

BRI: From Strategy to Profit

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Description : Almost exactly nine years ago today, while on an official visit to Kazakhstan, President Xi

Jinping announced the creation of a “Silk Road Economic Belt”. This has since come to be known as the “Belt and Road Initiative” (“BRI”) and in 2018 was included into the Constitution of China. In essence it is one of the largest infrastructure and development projects in history. As such it represents tremendous opportunity but also a source of concern, largely centered around implementation practices dealing with the loaning of money to countries to bolster BRI projects and the use of Chinese labour to construct several of these projects. A more recent development has been the rise of the “Global Development Initiative” (“GDI”) which was introduced by President Xi in his speech to the UN General Assembly a year ago. Although the Chinese government has clarified that the GDI is not replacing the BRI but is a twin engine to enhance cooperation. This further stresses the need to understand the strategy behind these “initiatives” and how cooperation can lead to mutual benefits. This presentation will examine the perspective of “for profit” businesses and how they can position themselves to realize profit based on an understanding of why the initiatives have been created.

I INTRODUCTION

One of the things that I am often asked to do is to determine the efficacy of financial decisions.

At one level it is simply

- a determination of the proper amount of funds to be employed
- selection of projects and capital expenditure analysis
- fund raising, and
- managing working capital

But at a more strategic level, it includes

- the magnitude of funds to invest to enable a firm to accomplish its ultimate goal,
- what kind of assets to acquire
- what pattern of capitalization should be followed, and

-what pattern to distribute income should be adopted.

In essence we are seeking to ensure the well-being of the company by accurately determining net return and associated risk, followed by a prudent decision. Naturally, this is not done in a vacuum.

Unfortunately, we have seen outright manipulation of the markets, misleading statements from the Fed (as an example look at “inflation”. Initially we were told that there was no inflation, then it was transitory, then it became good, now they admit that it is serious. Or look at recession, where the government has simply re-defined it), and desperate measures to keep the bubble inflated and prevent the liquidation of bad debt.

Only recently has there been any real desire to combat inflation by raising central bank interest rates. But it is really too little, too late. In 1979, when this actually worked US government debt was \$845 billion or 32% of GDP. It is now over \$30 trillion or 122% of GDP.

It is inescapable that the US government is broke. Raising the interest rate with a government this indebted won't fix inflation. It will just push the government closer to bankruptcy and precipitate a loss of confidence in the dollar, making prices seem even higher.

This means that the super bubble we are will deflate. In turn, this means that bonds, real estate, and stock face the risk of massive draw down. This means that there aren't many places to shelter.

But there is one possibility, the Belt and Road Initiative.

To help us determine if this is a “shelter”, we need to answer three questions

-what is the BRI

-what is the strategy underpinning the initiative and

-is there an obvious profit play for SME's

II BODY

Before we begin to look at these three questions it would be good to position ourselves in regard to the market. Why? -To determine if we even need a “shelter” and, if so, can the BRI provide that sanctuary for business.

Obviously, a shelter is only necessary if there is a storm on the horizon. For much of the world, especially in the G7, OECD, EU, and NATO countries, the American equity markets have immense influence⁰¹.

Therefore, we can take a quick shortcut and simply examine the American market to see if a storm is coming.

In January of this year we saw the beginning of a negative slide in the market. By June 16th, 2022 the S&P 500 index had dropped 23.55% price of Bitcoin collapsed 59% during the same time period, Dow Jones Industrial Average fell 18.78%, and the Nasdaq Composite fell 33.70% from its November 19th high.

However a summer rally occurred, ending in August with a 58% gain from the initial crash. Moreover this occurred before the economy was clearly deteriorating.

Therefore, the combination of a bear market rally during a period where the economic

decline was not yet apparent along with a super bubble (which has been defined as those that reach a 2.5 sigma or greater deviation from trend such as happened in the 1929 Great Depression, the 2000 dotcom, and 2021 covid) is a red warning flag.

In other words, large inflationary increases, such as we have endured this year, has always hurt multiples, although more slowly than normal this time. Unfortunately, now the fundamentals have also started to deteriorate quickly. The repeated fears of climate change, covid, monkey pox, the war in Europe, food shortages, energy shortages, supply chain difficulties, logistical price increases along with real commodity shock, the growing hawkishness of the Biden Administration and the unusual situation where there is a cross-asset overvaluation (equities bonds, and real estate all over priced and now quickly losing momentum) means that the worst is yet to come.

So, we do need a “shelter”.

That being the case, let's answer the first of the three questions regarding the BRI, what is it?

ABRI

When President Xi Jinping announced this project at a speech at Astana University on September 7th, 2013 he described it as an innovative approach to jointly build an economic belt along the Silk Road in order to forge closer economic ties, deepen cooperation, and expand development space. However what began as a development project with two key components : an overland “belt” across Eurasia and an ocean “road” across the Indian Ocean and through to Europe by way of the Suez Canal has

- on the one hand morphed into a catch all project that now includes not just infrastructure development but also health, digital, polar, and even outer space all with the aim of increasing connections with China through trade, investment, culture, and intergovernmental policy, and

- on the other hand, is potentially being subsumed into the “Global Development Initiative” (“GDI”) which was introduced by President Xi in his speech to the UN General Assembly a year ago. However, because there is no real action plan, timeline for delivery, no overall financial goal, no clarity on priority countries or regions, nor have any sectoral themes been announced, some critics have stated that the GDI is a new, “face saving” means for China to say the BRI is dead. Indeed, the Economist has stated that Chinese big infrastructure financing is over.⁰⁴ This is supported by Boston University's Global Development Policy Centre found that the loans from China's largest policy banks : the China Development Bank and the China Exim Bank plunged from \$75 billion in 2016 to \$4 billion in 2019⁰⁵ . In regards to financing for energy, one of the most important parts of the BRI and makes up the largest part of China's international loan portfolio. In 2016, \$35 billion was lent, by 2019 it was \$5 billion.

However, based on Chinese government signaling⁰⁶, it would appear that the GDI will focus on sustainable development through grants and capacity building. While the BRI is based on connectivity and infrastructure.

Now that we have a basic understanding of the BRI we need to identify its strategic purposes.

B STRATEGY

Henry Mintzberg, a Canadian management professor at McGill University stated that “Strategy is a pattern in a stream of decisions”. This is certainly the case in regards to how BRI fits into the overall aims of China and the governing Communist Party. It is safe to say that China takes a long term approach and, under Xi Jinping, China has its most powerful leader and its most centralized government since the Mao era. This is reflected in a planned, unified and coordinated approach that utilizes the law, government, business, sports and culture to achieve its goals. As described the Whitehouse Office of Trade and Manufacturing, this can be seen in 6 specific practices:

- the protection of China’s Home Market From Imports and Competition
- expansion of China’s Share of Global Market
- securing and controlling of Core Natural Resources Globally
- domination of Traditional Manufacturing Industries
- the acquisition of Key Technologies and Intellectual Property
- capturing Emerging High-Technology Industries⁰⁷

Put together, this is a strategy. How then does the BRI play a role in this?

Every organization is formed on some overarching goal & objective, such as building a profitable business by satisfying a need. In regards to a country, the overarching goals are simple : survival, relations with neighbours, and growth. Or in terms used by the BRI : development, foreign policy, and security

Let me discuss each of these briefly.

B i-Development

-The BRI represents the largest development project in human history. It has led to the creation of a vast network of railways, energy pipelines, highways, and streamlined border crossings, both westward— through the mountainous former Soviet republics—and southward, to Pakistan, India, and the rest of Southeast Asia.

-Naturally, this will promote the international use of the Chinese yuan and would support the planned creation of up to 50 special economic zones⁰⁸

-To date, 138 countries and 29 international organizations have signed cooperation agreements for the BRI⁰⁹. This accounts for the vast majority of the world’s population

-Clearly, this initiative alongside the Made in China 2025 serves as a means for China to develop new investment opportunities, cultivate export markets, and boost Chinese incomes and domestic consumption. This has led to increased manufacturing, service development, and employment.

-More broadly, the BRI promotes the restructuring of the economy to avoid the middle-income trap. By shifting to the production shift to producing higher-value goods and services. ¹⁰

-There is an additional point, the only project that is even somewhat similar to the BRI was the Marshall plan which helped to usher in the American Era and cement its position the major influencer in the world. It is likely that just as the Marshall Plan was successful in boosting exports, exporting currency, countering a rival, and fostering strategic divisions, the BRI which is

significantly larger (the Marshall Plan resulted in

\$13 billion equivalent of about \$115 billion in 2021¹¹ Whereas the BRI has resulted in about USD 730 billion of investment from 2013 to 2019¹² and it is estimated that the total cost will be 8 trillion dollars¹³).¹⁴

B ii-Foreign Policy

Napoleon Bonaparte once said that,

To know a nation's geography is to know its foreign policy.

China is a huge country with limited resources and a burgeoning population. One its east side lies an ocean and to its north is wide open steppe and south west is almost impenetrable mountains. Much of China's population is located in low-lying coastal areas, and is much more susceptible to environmental catastrophe or coastal invasion. In addition, China's coast is blocked in. There are other countries in between them and the open oceans. So in naval warfare, they can be hemmed in and contained quite easily. This also makes the waters around their coast less turbulent, so a navy blockading their coast wouldn't have to deal with weather hazards like a navy attempting to blockade the eastern coast of the US across the Atlantic would.

China's geography also limits its capability to project force. The United States can send its navies and air force out of either coast with ease and little resistance. China's geography keeps it from being able to do so.

As the country modernized its need for more natural resources has become a liability.

Based on all of these points, China's modern foreign policy was based on isolation, then as it opened up it was based on amity and friendship, followed by its current assertiveness as it struggles to obtain greater resources, security, and influence.

The BRI reflects this greater assertiveness. Ultimately, it is the foreign policy vision of Xi Jinping, to create global connectivity with China at the center.

This is accomplished by offering a vision of connectivity, funding, and construction via bilateral agreements between China and BRI members. This also shifts diplomatic relations to a more diversified and multilateral approach. In addition, China's investments will allow it to hold greater control over its trade relationships, secure its land borders, and expand its maritime influence across the Asia-Pacific.

This can be seen in the move from the original foreign policy position as seen by Deng Xiaoping's "Open Door Policy" (to make China's domestic economy as the main focus of its foreign policy¹⁴) and "24- Character Strategy" which prompted China's reintegration to the international community by prioritizing economic development and friendly diplomatic relations¹⁵.

China's current leader has reversed this low-profile approach towards foreign policy with a more active one. One that is characterized by its push for soft power and in China's embrace of globalization. This "charm" or "good neighbor" method has been conducted through economic investments under BRI and its related opportunities to focus on multilateral diplomacy in trade and development programmes particularly in Africa and Latin America under the 'Beijing Consensus' and conceptualized 'China Model'.¹⁶

In shedding Deng Xiaoping's philosophy of a low-profile attitude towards international politics, BRI is China's declaration to secure its borders and extends its geopolitical reach. This is very evident in regards to the "Road" portion of the BRI which identified China's maritime objectives as being the Pacific Rim, Indian Ocean, and South China Sea. As such, this is an exertion of territorial power. Similar to its method towards political advancement, China's defence strategies are accomplished through geo-economic means...which leads us into the third strategic factor : security.

B iii -Security

In a 2017 book entitled "In the Shadows of the American Century", the author Dr. Alfred McCoy argues, presciently, that the tools of empire that are used abroad come eventually come home to diminish homegrown rights (like NSA surveillance). He also states that,

If China succeeds in linking its rising industries to the vast natural resources of the Eurasian heartland, then quite possibly, as Sir Halford Mackinder predicted on that cold London night back in 1904, 'the empire of the world would be in sight.'¹⁷

Halford Mackinder was one of the first historians to provide a coherent theory on the relationship between geography and power and is regarded as one of the founding fathers of both geopolitics and geostrategy. He developed the Heartland Theory which basically stated that the future of global power lay not in controlling sea lanes but in the domination of the European-Asian-African landmass. This "World Island" would serve as a seat of global power through its stranglehold on the world's natural resources. At the center of the World Island is the Heartland or a continental pivot area around which the continent can be controlled. Mackinder himself said that.

'whoever rules East Europe commands the Heartland; whoever rules the Heartland commands the World-Island; whoever rules the World-Island commands the World.'

However, with the advent of the airplane, super cargo ships, containerization, computerization and efficient modern logistics. Technology and globalization have allowed for a number of peripheral countries. Especially those in the Anglosphere—like the United Kingdom, Ireland, Canada, the United States, Australia, and New Zealand—to combine natural resources wealth with a rules-based global order and the US dollar as the reserve currency to create an economic and financial system that raised standards of living and negated the 'land power' of the World Island.

It's also worth noting that two of the largest US military bases in the world today are Ramstein Air Base in Germany and the naval base at Okinawa. These bases are at the bottom and the top of the World Island, respectively.

The BRI project aims to unite the World Island, create a common market for three billion people, and capture the world's energy and food reserves in one great unification of power. It also overcomes China's geographical weaknesses, overcomes the maritime chokepoints it currently faces, and neutralizes the first, second and third island chains that contain the mainland.

From a security standpoint and in the context of Great Power conflict , the BRI is a master stroke, as it minimizes the sea power of the US and the UK.

C PROFIT-PLAY

In many respects, unless you are a large Chinese SOE or a large Anglo-American corporation it has been very hard over the last 2 years to realize growth and profitability...and this trend will continue. So how should a SME position itself, if it wishes to grow? And how does the BRI play into this?

Well, both the UK/US and China are, in many respects polar opposites but both share a difficult future unless the path they are on changes significantly

Let's examine this quickly.

- Under Deng Xiaoping China had adopted a collective leadership style. However, Xi Jinping prioritized an ideologically based economic agenda with generous support for state owned enterprises. He has taken a less pragmatic approach and has directly challenged the so called "liberal" world order and has been expanding China's sphere of influence. Despite this, China's economy is in bad shape, Growth has shrunk from its former double digits to about 3.5% which may affect the government's ability to keep people employed and offer continued real growth. Without this both political and domestic stability could be impacted. Doubly so when one considers the "covid-zero" policy, the aging population, shrinking workforce, poor productivity, water shortages, the housing, mortgage and banking crisis, rising debt, and soon the effects of new property taxes, along with lingering bitterness from the anti-corruption campaigns, purges, and attacks on the private sector. The forthcoming 20th Party Congress starting on October 16th will set the stage for the next 5 years. Although it is unlikely that broader policy will be changed, the introduction of new leaders, especially a replacement for Li Keqiang, the current Premier who will be retiring in March, will be telling. In addition, the composition of the Politburo is still unclear. What is clear is that the President believes that he is adding to China's international prestige and is escaping the middle income trap.

- Uncertainty and even chaos characterizes the situation within the US, UK and western Europe, where matters are, frankly, bad. Massive inflation, a manufactured energy crisis, food shortages, supply chain issues, a political agenda demanding further and continuous lockdowns initially based on covid but now on climate change, the rise of mass censorship, tensions arising from the war in the Ukraine, the rise of an oligarch class with the largest transfer of wealth in human history, and the loss of agency by the people. This November will be the mid-term elections in the United States where it is predicted that the Republicans will gain significant win. But, almost regardless of the election result, instability is likely to continue with Biden governing through executive order and emergency decrees.

Amidst all this gloom, there is a ray of sunshine and it is the BRI. For those SME's that are agile, innovative, and strategic, the BRI means opportunity. For two reasons.

- 1) It is a true bridge between these two polar opposites and yet, to a large degree, it is outside these polar opposites.

AND

- 2) The BRI is a step in the right direction because it not only helps China to achieve its : development, foreign policy, and security needs, but it can help to benefit countries and peoples along the maritime "Road" and the land based "Belt".

This may explain why President Biden has become more and more bellicose and have, for all intents and purposes, encouraged war through:

- irresponsible dialogue (last Sunday September 18th, 2022, President Biden on the TV show 60 Minutes stated unequivocally that US soldiers will be used to fight the PLA should a provocation occur with Taiwan),

- ignoring clear fault lines (Putin made it very clear that any attempt to bring Ukraine into NATO would trigger conflict, as has been China's position with Taiwan and yet Pelosi, the Speaker of the US House of Representatives antagonized the mainland with her visit to Taiwan. This triggered the largest defence exercise by the Chinese military facing the Republic), and

- by making ultimatums and issuing sanctions

Having said this where is the profit to be made, aside from the obvious local contracts?

The oldest business truism is that a successful business must either satisfy a need or create a need.

In broad terms, the BRI and its response from the west create four comprehensive areas for business exploitation and they include:

- ✚ sanction busting

- ✚ the offering of financing

- ✚ complimentary services opposite to that provided by the West For example,

- the SWIFT Society for Worldwide Interbank Financial Telecommunication can be replaced by Russia's System for Transfer of Financial Messages (SPFS) and China's Cross-Border Interbank Payment System (CIPS)

- Eventually, the newly certified Comac C919 or its next generation model will replace the Boeing 737 and Airbus A320. However, many of the plane's components, from the engines to the avionics, are still manufactured in the West.

These parts could be replaced by businesses located outside of NATO, the G7, etc

The Zhuhai Airshow which starts on November 8th of this year will showcase the C919 and will probably result in an announcement that it has sold a number of planes for commercial purposes, which will represent a huge turning point in aviation sales in the world

It is clear that energy and food shortages will occur in the west, this also represents a business niche to be filled

Finally

- ✚ From WWII onwards, the US noticeably transformed its geographical power into financial power (the dollar). It now is clear that the US dollar domination of the world's financial system is under duress. If the US dollar ceases to be the world's reserve currency then the US will again have to rely more on its:

- natural resources (energy, arable land, potable water) and

- domestic manufacturing, AND

- LESS on its financial markets,
the cheap cost of global labor and energy, and
the benefits of having the world's reserve currency.

The USA will again have to make things people want, instead of printing dollars for other people's real goods.

This will reignite manufacturing within the USA and this also is a niche for business profit.

III CONCLUSION

China has experienced rapid economic growth to become the world's second largest economy while modernizing its industrial base and moving up the global value chain. The result has been the amelioration of poverty and the rise in standard of living throughout the country. However, it has also generated fears from external parties and flamed hungers internally for greater security, development and a foreign policy that reflects China's roles as a world power.

From a business perspective, the BRI is neither solely a source of good will as described by Beijing nor is it the result of strategic cunning as portrayed by Washington. What it is, is an example of self-interest which

can benefit people as the project matures. Importantly, it can be the catalyst for SME profit when entrepreneurs and corporate leaders can identify the intersection between national strategy, the needs/wants and desires of people along the BRI, and the give and take of Great Power conflict which has and will expose potential business opportunity.

IV NOTES

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