IN FOCUS: BELT & ROAD INITIATIVE

A deep dive into China's plans for the biggest global infrastructure project in history, and what it could mean for the (re)insurance industry

By Samera Owusu Tutu

Some five years ago, China set the ball in motion for a major play on global power, and an economic revolution. At the heart of its plans was a jewel from its past: trade, and the paths that facilitate it.

With a global shift beginning to take place, a boon of opportunities is on the cards for the global insurance and reinsurance sectors - but only if they can navigate the technical and political minefields scattered along the way.

We put China's global infrastructure initiative under the microscope to understand why it's happening and what may lay ahead.

Launched in September 2013, the Belt and Road initiative (BRI) is the amalgamation of a modern-day silk road and the economic belt that supports it. The road element is in fact a sea route that will link China's southern coast to east Africa and the Mediterranean, and the belt is a complementary series of pathways connecting China to central Asia, Europe and the Middle East.

Given its international ambitions, it was quite fitting for China's president Xi Jinping to announce BRI in Kazakhstan. He outlined that through the two trade routes, not only would regional trade be increased, but economic cooperation would also be encouraged. The Initiative is set to boost trade and stimulate economic growth – while creating substantial business opportunities – throughout Asia and into Africa, Europe and the Middle East. Beijing has made no bones about the belief that BRI will usher in a new era of globalisation.

This assertion is not one to be sniffed at: according to HSBC – the Initiative's bank of choice – the countries within the geographic area impacted by BRI account for 29% of the global GDP.

And the sums being pumped into this initiative are groundbreaking. Reports from Fitch published early last year, outlined that China planned to invest $150m into an array of projects each year, to the ultimate tune of $900bn. Many of these projects are already underway.

With investment figures just shy of $1tn at the planning stage, BRI is set to become the largest global infrastructure project ever.

FitchRating BMI Research infrastructure analyst Christian Zhang highlights that now this figure stands at near the $2tn mark.

Zhang says: "The sheer value of the BRI – we have tracked around US$1.8tn in proposed and planned infrastructure that involve Chinese investment or involvement, according to our Key

Projects Database – alone justifies its potential to have a transformative impact on trade flows and economic development across Asia, Europe, Africa and the Middle East. Although many of these projects have yet to be approved or funded, they have the potential to meet the sizeable infrastructure needs of developing countries around the world."

Even at its earliest stage BRI surpassed the US' post-World War II (WWII) Marshall Reconstruction Plan, which was the last initiative to have such wide-spanning impact on trade flow and economic development. In the aftermath of WWII, the Marshall Reconstruction Plan provided the equivalent of what would be $800n in today's money to Europe in the form of reconstruction funds that aided in the movement of goods and services. As well as affecting 65% of the world's population, the Plan also impacted a third of its GDP – much like the BRI intends to today. It is worth noting that for several decades after WWII the US was both the world's largest trading nation and its largest bilateral lender.

The historical advantage garnered by the US due to the Marshall Reconstruction Plan was undeniable, and China is likely to experience very similar benefits.

Zhang adds: "Aside from the broader economic and geopolitical impacts, one reason why companies outside of Asia, Africa and the Middle East should be taking note of BRI is because the initiative also involves Chinese construction and infrastructure companies increasingly competing for projects overseas. Industrial domains ranging from construction vehicles, infrastructure engineering and railway vehicles – many of which have historically been dominated by European, American or Japanese companies – now face increased competition from Chinese counterparts.

"A prime example is the overseas expansion of Chinese rolling-stock manufacturer CRRC, which has gone from largely supplying domestic railways to winning contracts to build metro cars and high-speed trains for cities across North America, South America and Asia in recent years."

There are a number of countries on this modern silk road that stand to benefit greatly from the investment.

"From a reinsurance point of view, the increase in demand for insurance, brought on by the rapid scaling up of infrastructure and the development of new buildings, will help fuel urbanisation in the region.

Les Loh, Axis Re APAC

Among other initiatives, there are plans for bridges in Bangladesh, railways in Russia, a $1.1bn port project in Sri Lanka, high-speed rail in Indonesia, and an industrial park in Cambodia.

One of the more significant BRI projects is the $62bn China-Pakistan Economic Corridor (Cpec), which will entail the construction of power plants, wind farms, railways and motorways. This project alone is predicted to create one million jobs in Pakistan, sparking an economic revolution in the country.

The BRI will reshape the region. Little known towns, like the Pakistani town of Gwadar, will be changed from small fisherman strongholds with cinderblock houses, to more urbanised areas – Gwadar for one is a centrepiece in the Cpec project.

"One of the stated goals of the China-Pakistan Economic Corridor, which falls under the broad umbrella of the Belt and Road initiative, is to improve infrastructure and industrial development which, in turn, is aimed at increasing trade with China and the rest of the region," explains Zhang. "Gwadar in Pakistan was chosen because of its strategic location on the Arabian Sea; goods and energy products coming from Europe, Africa and the Middle East can, in theory, be offloaded at Gwadar and transported overland to China (and vice versa), compared to current routes which require ships to sail for another one to two weeks through the Straits of Malacca and the South China Sea."

China and Pakistan aspire to turn this 50,000 fisherman town into a "new Dubai", housing 2 million people. Zhang explains: "The projects that China is investing in in places like Gwadar revolve around port infrastructure: the port itself and surrounding roads, power facilities and industrial zones. In theory, this will attract investment from both domestic and overseas sources, boosting industrial production and generating employment – which will, in turn, spur urban development. In a way, BRI is exporting China's development model of using ▸

President Xi Jinping launches BRI in September 2013

China's president Xi Jinping first mooted the idea of BRI in September 2013, in a speech delivered at Nazarbayev University, Kazakhstan. Xi proposed that China and Central Asia collaborate on building a new Silk Road Economic Belt. Initially, the initiative went by the name 'One Belt One Road', but the ethos was the same.

During the speech, Xi said: "[China is] ready to share practices of development with other countries, but we have no intention to interfere in other countries' internal affairs, export our own social system and model of development, or impose our own will on others. In pursuing the Belt and Road Initiative, we will not resort to outdated geopolitical manoeuvring."

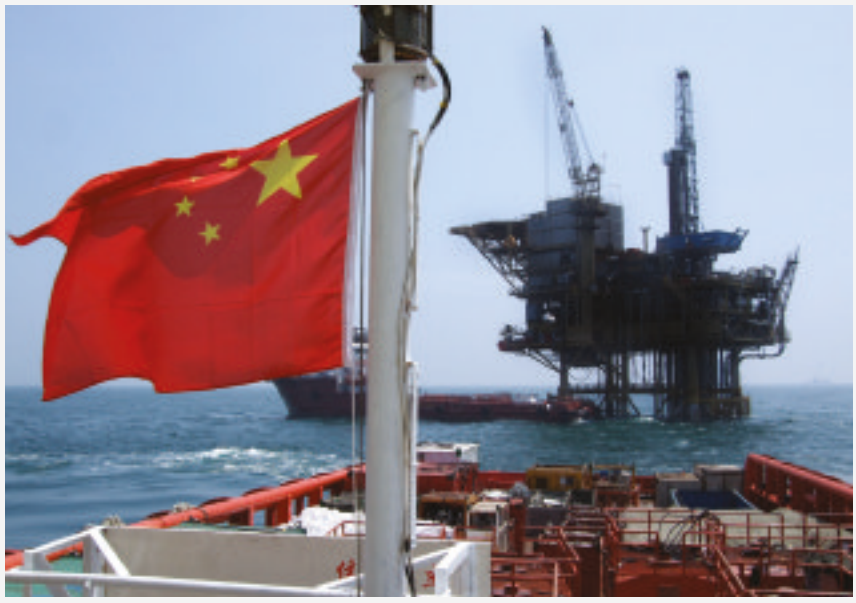
He added: "We have no intention to form a small group detrimental to stability, what we hope to create is a big family of harmonious co-existence."

infrastructure spending to spur economic growth."

To this end, Gwadar is experiencing a burst of construction, including a new container port, 1,800 miles of high-speed railway and superhighway, and a slew of new hotels. This will be achieved through a series of loans – not grants – and will give China the rights to operate the Gwadar port for the next 40 years.

The BRI is not just about ports and superhighways; the Initiative includes grand-scale Chinese power transmission projects as well, and these developments are paramount to nations likes Kyrgyzstan and Tajikistan. Axco Insurance Information Services global information analyst James Fox explains that projects are spanning as far as Eastern Europe, and that China has intentions to explore Latin America and the Caribbean: "The Chinese government is moving to develop similar links in Eastern Europe, the Caribbean and Latin America. Although not yet formally part of the BRI, significant state-led Chinese investment has flowed into tourism, mining and infrastructure in the Americas. This largely takes the form of major construction projects, which naturally have knock-on effects to other parts of the economy."

Fox adds: "BRI connections into these regions would provide a major boost to regional development and probably trade as well. Of course, a major increase in construction would have implications for local insurance dynamics and raise questions about the ability of local insurance markets to cover major projects, and legal questions of how premium is exported back to China."



Axis Re APAC deputy chief underwriting officer Les Loh believes that the BRI will pose significant opportunities for the insurance and reinsurance industries. Loh says: "The (re)insurance industry can capitalise on the various infrastructure projects that are part of this initiative by providing increased capacity and specialty insurance expertise. It is expected that various lines will benefit from the BRI, including marine cargo and credit bond, both of which are growth markets in the region because of BRI."

And this is not a short-term boost, PartnerRe Asia head of property fac, marine and Broker management David Philips believes the benefits to (re)insurance could span more than two decades.

He says: "Given the scale of infrastructure planned, BRI will create significant primary opportunities for (re)insurers, particularly in providing cover for engineering and construction risk. It is anticipated that infrastructure projects including road, railway, all varieties of power production and distribution systems, water treatment and distribution, IT infrastructure and even onshore energy projects – will create a flow of business opportunities for (re)insurers over the next two decades. Urbanisation of new areas along the route is likely to continue that trend by attracting further investment and creating new markets for (re)insurance products.

"Also, the majority of the 68 markets so far involved in the plan can be described as developing economies. For the insurance community, many of these markets represent the lowest insurance spend per capita in the world. If BRI investment in these countries does lead to urbanisation, and increased prosperity, this will in turn inevitably translate into a higher insurance spend."

These opportunities will be particularly poignant to those players

Cpec – what does it mean to Pakistan?

The China-Pakistan Economic Corridor (Cpec) is a 3,200km+ section of the BRI comprising highways, railways and pipelines. While the project has been budgeted at $62bn, consultancy firm Deloitte believe the final figure will be closer to $75bn. The estimated delivery date for Cpec is 2020, and $45bn of the spend has been allocated to ensure that that date is met.

According to Deloitte: "It is estimated that if all the planned projects are implemented, the value of those projects would exceed all foreign direct investment in Pakistan since 1970 and would be equivalent to 17% of Pakistan's 2015 gross domestic product."

The port at Gwadar is the cornerstone of Cpec. As an indication of the impact of the port on trade for China, oil imported from the Middle East would be offloaded at Gwadar and transported to China through the corridor, cutting the current 12,000 km journey to 2,395 km.

operating in the Asia-Pacific region; many in the region are already establishing BRI-related provisions in order to capitalise on the opportunities being presented.

Regarding Axis Re's offering, Loh adds: "As we focus on treaty reinsurance business in the region, we partner with a lot of specialty insurers throughout Asia. We provide them with the treaty capacity they need to expand in this area, helping them secure the appropriate level of risk coverage that is necessary when investing in BRI-related large-scale infrastructure projects. We also offer the value-added services of providing capacity and the technical know-how and knowledge transfer that help insurers adequately assess the specialty risks associated with BRI projects."

Philips believes PartnerRe Asia will also seize the opportunity: "BRI is a significant opportunity for global reinsurers such as PartnerRe, that have considerable experience of large infrastructure projects and deep technical underwriting expertise in engineering and construction, credit & surety, political risk, marine and other related lines."

As well as specific lines relating to the road and belt, BRI will provide substantial opportunities to the (re)insurance markets from the associated urbanisation. Loh highlights that concentrated urbanisation goes hand in hand with development on China's infrastructure projects.

"We have seen this before in China when the country first began its mass urbanisation efforts and opened up the economy," Loh says. "From a reinsurance point of view, the increase in demand for insurance, brought on by the rapid scaling up of infrastructure and the development of new buildings, will help fuel this urbanisation in the region. That, in turn, will bring new opportunities for reinsurers, mainly relating to the need for specialised insurance and reinsurance coverage that can protect against the more complex risks that will come to the forefront as the region becomes more urbanised."

Loh stresses the necessity for the insurance and reinsurance industries to keep abreast of progress on BRI, stating that the need for risk management on a project of this scale is profound: "(Re)insurance is an integral part of the fabric of society and economies. An expanding economy, where new commercial development and infrastructure proliferate, is particularly in need of sound (re)insurance coverage and risk management expertise."

Many of these associated risks bubble below the surface, and are beyond the nuts and bolts of the physical infrastructure developments. These tensions are rooted in the skepticism surrounding the Initiative. Fundamentally, the motives behind BRI are not completely altruistic. China's past growth has been heavily tied to investment in property and manufacturing. As this has slowed, so has growth, leaving excess capacity. Currently, investment in infrastructure has buoyed growth for the country, but not enough to match growth of previous years. The BRI provides China with a larger scope of infrastructure projects to invest in.

Fitch previously reported in Fitch Wire+ that IBR "is driven primarily by China's efforts to extend its global influence and relieve domestic overcapacity. There is a risk that projects might not be aimed at addressing the most pressing infrastructure needs and could fail to deliver expected returns".

IBR also provides China with an outlet for excess steel, which is not being utilised due to the slowdown in domestic construction.

According to the Fitch Wire+ report: "Capacity utilisation in the

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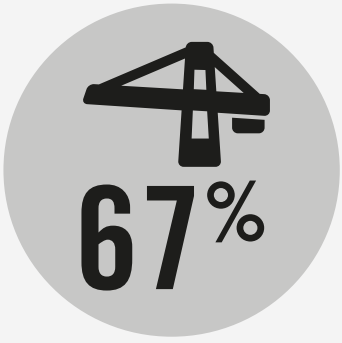
Global GDP accounted for by countries potentially encompassed by the BRI, according to HSBC



Record low for capacity utilisation in the steel sector in 2015

XINHUA NEWS AGENCY/REX/SHUTTERSTOCK

↑ **GWADAR** China intends to turn Gwadar into the next Dubai through investment and urbanisation

steel sector, fell to a record low of 67% in 2015, down from 76% in 2012 and well below the 80% - 85% rates usually seen in healthy sectors. Significant spare capacity has also emerged in the construction and engineering sectors, driven in particular by the slowdown in property investment."

"China aims to relieve its overcapacity and create new markets for its own economy," Axco Insurance Information Services' James Fox says. "BRI is shaping perceptions of China around the world, extending its soft power, but also prompting some local pushback to Chinese workers and foreign ownership. Ultimately, the state-led BRI model means that the Chinese sphere of economic and geopolitical influence is much wider than it was 10 years ago."

Furthermore, the BRI contracts are exclusively for Chinese companies, which in turn bring Chinese workers. This was a practice that was prevalent during China's involvement in infrastructure projects in countries in Sub-Saharan Africa. When China withdrew from these projects, it was evident that skill-sharing had not taken place, and the local economies had not seen the boosts associated with major infrastructure projects.

BRI has strong political motivations, given that China is trying to expand its strategic international influence, and this could lead to the subjugation of market forces. FitchRatings believes that "genuine infrastructure needs and commercial logic might be secondary to political motivations". With implied support from the Chinese government, there is less need for these projects to be profitable, putting more commercially minded entities at a disadvantage.

To add to this, PartnerRe Asia's Philips believes China will have a further competitive advantage: "The scale and speed of China's economic development has been unrivalled. If the new trade routes, particularly the ability to move goods and services west are successful, it means lower cost and even greater competitive advantage for China vs the rest of the world's major trading markets."

FitchRating BMI Research's Zhang supports the notion that China is making a major power play with BRI, and flags that it will aid in displacing US influence in the region: "The other main reason for the view that BRI is globally impactful is because the initiative is seen as a symbol of China's economic and political influence displacing that of the United States in the region. Developments in the Philippines over the past two years illustrate this – after President Rodrigo Duterte announced his 'separation' from the United States, China announced several billions of dollars of infrastructure and industrial investment in the country."

FitchRatings BMI Research head of Asia country risk Chua Han Teng says that the usurping of US power in the region coupled with the specific path BRI will take could lead to friction: "The BRI is an effort by China to expand its influence through trade and transport linkages as it grows more powerful economically and this is likely to create political friction in the region. One of the key routes for the Belt & Road Initiative will pass through Sri Lanka and the Indian Ocean, which India views as its sphere of influence. In addition, the China-Pakistan Economic Corridor could lead to increased tensions between Beijing and New Delhi as China plays a more active role in the region."

As BRI gives Beijing greater leverage over neighbouring countries, allowing China's influence to grow, pushback from other powers is inevitable. In the midst of development, India has shown that it is wary of being indebted to China, and India's prime minister Narendra Modi has been vocal in his

Proposed and planned BRI infrastructure that involve Chinese investment or involvement

distrust for the BRI, stating that China was trying to "undermine the sovereignty of other nations".

"There is definitely tension, especially when Modi is under constant pressure from more assertive Indian nationalists in the BJP who view China as a threat," says Axco Insurance Information Services' Fox. "The BRI has generally accelerated strategic economic competition between China and India across the wider Asia region. The development of infrastructure for the Cpec is further ratcheting tensions in Kashmir, further entrenching both sides' claims of sovereignty there, and increasing Indian fears of Chinese encirclement in the Indian Ocean due to the Chinese state's port developments in Gwadar in Pakistan and Hambantota in Sri Lanka."

Fox adds: "Concerns over each other's sphere of influence in Bhutan contributed to the military standoff on the Doklam peninsula, while similar pressures continue to affect Nepalese politics. The initiative has forced Japan, the US and India to recognise aligned interests in opposition to China, and are now collaborating more closely on regional connectivity, trade and a rival investment initiative in Africa, in addition to security ties, (spurring the revival of the Quad dialogue between Indian, Japan, the US and Australia), potentially influencing the geopolitical calculus in North Korea and the South China Sea, and fuelling Chinese fears of US-led containment. Eagerness to accept the BRI cash has seen some moderation of stances regarding the South China Sea towards Beijing's position among APEC member states, however."

According to FitchRatings, these concerns are not unfounded, as the pace of urbanisation in some of the chosen BRI locations is also likely to lead to social and political tensions.

"The potential issue with urbanisation in frontier regions like Gwadar is that population growth could outpace growth in housing, utility and social services," says Zhang. "The formation of informal settlements could exacerbate healthcare issues and be the source of social unrest. Shortages of water, power, health or educational facilities could diminish the area's appeal to investors and workers, limiting its potential impact on the regional economy and global trade flows. Security issues are also present for projects in Gwadar – Gwadar is located in Balochistan province which has an active separatist movement, while many road, railway and pipeline projects in Pakistan are planned to go through areas controlled by the Taliban or other extremist groups. Unofficial lists of BRI countries include regions with even higher political risks such as Syria and Yemen."

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Zhang also adds that opposition to the erosion of sovereignty has already surfaced in places like Sri Lanka, where the sale of the China-backed Hambantota Port to a Chinese state-owned company drew vocal criticism from politicians and the public.

While India, Japan and the West have made their concerns known, the developing countries that stand to benefit from BRI are eager for the investment.

Fox highlights that fiscally squeezed governments around the world have made it clear that they want a share of the initially earmarked $900bn pot of concessional finance.

"China's transactional, even mercantilist, approach has been criticised by the West, India and Japan, but some developing countries are eager to accept an alternative to an aid-led development model that they consider bankrupt," Fox explains. "Politicians are keen to build political and economic links with China and secure funding for much-needed infrastructure projects without the more stringent oversight demanded by other international institutions and governments. China is deliberately targeting emerging markets, and is keen to be a part of economic success stories like Ethiopia."

Whether for or against BRI, the ball is in motion and all in the regions affected will be carried along for the ride. Inflated influence and leverage for China is inevitable; it's for the insurance and reinsurance industries to now take note and capitalise on what could be the beginnings of a new red era. ■