not a little unease about China's intentions. But at the same time, these highly visible transportation and energy projects – which make a difference in peoples' daily lives, were financed successfully, and completed on schedule – have won a measure of local respect. In a 2016 Afrobarometer survey spanning 36 African countries, 63% of respondents found China's influence to be "somewhat" or "very" positive, and 24% of respondents believed that China represented the best development model for Africa, compared to 30% for the US.[27]

Starts and Stops

Something as grand and ambitious as B&R inevitably faces challenges. Overseas infrastructure investments are inherently complicated by disparate regulatory and tax regimes, negotiations over asset ownership and financing, military tensions (real or perceived), and terrorism threats. Within China, deals require coordination between numerous ministries as well as banks and SOEs.[28]

Very few projects have been definitively canceled. More commonly, projects are announced with vague timelines, and proceed to slog through long negotiations and government clearance delays.

Despite this, very few projects have been definitively canceled. More commonly, projects are announced with vague timelines, and proceed to slog through long negotiations and government clearance delays. One interesting example is the proposed building of canal across the narrow land mass of South Thailand. While plans for this were originally drawn up as early as 1677, the modern iteration – a 102 kilometer long, 400 meter wide waterway expected to cost $28 billion – has been part of China's maritime strategy since at least 2005, and for good reason: the project could secure China's energy imports by reducing its reliance on the heavily trafficked Malacca Strait.[29]

Thailand's position has been ambivalent at best. Supporters argue that the project could bring jobs and transform the area into a global economic and transportation hub, while opponents object to a project that would "cut the nation into two countries" and potentially embolden separatists in the south. There are also prickly questions about the project's affordability and environmental risks.

In May of 2015, a hasty announcement that a memorandum of understanding had been signed by the China-Thailand Kara Infrastructure Investment and Development Company was swiftly followed by denials from the Thai government, and it seemed that the project was winding down.[30,31] But as of early 2017, the proposal had again found domestic support with a group of political and former military leaders. Their hope – and China's – is that Thailand's new King will be more amenable to a deal. [29]

Credit Risk in South and Central Asia

Another risk category involves stretched project loans that could lead to default and "debt traps" for the recipients. B&R skeptics warn that China is investing in poor countries for their access to natural resources and strategic ports, or their potential as future markets for Chinese exports. Outside of concessionary loans, debt available to poorer countries typically charge higher interest to reflect both the elevated risk and the countries' lack of alternatives. But even if the loans fail, Chinese contracting firms may be able to negotiate ownership stakes and recoup some of their investment.

Some Chinese businessmen have joked about "One Road, One Trap,"[28] and Sri Lanka's recent history reads like a dramatic warning. The country owes close to $8 billion in Chinese loans and unpaid interest related to construction of the Hambantota Deep Sea Port, Mattala Airport, and an ambitious Colombo Port City built on reclaimed land.[32] Domestic concerns about Chinese involvement were high enough that a new government came to power in 2015, campaigning on the promise to cancel construction on Colombo Port City and wipe away loans. Eventually, this new government came to realize that the country was too reliant on Chinese investment and aid to cut off ties, and reinstated project construction.[33]

In the process, China Merchants Port Holdings obtained a 99-year lease on the strategic Hambantota Port in a controversial debt-for-equity exchange.[34] Another Chinese SOE, China Harbour Engineering Company, obtained a 99-year lease over large parts of Colombo Port City land in return for its original investment.[35] As for the projects themselves, many do not seem to have justified Sri Lanka's original gamble. Mattala Airport today is known as "the world's emptiest international airport" where a busy day comprises two flights. And the newly developed Hambantota, which had previously been better known for its jungle wild life, has so far failed to attract the hoped-for business activity.[35]

This case is concerning as B&R's current roster includes projects in some of the poorest countries in Central and Southeast Asia, as illustrated in Figure 5. In Laos, for example, not only does the planned $6 billion in railway projects represent 38% of 2016 GDP, but the economy is also heavily dependent on potash, a fertilizer commodity with a volatile price.

Figure 5. B&R Projects in Central and Southeast Asia

Country	S&P / Fitch Sovereign Rating	Investments and Scale	Relative Scale[36]
Laos	NR / NR	• $6B high speed railway linking China to Southeast Asia via Laos[37]	38% of 2016 GDP
Kazakhstan **Turkmenistan** **Kyrgyzstan**	BBB– / BBB NR / CCC– NR / NR	• $45B of deals signed between China and Kazakhstan, Turkmenistan, Kyrgyzstan • 1,454-km Kazakh-China natural gas pipeline link[38]	26% of the countries' combined 2016 GDP
Kyrgyzstan	NR / NR	• $1.54B in debt to Exim • Projects include a 405-km high voltage Hatakikomi power line[39]	Debts represent 23% of 2016 GDP, and >40% of total external debt[40]
Pakistan	B / B	• $62B worth of investments, including a 1,100-km motorway, updated Karachi-Peshawar rail line, and a $2.5B gas pipeline[41,42]	22% of 2016 GDP
Tajikistan	NR / NR	• Estimated >$1B of debts to China[43]	>15% of 2016 GDP
Uzbekistan	NR / NR	• 31 contracts worth $15.5B[44] including: 123-km Pap-Angren railway that cost $1.9B, financed in part by Exim,[45] and three gas pipelines linking Turkmenistan to China through Uzbekistan[46]	23% of 2016 GDP

To be fair, both sides share in credit risk. A Chinese bank that has been saddled with non-performing loans cannot recycle capital into fresh loans, and the illiquidity is a drain on the domestic economy. If the loans are kept afloat through government infusions and financed by Chinese taxpayers, investors may feel emboldened to make more bad investments. As China is counting on outside investors to share in B&R financing opportunities, maintaining confidence in the initiative's viability seems critically important.

On the lender side, a country that cannot repay its loans will ultimately pay in other ways. Typically, defaulting countries suffer from currency devaluations and capital flight as panicked citizens rush to remove their savings from the banking system. And as shown from Sri Lanka's case, a country with its back to the wall could end up ceding its land or other valuable resources.

China's project partners are undoubtedly aware of these risks, but may feel they have no other option. For a country like Laos – landlocked, crippled by unreliable roads and power, and largely left behind by the rest of the world – China's investments could appear to be the only way out.

Finally, to keep things in context, China's outbound investments extend beyond the Belt and Road region to embrace a variety of projects, as shown in Figure 6.

Figure 6. Examples of Chinese Outbound Investments

Country/ Region	Scale
Africa	• 2016: China Road and Bridge Corporation won a $4B contract to build the Nairobi-Mombasa Railway. Current value of Chinese transportation projects is estimated at $28B[47] • Between 2000 and 2015, the Exim Bank of China made $63B of loans to Africa, compared to $1.7B from the U.S. Eximbank[48]
Balkan Peninsula	• Extended 5.5B EUR of loans to Serbia for the construction of bridges, highways, and railroads. Chinese funding for the highway between Belgrade and Montenegro's Port of Bar is reportedly costing hundreds of millions of USD • Planned 217-mile high-speed rail line between Belgrade and Budapest[49]
Brazil	• September 2017: China Merchants Port announced plans to purchase 90% of Brazilian port operator TCP Participações for $924 million[50] • 2016: State Grid International acquired 29% in Brazil's power distributor, CPFL, for $2.3B, bringing its total ownership up from 23% to 52%[51] • 2015: China's Three Gorges acquired controlling stakes in two of Brazil's largest hydroelectric dams for $3.7B[52]

Figure 6. Examples of Chinese Outbound Investments (Continued)

Country/ Region	Scale
Malaysia	• Signed agreements totaling $48B encompassing ports, roads and bridges – including investments in the Strait of Malacca. These include multiple projects with contract values in excess of $1billion, with China Railway Construction, China Railway Engineering, China Communications Construction, Power Construction Corp[53]
Pakistan	• China Pakistan Economic Corridor (CPEC) encompasses projects with a combined estimated cost of $62B, including: a 1,100-km motorway, an updated Karachi-Peshawar rail line, and a $2.5B gas pipeline[41,42]
Sri Lanka	• Borrowed >$5B from China to fund the $1.1B Hambantota port, the $270 million Mattala Airport, and $1.5B for construction on the Colombo City Project[32]

The Long View

At this point, we can revisit some of the financial questions we first set out to address:

Sources of Cash

Much of the initial seed funding came from China's foreign reserves, but project-level participation is spread across multiple layers of funding institutions that include policy banks, state-owned banks, multilateral development banks, and private commercial banks. In the future, private Chinese citizens may also participate if B&R projects go public.

International participation is critical for B&R. Policy banks often work directly with local governments to reduce credit risk. The Asian Infrastructure Investment Bank (AIIB) was set up in part to facilitate global investment, and foreign countries' participation in its capital has grown to 70%.[54]

Uses of Cash

Despite China's centralized political system, B&R project generation and funding has been extremely de-centralized. Chinese firms and recipient countries have strong incentives to brand their infrastructure plans as B&R.

The majority of investments are structured as loans with modest yields, even for some projects with high credit risk. Many of these loans do not appear attractive from a strictly commercial standpoint, but banks are also motivated by policy mandates. Project participation for Chinese construction companies can entail more upside, with some projects leading to asset operating rights, land access, or partial asset ownership. And as seen with Africa, investments often precede accelerating trade activity between China and its partner countries.

Distribution of Risk and Upside

Borrower countries can stand to gain from new credit avenues. Assuming that project scope is contained and completed projects generate reasonable returns, B&R investment can be a substantial boon for the borrowers.

However, risk-sharing tends to be asymmetrical, and lenders are in a much stronger negotiating position if repayments fall through.

Considering the unprecedented scale and time frame of B&R's implementation – with the ultimate goal of building up a Eurasian economic network around China – outsiders may wonder how one country can plan on such a scale. Chinese leaders have a history of long-term planning. Economic reforms initiated by former President Deng Xiaoping in 1977 continued for decades after his death in 1997 under the watch of his like-minded successors. During his life, Deng frequently proclaimed that China was prepared to wait 100 years to reunify with Taiwan.[55]

This sort of patience is critical for B&R, as individual projects can take 10 years to complete, and economic relationships with neighboring countries may not pay off for decades, if ever. Finally, the year 2049 carries a symbolic milestone to China as the 100th anniversary of the formation of People's Republic of China. All of this suggests that President Xi's party is willing to weather near-term losses, criticism, and uncertainty for the sake of China's long-term positioning.

Xi's foreign minister, Wang Yi, has said that the initiative is Mr. Xi's most important foreign policy.[28] Considering the efforts President Xi undertook to solidify his power base leading up to the 19th Communist Party Congress in 2017, it is unlikely that continuation of his prestige project will be in doubt.

Considering the efforts President Xi undertook to solidify his power base leading up to the 19th Communist Party Congress in 2017, it is unlikely that continuation of his prestige project will be in doubt.

Over the next fifty years, Belt and Road initiatives have the potential to dramatically shift the fortunes of the economies and companies involved. Not everyone can wait decades to assess the outcomes, but there are still several indicators that investors can monitor:

- How are insolvent loans accounted for on bank ledgers? Which institutions incur the ultimate risk of failed loans?
- How do Chinese banks manage their growing exposure to diverse and challenging B&R economies?
- Can China's project partners realistically afford to pay off their loans? What happens when a poorer nation cannot meet its payments?
- Do infrastructure projects bring in sufficient revenue for their host countries? Does project construction create employment opportunities for local workers?
- Do the resulting trade deals between China and Eurasian partners appear fair and politically sustainable?

In the end, China's leadership should be applauded for their risk-taking in the name of long-term growth and willingness to work with nations that have been sidelined by global financial institutions. The hope is that China's banks and smaller business partners are given adequate protections in the process.

Notes

[1] "Building the Belt and Road for win-win development," *China Daily,* 3 February 2017. http://www.chinadaily.com.cn/opinion/2017-02/03/content_28087627.htm

[2] "China Pledges $124B for New Silk Road Plan," *Financial Tribune*, 15 May 2017. https://financialtribune.com/articles/world-economy/64461/china-pledges-124b-for-new-silk-road-plan

[3] "China encircles the world with One Belt, One Road strategy," *The Financial Times,* 3 May 2017. https://www.ft.com/content/0714074a-0334-11e7-aa5b-6bb07f5c8e12

[4] "Our Bulldozers, our rules," *The Economist,* 2 July 2016. https://www.economist.com/news/china/21701505-chinas-foreign-policy-could-reshape-good-part-world-economy-our-bulldozers-our-rules

[5] Prabhash K Dutta, "Can China really encircle India with its String of Pearls? The great game of Asia", *India Today,* 15 June 2017. https://www.indiatoday.in/india/story/china-encircle-india-string-of-pearls-982930-2017-06-15

[6] Sara Hsu, "China's Energy Insecurity Glaring in South China Sea Dispute," Forbes, 2 September 2016. https://www.forbes.com/sites/sarahsu/2016/09/02/china-energy-insecurity-south-china-sea-dispute/#6fb6f2642eec

[7] "RMB internationalisation: Can the Belt and Road revitalise the RMB?", *SWIFT*, 28 July 2017. https://www.swift.com/news-events/press-releases/rmb-internationalisation_can-the-belt-and-road-revitalise-the-rmb_

[8] "Central bank official says China keen to promote use of yuan in commodity pricing", *South China Morning Post,* 19 September 2017. http://www.scmp.com/news/china/economy/article/2111892/central-bank-official-says-china-keen-promote-use-yuan-commodity

[9] "CPI Inflation Calculator", Bureau of Labor Statistics. https://data.bls.gov/cgi-bin/cpicalc.pl?cost1=13&year1=194801&year2=201709

[10] Saibal Dasgupta, "Beijing sets out global ambition with expansion of Belt and Road Initiative," *The National,* 14 May 2017. https://www.thenational.ae/business/beijing-sets-out-global-ambition-with-expansion-of-belt-and-road-initiative-1.15349

[11] Zhang Yuzhe and Han Wei, "China Steps Up Supervision of Policy Lenders," *Caixin,* 30 August 2017. http://www.caixinglobal.com/2017-08-30/101137589.html

[12] Shu Zhang and Matthew Miller, "Behind China's Silk Road vision: cheap funds, heavy debt, growing risk," *Reuters,* 15 May 2017. https://uk.reuters.com/article/uk-china-silkroad-finance/behind-chinas-silk-road-vision-cheap-funds-heavy-debt-growing-risk-idUKKCN18B0YO

[13] Brenda Goh and Yawen Chen, "China pledges $124 billion for new Silk Road as champion of globalization," *Reuters,* 13 May 2017. https://www.reuters.com/article/us-china-silkroad-africa/china-pledges-124-billion-for-new-silk-road-as-champion-of-globalization-idUSKBN18A02I

[14] Christopher J. Neely, "Chinese Foreign Exchange Reserves and the U.S. Economy ", *Federal Reserve Bank of St. Louis,* 6 May 2016. https://research.stlouisfed.org/publications/economic-synopses/2016/05/06/chinese-foreign-exchange-reserves-and-the-u-s-economy/

[15] Peng Qinqin and Denise Jia, "China State Banks Provide Over $400 Bln of Credits to Belt and Road Projects," *Caixin,* 11 May 2017. http://www.caixinglobal.com/2017-05-12/101089361.html

[16] Kane Wu and Julie Zhu, "Exclusive: China's 'big four' banks raise billions for Belt and Road deals," *Reuters*, 21 August 2017. https://www.reuters.com/article/us-ccb-fundraising/exclusive-chinas-big-four-banks-raise-billions-for-belt-and-road-deals-sources-idUSKCN1B20ER

[17] "China new 'Silk Road' investment falls in 2016," *The Financial Times,* 10 May 2017. https://www.ft.com/content/156da902-354f-11e7-bce4-9023f8c0fd2e

[18] "Chinese banks to lend 380 billion yuan to support Belt and Road cooperation," *Reuters*, 13 May 2017. http://www.reuters.com/article/us-china-silkroad-financing/chinese-banks-to-lend-380-billion-yuan-to-support-belt-and-road-cooperation-idUSKBN18A025

[19] Ma JingJing, "Chinese, foreign financial institutions open slew of branches to support initiative," *Global Times*, 22 May 2017. http://www.globaltimes.cn/content/1048113.shtml

[20] Chen Jia, "Firm footing for Asia's economic growth," *China Daily,* 26 July 2015. http://www.telegraph.co.uk/sponsored/china-watch/business/11762805/aiib-new-silk-road-fund-economic-growth-asia.html

[21] "AIIB chief unveils aim to rival lenders such as ADB and World Bank," *The Financial Times*, 3 May 2017. https://www.ft.com/content/3a938ee4-0288-11e7-aa5b-6bb07f5c8e12

[22] Enoch Yiu, "HK can become Belt and Road funding hub – but analysts warn investors that its thousands of expected projects are not guaranteed gravy trains," *South China Morning Post*, 1 May 2017. http://www.scmp.com/business/companies/article/2088198/hk-can-become-belt-and-road-funding-hub-analysts-warn-investors

[23] "Chinese SOEs can manage B&R investment risks: official," *Xinhua,* 8 May 2017. http://news.xinhuanet.com/english/2017-05/08/c_136266324.htm

[24] "Chinese banks gearing up for Belt and Road investment," GBTimes, 22 August 2017. http://gbtimes.com/chinese-banks-gearing-belt-and-road-investment

[25] "Chinese investment in Africa: Beijing's testing ground," The Financial Times, 3 June 2017. https://www.ft.com/content/0f534aa4-4549-11e7-8519-9f94ee97d996

[26] Vickers Securities, "Asian Insights SparX: One Belt One Road Infrastructure Sector," 24 July 2017, 21. https://researchwise.dbsvresearch.com/ResearchManager/DownloadResearch.aspx?E=cjaghk-b

[27] Kim Yi Dionne, "Here's what Africans think about China's influence in their countries," *Afrobarometer*, 28 October 2016. http://afrobarometer.org/blogs/heres-what-africans-think-about-chinas-influence-their-countries

[28] J.P., "What is China's belt and road initiative?," *The Economist*, 15 May 2017. https://www.economist.com/blogs/economist-explains/2017/05/economist-explains-11

[29] William Mellor, "Influential Thais in push for Kra Canal project," *Nikkei Asian Review,* 7 August 2017. https://asia.nikkei.com/Politics-Economy/Economy/Influential-Thais-in-push-for-Kra-Canal-project

[30] "China announces strategically important Kra Isthmus Canal in Thailand," *China Daily Mail*, 17 May 2015. https://chinadailymail.com/2015/05/17/china-announces-strategically-important-kra-isthmus-canal-in-thailand/

[31] "The real threat to S'pore – construction of Thai's Kra Canal financed by China", The Independent, 2 October 2016. http://www.theindependent.sg/the-real-threat-to-spore-construction-of-thais-kra-canal-financed-by-china/

[32] "For Pakistan, a grim reminder from Sri Lanka: China gives loan, then grabs land," *The Economic Times,* 29 July 2017. http://economictimes.indiatimes.com/news/international/world-news/for-pakistan-a-grim-reminder-from-sri-lanka-china-gives-loan-then-grabs-land/articleshow/59822644.cms

[33] Wade Shepard, "China's Jewel in the Heart of the Indian Ocean," *The Diplomat,* 9 May 2016. http://thediplomat.com/2016/05/chinas-jewel-in-the-heart-of-the-indian-ocean/

[34] Ankit Panda, "Sri Lanka Formally Hands Over Hambantota Port to Chinese Firms on 99-Year Lease" *The Diplomat,* 11 December 2017. https://thediplomat.com/2017/12/sri-lanka-formally-hands-over-hambantota-port-to-chinese-firms-on-99-year-lease/

[35] Yogita Limaye, "Sri Lanka: A country trapped in debt," *BBC News,* 26 May 2017. http://www.bbc.com/news/business-40044113

[36] "GDP Ranking," *The World Bank,* 1 July 2017. https://data.worldbank.org/data-catalog/GDP-ranking-table

[37] Peter Janssen, "Land-locked Laos on track for controversial China rail link, *Nikkei Asian Review,* 24 June 2017. https://asia.nikkei.com/Politics-Economy/International-Relations/Land-locked-Laos-on-track-for-controversial-China-rail-link

[38] Zheng Xin, "New pipeline broadbases gas supplies," *China Daily,* 15 April 2017. http://www.chinadaily.com.cn/business/2017-04/15/content_28939945.htm

[39] "Kyrgyzstan Reaches New Heights of Debt", *Eurasianet,* 5 July 2016. http://www.eurasianet.org/node/79531

[40] Bruce Pannier, "Podcast: For Central Asia, 'OBOR' Means 'China,' And All That Comes With That," *Radio Free Europe / Radio Liberty,* 21 May 2017. https://www.rferl.org/a/majlis-podcast-one-belt-one-road-project-central-asia-china/28500388.html

[41] Salman Siddiqui, "CPEC investment pushed from $55B to $62B," *The Express Tribune*, 12 April 2017. https://tribune.com.pk/story/1381733/cpec-investment-pushed-55b-62b/

[42] "How will CPEC boost Pakistan economy?, Deloitte, 2. https://www2.deloitte.com/content/dam/Deloitte/pk/Documents/risk/pak-china-eco-corridor-deloittepk-noexp.pdf

[43] "Tajikistan's external debt up nearly 80 million USD last year, says Tajik official," ASIA-Plus, 27 January 2017. https://news.tj/en/news/tajikistan/economic/20170127/236046

[44] "Kyrgyzstan and the Great Silk Road: compatibility of concepts," *KABAR*, 10 June 2017. http://old.kabar.kg/eng/analytics/full/11093

[45] Qishloq Ovozi, "Uzbekistan's New Railway To Isolation," *Radio Free Europe / Radio Liberty*, 25 February 2016. https://www.rferl.org/a/qishloq-ovozi-uzbekistan-tajikistan-railway-angren-pap/27574309.html

[46] "As the construction of Turkmenistan's largest pipeline is halted, the country's crisis worsens," Asia News, 3 March 2017. http://www.asianews.it/news-en/As-the-construction-of-Turkmenistan's-largest-pipeline-is-halted,-the-country's-crisis-worsens-40181.html

[47] Vickers Securities, "Asian Insights SparX: One Belt One Road Infrastructure Sector," 24 July 2017, 4. https://researchwise.dbsvresearch.com/ResearchManager/DownloadResearch.aspx?E=cjaghk-b

[48] "Ports and roads mean China is 'winning in Africa'," *The Financial Times*, 3 May 2017. https://www.ft.com/content/65591ac0-2f49-11e7-9555-23ef563ecf9a

[49] Barbara Surk, "As China Moves In, Serbia Reaps Benefits, With Strings Attached," *The New York Times*, 9 September 2017. https://www.nytimes.com/2017/09/09/world/europe/china-serbia-european-union.html?mcubz=3

[50] "China deepens overseas port holdings," *The Financial Times*, 3 September 2017. https://www.ft.com/content/451e1b80-912c-11e7-bdfa-eda243196c2c

[51] "China's State Grid will buy another 29% stake in CPFL (Brazil)," EnerData, 28 September 2016. https://www.enerdata.net/publications/daily-energy-news/chinas-state-grid-will-buy-another-29-stake-cpfl-brazil.html

[52] "China Three Gorges wins bid to operate two Brazilian hydropower plants," *Xinhua*, 26 November 2015. http://news.xinhuanet.com/english/2015-11/26/c_134857429.htm

[53] Keith Zhai and Pooi Koon Chong, "China Wants This Malaysian Port to Rival Singapore (And That's Not All)," *Bloomberg News*, 31 July 2017. https://www.bloomberg.com/news/articles/2017-07-31/chinese-money-pouring-into-malaysia-could-help-najib-razak-with-votes

[54] "The AIIB: The Infrastructure of Power," *The Economist*, 30 June 2016. https://www.economist.com/news/finance-and-economics/21701494-reasons-be-enthusiastic-about-chinas-answer-world-bank-infrastructure

[55] Suisheng Zhao, "Are China and Taiwan moving toward confrontation?," *East Asia Forum*, 27 September 2016. http://www.eastasiaforum.org/2016/09/27/are-china-and-taiwan-moving-toward-confrontation/

Glossary

Fitch National Credit Rating

an assessment of creditworthiness for sovereign-level issuers. (Source: Fitch Ratings)

Multilateral Development Bank (MDB)

an international financial institution, chartered by a group of countries, that provides financing and advisory services in support of economic development.

Policy Banks

three banks in China (Agricultural Development Bank of China, China Development Bank, and Export-Import Bank of China) that were established in 1994 to finance state-invested projects, as well as economic and trade development priorities.

Public Private Partnerships

a government service or private business venture that is funded and operated through a partnership of government and one or more private sector companies.

Renminbi (RMB)

the official currency of the People's Republic of China. The name literally means "people's currency." The yuan (sign: ¥) is the basic unit of the renminbi, but is also used to refer to the Chinese currency generally, especially in international contexts.

S&P Sovereign Rating

a rating that assesses a sovereign government's willingness and ability to service its debt on time. (Source: S&P Global)

State-owned Enterprise (SOE)

a legal entity that is created by the government in order to participate in commercial activities on the government's behalf. A state-owned enterprise can be either wholly or partially owned by a government.

The views and information discussed in this commentary are as of the date of publication, are subject to change, and may not reflect Seafarer's current views. The views expressed represent an assessment of market conditions at a specific point in time, are opinions only and should not be relied upon as investment advice regarding a particular investment or markets in general. Such information does not constitute a recommendation to buy or sell specific securities or investment vehicles. It should not be assumed that any investment will be profitable or will equal the performance of the portfolios or any securities or any sectors mentioned herein. The subject matter contained herein has been derived from several sources believed to be reliable and accurate at the time of compilation. Seafarer does not accept any liability for losses either direct or consequential caused by the use of this information.

As of December 31, 2017 the Seafarer Funds had no economic interest in the entities referenced in this commentary.

ALPS Distributors, Inc. is the distributor for the Seafarer Funds.

Investors should consider the investment objectives, risks, charges and expenses carefully before making an investment decision. This and other information about the Funds are contained in the Prospectus, which may be obtained by calling (855) 732-9220. Please read the Prospectus carefully before you invest or send money.

Important Risks: An investment in the Funds involves risk, including possible loss of principal. International investing involves additional risks, including social and political instability, market and currency volatility, market illiquidity, and reduced regulation. Emerging markets are often more volatile than developed markets, and investing in emerging markets involves greater risks. Fixed income investments are subject to additional risks, including but not limited to interest rate, credit, and inflation risks. Value investments are subject to the risk that their intrinsic value may not be recognized by the broad market. An investment in the Funds should be considered a long-term investment.

SEAFARER