THE BELT AND ROAD
PLEDGE OF THE DRAGON

BALKAN STABILITOCRACIES
A WORLD IN (DIS-)ORDER?

Abidhadjaev • Bieber • Bremmer • Hilarion • Katz • Li
Nakahigashi • Nolan • Rahmstorf • Rudd • Saltybayev
Sok • Troubridge • Wang • Yoshino • Zaev
The Strategic Case for a London-Beijing Trade Axis

Sir Tom Troubridge

In March 2019, the United Kingdom will leave the European Union. The negotiations over the terms of the UK’s departure are proving difficult, not least because Brussels needs to fill a large budget gap (the UK is the second largest contributor to the EU budget), and because it is determined to ensure the UK has less advantageous access to the EU after leaving than it would have had as a member, in order to discourage other potential leavers.

In December 2017, the UK agreed stage one of negotiations with regard to the divorce bill, the status of EU citizens in the UK (and UK citizens in the EU), and the vexed Irish border issue—although the last point is likely to reoccur in stage two. The UK would like to leave while keeping as much access to trade and services as possible—sometimes described as having your cake and eating it too.

The negotiations are further complicated by the continuing battle between ‘remainers’ and ‘leavers’ within both the main political parties in the UK, and, indeed, within the British Cabinet itself; none of this bodes well for a smooth departure. Given the significant trade surplus that the EU has with the UK, and London’s contributions to Brussels’s security and intelligence gathering, most people agree that it is in the interest of both parties to agree a sensible deal. I wonder how many divorce lawyers give that advice to the warring couple!

There has been much debate about soft Brexit and hard Brexit, although these terms are not well defined and mean different things to different people. Soft Brexit seems to imply staying in the single market and customs union, which means accepting free movement of people, paying into the EU budget, and accepting European courts, but without having any say on future policy and laws (i.e. staying a member but with no say). Hard Brexit implies leaving the single market and customs union and ideally having some sort of a trade deal with the EU on an ongoing basis, which would be as simple and tariff-light as possible.

There are some signs of a compromise appearing, according to which the UK would leave the EU in March 2019, but retain some sort of transitional deal for two years on much the same basis as now, allowing for a longer term deal to be worked out in the interim. This sounds sensible and would be welcomed by the business community. Whether it can be agreed on by politicians, however, is another matter entirely.

One of the main reasons for leaving the EU is to enable the UK to strike its own trade deals with non-EU countries. For those countries that already have a trade deal with the EU, this should be relatively straightforward. However, there are some significant countries that do not currently have trade deals with the EU, not least the United States and China. The UK is
in early discussions with both of these countries with regard to potential trade and investment agreements, but cannot sign such an agreement until it has officially left the EU.

The World Economy in 2050

While Brexit, hard or soft, is likely to lead to some short-term disruption to the UK economy, one needs to look at the longer term prospects to see who are likely to be the winners and losers in the world economy. PricewaterhouseCoopers (PwC) published an interesting report recently, looking at how the economic order might change by 2050. Cumulative GDP growth between 2016 and 2050 is forecast at 130 percent, with China representing 20 percent of global GDP in Purchasing Power Parity (PPP) terms by 2050. India comes in second, followed by the United States and Indonesia. The UK does not have a trade agreement with any of these countries.

The EU27’s share of global GDP at PPP terms is forecast to fall from 15 percent to just 9 percent. Despite Brexit, the UK is only forecast to drop one place, from ninth to tenth, with Germany the only EU member state predicted to remain in the top ten, in ninth place. France is forecast to drop out of the top ten, while Italy and Spain are projected to drop out of the top 20, and be overtaken by faster-growing emerging economies, such as those of Mexico, Turkey, and Vietnam.

While projections invariably differ from the reality, the general trend of economic growth towards the East and emerging economies is agreed by most economists, and illustrates the importance of building strong trade links with such countries.

UK Trade with China

The UK has been trading with China for more than 200 years; probably longer, in fact, if one goes back to the days of the early Silk Road. The early nineteenth century was a difficult time for UK-China trade, with two wars fought over trade access and the granting of the lease over Hong Kong. In the early 1950s, the China-Britain Business Council (CBBC) began sending trade delegations to China, despite the latter’s behavior as a closed country without a fully established diplomatic relationship with the UK. Trade has increased strongly in the last ten years, while UK exports to China (including Hong Kong) have grown at just over 10 percent per annum, to reach £24 billion in 2015. The UK has become the most popular destination for Chinese outbound investment in Europe, and the fourth most popular destination for Chinese outbound investment worldwide.

In November 2015, Chinese President Xi Jinping made a very successful state visit to the UK, heralding the beginning of a so-called ‘Golden Era’ in Sino-British relations. The UK has a lot to offer to China as Beijing moves its economy from a cost-competitive manufacturing export one towards a more advanced manufacturing, service sector, and consumer-led economy. We have seen great demand for British consumer brands, healthcare, and old-age care expertise, education, advanced manufacturing, green energy, financial services, and agricultural expertise. Since the referendum to leave the EU in June 2016, Chinese investment in the UK has continued to increase, partly fueled by the fall in the value of Britain’s currency. The anecdotal feedback from visits to China is that they are not too concerned by Brexit, for China does not rely on the UK as a gateway to Europe or as part of an integrated manufacturing or banking business.

China also sees the City of London as an important part of its plans to internationalize the renminbi. London has already been granted most favored status for trading the renminbi outside of Greater China and is the world’s largest offshore renminbi clearing center. Considering how the renminbi is forecast to significantly increase its share of global currency trading over the next two or three decades, this is an important signal for the future of the City of London.

The UK is one of the most popular destinations for Chinese students to attend language schools, private schools, and universities. There were over 100,000 such students in the UK in 2016, and British schools and universities are now starting to open campuses in China. This creates an important link between China and the UK, as these students forge careers in both countries and strengthen the ties between them.

Finally, the UK has shown great support to China on the Belt and Road Initiative (BRI). The UK was an early joiner of the Asian Infrastructure Investment Bank (AIIB) and an enthusiastic supporter of BRI from its inception in 2013.

CBBC has published three reports on the Belt and Road, the first in 2015, in conjunction with the UK Foreign and Commonwealth Office, designed primarily to educate UK companies on the project and the opportunities it brings. The second report, published in partnership with Tsinghua University in 2016, demonstrated how UK-China collaboration on BRI projects is a present reality, with over 20 case studies of live projects that demonstrated the depth and breadth of already existing cooperation. Lastly, the third report, published in partnership with the Chinese Academy of International Trade and Economic Cooperation (CAITEC), was launched at President Xi’s flagship BRI Forum in Beijing in May 2017.
The Importance of BRI

The scale of the BRI project is vast, but not well understood in the West. It is hard to pin down statistics, but the Center for Strategic and International Studies (CSIS) recently published some figures. It estimates that BRI extends to 65 countries with a combined GDP of $23 trillion and touches 4.4 billion people, or 62 percent of the world’s population. The estimated cost of infrastructure needs over the next two or three decades alone is $26 trillion, with China pledging around $1 trillion to date.

Some have described the BRI project as “the Marshall Plan for Asia,” which will help lift China not only to the world’s economic throne, but also to the political one, as the project brings prosperity to many relatively poorer countries along the various routes. There is a spin-off benefit to China’s construction and infrastructure sector as its own infrastructure development matures and slows down, with BRI projects taking up the slack. There will also be gains in countering overcapacity in other heavy industry sectors that supply the infrastructure sector. It will also help with the internationalization of the renminbi. Finally, President Xi has made BRI his signature project and will do everything in his power to set it on the right path for the future.

Strategic Fit for the UK

As Chinese companies move beyond the country’s borders to form their particular BRI routes, their operations can be supplemented in a number of areas in which UK companies have a lot of experience to offer. The immediate key sectors are infrastructure, professional services, maritime and logistics, banking, and financial services (including insurance). Chinese SOEs have experience of large infrastructure projects, particularly in Southeast Asia and parts of Africa, but BRI will bring a whole new level of complexity to dealing in different jurisdictions, legal and cultural, managing turnkey projects with multiple international partners, extended supply chains, and financing and funding challenges—to name but a few. World-class companies, such as Atkins, Arup, and Mott MacDonald, are already engaged in providing project assessment, engineering, design, project management, and other similar services on large projects in BRI countries.

The diverse nature and complexity of operating in many BRI countries empha-

sizes the need for locally specialized and experienced professional and legal services. UK service providers—especially those with a deep-rooted presence and significant experience in BRI countries—can leverage their local knowledge and experience to support Chinese enterprises. Many of the developing economies along the BRI routes will have relatively simple tax, accounting, and audit regimes. It is therefore important for Chinese enterprises to have a thorough understanding of the differences between various regimes across different jurisdictions. UK professional services giants, such as the big four accounting firms, can help Chinese enterprises in these areas.

The nature of BRI investments requires legal services including due diligence, contract negotiations and execution, dispute and arbitrations settlement mechanisms, efficient tax structures to enable funds to move in and out of BRI countries, as well as employment law, visas, and other people-related matters. In addition, there are many different legal systems in place in BRI countries, which makes it difficult to find one law in common. English law is already in use globally in industries including shipping, insurance, and other commercial undertakings, with arbitration processes in place in cities such as Hong Kong and Singapore—which means that English law may be a suitable legal framework for many BRI projects.

Consider the global shipping industry, where China’s role has grown significantly in recent years. English law is currently used in shipping disputes internationally, and significantly more than the law of any other country. More pertinently, all Chinese shipping contracts are governed by English law. UK maritime insurance providers can supply the necessary cover against potential project risk, including protection and indemnity (P&I) insurance, operational risks, and cargo loss or damage. UK shipbrokers are a dominant force with a great deal of traction in the maritime industry. China is currently producing 90 percent of the world’s standard dry cargo, while around 30 to 40 percent of dry bulk and 50 percent of tanker fixtures are transacted by UK-based ship broking companies.

As a global leader in the banking and finance sector and the world’s largest exporter of financial services, the UK has the skills, experience, and expertise necessary to the operations of Chinese companies seeking to expand overseas. Financing for BRI projects is likely to come from many different sources, in addition to the finance being...
made available by Chinese sources. UK financial institutions have great experience in advising on the most appropriate way to finance projects, depending on their risk profile, cash generation ability, investor requirements, and local country requirements.

The internationalization of the renminbi has been moving forward in recent years, and London has been recognized as the leading center for renminbi trading and settlement outside of Greater China. BRI will lead to a massive expansion in the flows of renminbi globally, as the currency becomes increasingly used for BRI projects. Chinese companies are likely to want to raise renminbi to finance projects and require customers and suppliers to settle in renminbi. London has a great opportunity to position itself to capture a lot of this business.

Environmental sustainability is high on the BRI agenda. Much of the momentum for this will need to come from greater participation of the private sector with UK banks and the London Stock Exchange, which offer platforms for green financing products. There will be opportunities for financial intermediaries to support financial institutions and governments in identifying, monitoring, supervising, and evaluating green projects, as demand increases for information disclosure and risk control.

London is an especially suitable location for the issuance of green bonds by Chinese issuers on the international markets. China is taking an increasingly responsible role in the environment, and BRI has the capacity to do great damage to the environment if not structured in a sustainable way.

The sheer scale of BRI means there will be a multitude of challenges and risks associated with the opportunities. London is the global center of the insurance industry and UK companies can manage risks associated with breaches of local laws and regulations, accidents, or natural or man-made disasters, as well as political risk. UK insurers and reinsurers also have the capabilities to develop BRI insurance products and services to help Chinese enterprises engage more effectively in BRI opportunities. Some examples include short-term credit insurance products, export credit insurance products, and overseas investment insurance.

As a global leader in the banking and finance sector and the world’s largest exporter of financial services, the UK has the skills, experience, and expertise necessary to the operations of Chinese companies seeking to expand overseas.

**MORE EDUCATION, INCREASED AWARENESS**

BRI was launched in 2013 and was given a significant boost at the BRI Forum in Beijing in May 2017, which was attended by 29 heads of state, 50 trade ministers and representatives of most of the 65 countries involved in the BRI. Some 1,500 delegates listened to keynote speeches from leaders such as President Xi, Russian President Vladimir Putin, and Turkish President Recep Tayyip Erdoğan—as well as the heads of multilateral institutions such as the World Trade Organization, the World Bank, the International Monetary Fund, the World Economic Forum, and the United Nations.

The UK was represented by Philip Hammond, the Chancellor of the Exchequer, who also made a keynote speech. He said that China and the UK have a long and rich trading history. I welcome the Belt and Road initiative as an opportunity to strengthen these ties. As we embark on a new chapter in our history, as we leave the European Union, we want to maintain a close and open trading partnership with our European neighbors and at the same time pursue our ambition to secure free trade agreements around the world with new partners and old allies alike. Our ambition is for more trade, not less trade, and China clearly shares this ambition. The scale of infrastructure investment required cannot be met by public financing alone and the UK, I believe, can be a natural partner in delivering this infrastructure by supporting the finance, the design and the delivery needed to make the vision a reality.

A number of UK-based institutions and organizations, like CBBC, are doing their part to educate the UK business sector to BRI’s opportunities. However, much more needs to be done at all levels of UK business and the media. While the UK is a natural partner for China, it is not the only partner, and other countries in Europe and further afield will be making their case along similar lines. The UK Prime Minister is visiting China in early 2018 and will be reaffirming London’s commitment to the trade relationship with China, including BRI.

In conclusion, the potential for the world economy and the UK is enormous if BRI unfolds in line with President Xi’s vision. We are looking at decades of investment and construction. The high-level vision is in place and it is now up to governments and companies to move forward at a more strategic level and on the ground. Inevitably, there will be opposition and setbacks along the way, but the number of different routes will help mitigate this risk. I hope that the UK plays its part in BRI, as I firmly believe that the UK has numerous strategic advantages to offer, and, equally importantly, cannot afford to pass up this opportunity as Brexit looms.

---

Sir Tom Troubridge