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The Belt and Road Initiative in Recipient Countries: The Perils and Benefits of China's Major Infrastructure Program

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Abstract

The BRI is one of the largest projects to give China a greater global projection. From a financial point of view, it is a way of obtaining resources for the production of high-value technological goods and the construction of infrastructure in developing countries to transport goods to China. Based on experiences from countries such as Pakistan, Laos, Saudi Arabia, and Greece, we will analyze the influence and impact of Chinese investment in recipient countries on variables such as exchange rate, balance of payments, or foreign direct investment. This paper will explain that there is a positive correlation between the level of resources of recipient countries and their benefit to the local economy.

Keywords: Belt and Road Initiative (BRI), Chinese investment, Economic impact

1. Introduction

The Belt and Road Initiative (BRI) is Xi Jinping's most recent major pharaonic project. It was created in 2013 and constitutes a global vision of the country's future until 2049, the centenary of the creation of the People's Republic of China (PRC). Such a project has even been included in the country's Constitution so that the political, financial, and legislative dimensions converge.

Firstly, at the political level, the BRI seeks to create a community of countries in the geographical area of Central Asia and Southeast Asia, Africa, and Latin America with which to make a cultural exchange and, at the same time, pursue economic and political collaboration in which all the demands of the participating countries are treated equally. The Chinese argue that in the long term, it seeks to create a space of cooperation where all the parties have mutual gains.[1] This creates a sphere of influence in which China benefits from imports of raw materials and the

[1] Quin, Y., Zhou, G., & Luo W. (2017). *100 preguntas sobre la Nueva Ruta de la Seda* Editorial Popular, Madrid. p. 71.

construction of critical infrastructure such as railways or roads for recipient countries. On the financial side, it can be said that it seeks to promote Foreign Direct Investments (FDI) in third countries to thicken its financial account in the balance of payments, receive more investments from outside, and predictably generate important effects on the current account.

From the normative dimension, there has been a reduction in impediments to investment, such as the removal of non-tariff barriers. In this way, obstacles such as the impossibility of converting to a specific currency are eliminated. This is accompanied by a simplification of bureaucratic processes for the BRI projects to make investments disbursed in a more efficient and faster way. Similarly, the focus is on protecting bilateral investment agreements.[2] Thus, not only is it an outward investment, but it strengthens relations between the two countries, and China is thus the first trading partner in many of these places.

1.1 The logic behind project implementation: it is more than just logistics

This project is financed through a public-private partnership where the State contributes 63 percent while the remaining 31 percent belongs to private capital.[3] The latter comes mainly from large companies that aim to be part of the profits generated in FDI. In addition, to carry out such a project, ad hoc institutions have been created to finance it, such as the *Asian Infrastructure Investment Bank* (AIIB), which was established in 2014 with an initial capital of $100 billion. Interestingly, it is often considered to be a World Bank competitor, as it contributes $20 billion annually to the project and is expected to increase over the next few years to 60 billion.[4]

The logic behind the BRI is to build a global network that makes it easier for China to develop its high value added products and channel investment to foreign countries. This will be carried out through the import of raw materials to China, which will be operationalized through the infrastructures created in the countries on which the investment is focused since it is a way to reduce the obstacles for recipient countries to export to China. With these materials, the aim is to speed up and reduce the cost of the production of high-value-added goods, with examples such as the semiconductor industry produced in China but with materials coming from Congo.

It is organized along six economic corridors, including Eurasia, Central Asia, Southeast Asia, Africa, and then certain areas directed to Latin America. They have helped China gain competitive advantages in its products. To cite an example of this situation, *Huajian Group* established

[2] Ibid., p.87-92

[3] Ruíz Rodríguez, Alejandro, 2021, *La Nueva Ruta de la Seda en el Mundo. China y el Pivot to the West.* Biblioteca de la Escuela Diplomática

[4] Esteban, Mario y Otero, Iglesias. *"Que podemos esperar de la Nueva Ruta de la Seda y del Banco Asiático de Inversión en Infraestructuras liderados por China?* Real Instituto Elcano, Abril 2015

part of its shoe production in Ethiopia due to cheaper production costs and is currently managed by *Quiyuan Group*. As Ethiopia has no access to the sea, this company uses the BRI railway operated by the *Railway Group* to Djibouti with access to the Red Sea.[5] On paper, Ethiopia benefits from an additional source of income and funding. In practice, China can export its products at a lower price due to low production costs to Europe and the US without facing tariffs.

It should not be dismissed the diplomatic component behind, as all member countries have to adhere to the principles of the "One-China policy."[6] This is a principle stating that Taiwan is also part of China. In this vein, India, which many view as a key geographical location for Chinese investment, does not belong to the BRI group of countries, given that it does not publicly accept such a policy. This contrasts with Pakistan, which is its neighbor nation and receives large amounts of Chinese investment. The result is an asymmetrical interdependence of Asian countries to create an alternative space to the global financial dominance of the West and the Washington consensus.

2. Hypothesis

From a financial point of view, is Chinese investment in developing countries belonging to the Belt and Road Initiative a generator of equal mutual gains, as stated in the initiative's main objective?

My initial hypothesis is that for the recipient country, it is undoubtedly an opportunity to benefit tangibly in projects led by China, either through transport networks or factories. This will reflect positively on the balance of payments of the recipient countries, while China will become the world's main trading partner. With strong investment in a developing country, the theory says that the local currency will appreciate, which means that its value will increase in relation to the Chinese yuan, and that will generate an effect in the Chinese exports of machinery for the construction of critical infrastructure in the recipient country that will be part of the BRI framework.

3. An analysis of the effect of the BRI on the recipient countries.

To corroborate or rule out the hypothesis, we will draw on the experience of some of the countries where Chinese investment through the BRI is most representative and thus explain the possible impacts on the FDI, balance of payments, and the exchange rate.

3.1 Pakistan, not all that glitters is gold

To begin with, Pakistan is one of the key countries within the BRI due to projects such as the construction of 7,800 km of rail for freight transport in the country or the creation of a road connecting Kashgar, in western China, with Islamabad, the capital of Pakistan, covering a distance of

[5] Sierra, Ander; Marrades, Ángel. *La nueva era de China. La gran estrategia para el sueño de Xi Jinping* Fuera de Ruta, p. 225

[6] Édition Le Monde hors de série *La nouvelle route de la soie* Octobre 2022, ISBN 9782368041222

approximately 700 km.[7] With such a huge investment, one could say that the country has made a great leap forward and has positioned itself as a regional leader thanks to the FDI. Indeed, with these infrastructures, China has become the first country in exports from Pakistan, with 23 percent of the total export portfolio, and it is estimated that 60,000 jobs have been created since the start of construction. It has prospects for job creation of 2,300,000 more jobs by 2030.[8]

We will verify this situation through the composition of the balance of payments which is a summary of the transactions between one country and the rest. The first element is the current account which includes the country's total exports and imports. The trend we have observed since 2004 clearly shows that it is in deficit, meaning there are more imports than exports. This data must be complemented with the financial account that provides information about investments received and made so that we will know the commercial and financial situation of the country in relation to the rest. The result is that the financial account is in surplus, meaning it receives more investment than it makes.

We argue that this balance of payments structure makes sense for Pakistan as it imports materials from China, such as specialized machinery to build railways more efficiently, and it also obtains Chinese investment to sustain the viability of these projects.,

With this data in hand, we will check the evolution of the exchange rate between the two countries. In March 2018, the Chinese yuan was changed to 17.48 rupees, while more recently, in March 2023, the exchange rate for the0.9125 Pakistani rupees. This means that there has been an appreciation of the currency since the moment China began investing in the country. In other words, the value of the local currency has increased as it has received Chinese investment. At the same time, there has been a depreciation of the Chinese yuan, which implies that a cheap currency is more attractive in the international currency exchange market so China benefits from exports to Pakistan.

Since correlation does not imply causation, we observe other factors that can influence the exchange rate, such as inflation, since it is one of the components that affect exchange rate variations. The theory says that a relative increase in inflation in a country relative to another leads to a depreciation of that currency. This is produced because an increase in prices in one country makes investors to choose the other country to lower costs; hence this second currency will appreciate in relation to the local. Since 2015, inflation in Pakistan has been growing steadily from 2.5 percent to the current 9.5 percent, partly produced by an economic crisis that affects the country motivated by factors such as governmental ineffectiveness or the consequences of the coronavirus pandemic. By contrast, China's inflation rate is 2 percent and has been declining since 2014. The consequence is that Pakistan's price level is higher than

[7] Ruíz Rodríguez, *La Nueva Ruta de la Seda.*

[8] Ibid.

China's, so the theory states that an increase in demand for the Chinese yuan against the rupee would generate an appreciation of the Chinese yuan against the Pakistani rupee.

Consequently, it is counter-intuitive since the logic would have said that there should be a depreciation of the Pakistani rupee compared to the Chinese yuan. Therefore, it is necessary to look further to understand this scenario. My theory is that it is due to the importance of international financing to alleviate the country's high inflation, they had to resort to international funds, as is the case of those of the IMF or the World Bank. Therefore, together with China's previous investment under the BRI, the capital account thickens and has more weight than inflation. The result is a scenario closer to that of a developing country that sees foreign investment as an opportunity for its currency to increase in value.

3.2 Laos, the South East Asian commercial connector suffering from debt trap diplomacy

Another potential country within the BRI is Laos. China's investment in Thailand is currently concentrated on constructing a more than 400 km long railway to bring its trade closer to that of Thailand.[9] This is because Laos is a land-locked nation with no access to the sea, so it will not be able to carry out trade flows effectively from China to Laos. This means that Laos has become a commercial connector for the transport of goods to Thai ports. There is recently another railway under construction connecting the capital of Laos with southern China for passenger transport. Laos has obtained direct investment from Chinese companies such as *CAMC Engineering* or *Shanghai Wafeng* in direct investment and portfolio investment valued at 500 million dollars.[10]

On this basis, and given that the country has a small population of 7 million, it could be seen as one of the clear beneficiaries of the investment from the BRI. To do this, we will check the evolution of its GDP per capita since the first disbursement of Chinese investments in the country. Currently, in 2023, its GDP per capita is $2,500 and has been increasing since 2005, when its GDP per capita was $1,100. We see that it grew in the following twenty years, double what it has grown since 1988, so clearly, there has been an increase in the country's economic growth. In its neighboring countries, Myanmar has grown at a similar rate, although it is at a lower GDP per capita, $1,600. With Thailand, both countries have experienced a similar level of growth, although Thai per capita GDP ($6300) is higher than Laos. A similar trend can also be observed in Vietnam. Consequently, all Southeast Asian countries have increased their GDP per capita since the Belt and Road Initiative was implemented in 2013.

Now that we have proven that all countries in the region have experienced similar economic growth, what does China see financially in Laos to make it so attractive for the

[9] Ibid.

[10] Ibid.

BRI? I argue that the Asian giant leans towards this country because of the low production costs and the dependence that Laos can generate on China.

On the one hand, the works carried out through this initiative often need expensive machinery, so China prefers operating in countries where they can take advantage of cheap labor and, predictably, with little worker protection to prevent infrastructure costs from rising too high and, therefore, make an economic profit from it. In this regard, Laos is one of the countries with the lowest per capita GDP in the region, second only to Myanmar. Still, the country in question is in a stronger geographical position for freight transport, unlike Myanmar.

On the other hand, when we compare different values among the countries of the region, Laos negatively outstands from their level of indebtedness with China in the realization of these projects, which has created a debt crisis in the country and has been observed more notoriously since 2019. This is called *debt trap diplomacy* and creates a long-term dependence on recipient countries and undermines the free development of that economy. In the case of Laos, their debt is proportional to a significant amount of their GDP; hitherto, China can hold tighter control of Laos. In terms of the exchange rate between the Laos Kip and the Chinese Yuan, we see that 1 Chinese yuan is currently paid at 2.45 kip but is only the consequence of the appreciation in the Kip since until 2020 it has remained stable between 1.2 and 1.3.

I hold that although there has been a substantial increase in the GDP per capita of the country due to the BRI, it is presented as a fallacy since economic growth is repeated among all Southeast Asia. I believe that Chinese investment by the BRI has contributed to economic instability since Laos' economic system is not as developed as one might expect, and that has given way to what is known as *dollarization*. This is a phenomenon that responds to a greater presence of dollars in a country's local economy, so that the local currency is replaced by a more reliable foreign currency, which is the dollar. In the case of Laos, there has been a gradual loss of confidence in the Kip and the dollar has been chosen to conduct transactions in the international market.[11]

With this rationale, one might think its immediate consequence is the loss of confidence in Laos toward China. However, this is not the case as Laos is tied to the Asian giant, not only because of the debts but also because of the investments underway in that country.

In conclusion, Laos' experience at the BRI shows that the asymmetry of power is more than striking since China will always have the last word on the country's financial future. In a sense, it can be said that Laos is immersed in a vicious

[11] Jayant Menon, Asian Development Bank, 2007, *Dollarization and the multiple currency phenomenon in Lao PDR.*

circle that is difficult to escape from, and its future has been mortgaged in exchange for having minimal prospects of commercial growth.

3.3 Saudi Arabia. When there is money, there is power.
Moving further, one of the peculiarities of the BRI is that it also incorporates countries with a higher level of economic development as it is the case of Saudi Arabia (GDP per capita $23,000 compared to $12,000 in China) or Greece ($20,000) My initial theory as far as FDI investments are concerned is that these countries will have an more equal relationship with China so they will not incur into the pernicious problems associated with such investment.

In the case of Saudi Arabia, the balance of payments indicates that the financial account has been in deficit since 2017 while the current account is in surplus. This composition indicates that they make more exports than imports. Following the logic of the BRI, we can think that Saudi Arabia would be one of the places to obtain resources and raw materials for the final production of goods in China. This is not the only country that occupies this role since it is widely known the exports of coltan from Congo to developed countries, which China is the largest exporter of this good. Consequently, if we check the composition of the Saudi Arabian trade balance, they export oil and electronic components for electric mobility, where China is by far the largest importer.

With this data, it can be said that Saudi Arabia is the marketplace for obtaining oil resources to supply the high demand for vehicles of a country like China, that owns 300 million cars and for a growing electric mobility industry. However, this does not provide details on the benefits provided by the BRI since Saudi Arabia is a high-income country that has mainly benefited from oil exports, especially when the price of the barrel of oil reaches its maximum (usually 143$ the barrel).

I am therefore going to use qualitative data. On the one hand, when the commercial relationship between a company and a country is considerably strong, both countries tend to sign bilateral agreements to consolidate this relationship. In our case, *Aramco* is one of the main exporters of oil to China; as a result, China has signed a strategic cooperation agreement with Saudi Arabia.

On the other hand, regarding technology, the Chinese company *Enovate Motors* is establishing an innovative plant on Saudi soil carried out through a joint venture with the Saudi company *Sumou* worth $500 million. Likewise, *Huawei* will provide cloud computing to the entire Saudi territory offering greater connectivity to the country.

In my opinion, the component that comes into play here is market expectations which are regarded as one of the aspects that affect the exchange rate the most, along with inflation, income level, government actions, and the interest rate. Thus, when positive news for a country's economy comes to light, it will be reflected through an increase in the currency's value. At the same time, if the information is negative, there will be depreciation, so the Government will try to counter the situation by generating calm under a stressful situation. Against this background, in the case of Saudi Arabia, the news of *Enovate Motors* became known in December 2022, while that of *Huawei* in February 2023. If market expectations work, it has to be reflected in the exchange rate through an appreciation of the Saudi riyal against the RMB yuan. Indeed, in November 2022, 1 yuan was paid at 0.51 riyal and is now paid at 0.55, so there has been an appreciation of the riyal in relation to the yuan.

Therefore, Chinese investments in Saudi Arabia have brought a significant economic benefit to Saudi Arabia as a recipient country, in the same way as for China, which has benefited from obtaining material resources from the Arab country.

3.4 Greece: Diversification is the key

In the case of Greece, it was the first of the European countries to join the BRI and has an economic status similar to that of Saudi Arabia. From China come investments in infrastructure like maritime ports, particularly Piraeus port, which China controls around 51 percent.[12] It has been acquired by the company *Chinese Ocean Shipping Company* (COSCO). The shares of this shipping company framed in the BRI are the best example of portfolio investments, that is, owning stakes in different companies so it has a diverse investment portfolio. In the case of COSCO, this partial acquisition is directed to the ports of different countries, among which Greece occupies a special place. Thus, in Germany, it owns 25 percent of the port of Hamburg, and in Peru, it acquired 60 percent of the port of Chancay. Similarly, they are currently interested in acquiring a container terminal at the port of Algeciras in Spain.

Therefore, my theory is that Greece would benefit fundamentally from investment in the country's maritime infrastructure within the framework of the BRI. Nevertheless, revenues coming from the FDI in the framework of the BRI are not going to be so drastic due to European-level competition regulations such as EU Directive 2005/29/EC which prevent unfair competition and ensure that all companies operate under the same rules.

In theory, we first look at the composition of Greece's trade balance. This has been generally negative, indicating a trade deficit, that is, more imports than exports are made. We now turn to the main countries with which Greece trades. Thus, we observe that in specialized machinery, China ranks third in imports after Germany and Italy. The BRI investment in Greece is in the ports, so we will consider imports into machinery. Thus, of the total imports from China to Greece, 35 percent are specialized machinery for the operation of the port of Piraeus, which constitutes $1 billion in investment. If we compare it with Germany, imports of machinery are $650 million and Italy $640 billion. The rest of the countries from which Greece imports machinery, such as France, the Netherlands,

[12] Plamen Tonchev, *Chinese influence in Greece,* CEPA report, August 2022.

Belgium, or Spain, do not reach $400 million in investment in machinery.

The conclusion we can draw is that China is the main country from which to import machinery for the ports of Greece. However, unlike the countries previously analyzed, Greece is diversified in terms of imports, which means that there is no such strong dependence on Greece to China since total Chinese imports of machinery constitute only 30 percent of the total import portfolio in machinery.

4. Conclusion

This essay has analyzed the economic and financial situation of the countries in which China invests within the framework of the BRI. Therefore, the answer to the research question posed at the beginning of this essay is that the more income and better economic structure the country has, the better profits the country can enjoy. If China invests in countries such as Pakistan or Laos, where its financial system is not as consolidated as that of other BRI recipients, the beneficiary country is primarily China, while Laos or Pakistan faces a more adverse situation. On the contrary, in the case of Saudi Arabia or Greece, whose economies are more prosperous and have a better developed financial system, they can enjoy the mutual gains of the BRI. In conclusion, it can be said that BRI is constituted as a global infrastructure network from which China can derive resources and benefits at the expense of developing countries.

5. Possible future pathways and recommended actions

This last section of the essay aims to offer a series of recommendations to the countries analyzed. First, in all projects carried out by Chinese companies in foreign countries through the BRI, they must go to the international currency exchange market. The problem I see is using the spot rate. Therefore, going to the spot market in countries with an underdeveloped financial industry can be harmful as it generates high currency volatility, so there would be great uncertainty regarding cash flows. Therefore, it is advisable that China hedges the exchange rate for Chinese companies investing in Pakistan to avoid pernicious problems arising from the inflation crisis, such as a potential economic crisis affecting the stability of the Pakistani rupee. It could be done through currency-forward contracts as many of these companies make investments of over $1 million. This is also because China shouldn't resort to the currency market future contract due to the small international projection of the Pakistani rupee, which makes it difficult to go to the Chicago Mercantile Exchange Market. Thus, by locking in the currency's exchange rate, China will gain certainty in the investments that the country makes in Pakistan and in any other state whose financial industry is not so developed.

In the case of Pakistan, faced with rampant inflation, the Government can peg the value of its currency to that of China. This will generate a situation similar to that of purchasing power parity theory (PPP theory) since inflation tends to stabilize under the same currency.

On the other hand, Laos is in a situation that resembles that of Sri Lanka with China as far as the debt trap is concerned. Sri Lanka has not been able to repay the loans made by China for the construction of infrastructure, and as a guarantee, they ceded the operation of its port to China for a period of ninety-nine years. Fortunately, the situation in Laos has not reached such a point because the amount of debt proportional to its GDP is not as high as that of Sri Lanka.

Nevertheless, action must be taken if Laos does not want to end up in the same scenario. To remedy the situation, Laos could negotiate a restructuration of their debt directly with China but in the long run that would only exacerbate asymmetry in Sino-Laotian relations. Therefore, one solution could be to resort to syndicated loans in the international financial market so a diverse group of international banks resort to financing Laos through a very low interest rate and a very extended grace period. In that way, Laos would obtain financing to pay its debts to China and would not increase its dependence on that country. However, in the future Laos would also have to return the money to international banks. A better alternative would be to turn to the IMF in which, through its conditionality program, it can obtain resources to pay the debt and, at the same time, be able to reform its financial system so that the situation of dependence is not so strong.

Moreover, for Saudi Arabia, China constitutes itself as a relevant trading partner from which to receive FDI. Given the level of resources the Arab country possesses, it is unlikely that the relationship between China and Saudi Arabia will not be symmetrical. I would recommend continuing cooperation through trade agreements to establish multinationals in the other country so that the mutual benefits of the relationship under the BRI are fully extracted. In this sense, a possible form of cooperation between them can be in the so-called "Digital Silk Road."[13] This project is part of the new technological revolution in which China claims to be a major player. The "Digital Silk Road" seeks to create a global communications network, thus generating a new framework where relations between countries are more effective and faster. Saudi Arabia could act as a financial arm in cooperation with the Asian Infrastructure Investment Bank (AIIB) to make projects financially viable.

Finally, given the country's history of economic and political instability, Greece should continue with the current balance of payments structure and, more importantly, the variety of trading partners for the import of machinery. I believe that this will ensure that dependence on China is not excessively high, so the pernicious problems associated with it are eliminated and at the same time, they can benefit from the income coming from that investment.

[13] Hillman , J.E. (2021). The Digital Silk Road: China's quest to wire the world and win the future.

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