If you build it, will they come?

As global trade growth declines, China is building ports all over the world. *Finbarr Bermingham* asks whether there's enough trade to go around.

A lone security guard in a hi-vis vest braves the scorching Sri Lankan heat, tosses his cigarette and ambles over, wondering why someone is taking photographs of a dormant building site. At this stage last November, the diggers had been motionless on the rubble for months. But the guard was hopeful that his solitary stint would soon be over. Work would surely recommence, he said, because there's too much money at stake.

The US$1.5bn Colombo Port City, which will include, among other facilities, a deep-sea port and a Formula 1 track, is being built by China Harbour Engineering Corporation, using export finance provided to the previous Sri Lankan government by Chinese agencies. The new government, however, was unhappy with what it considered to be unfavourable terms and the opacity with which contracts were awarded. But right enough, after months of renegotiation, work is set to resume in May on one of the most important trade infrastructure facilities in the Indian Ocean.

Almost 3,000km away, on the far-side of India, Pakistan's military had dispatched hundreds of soldiers to the southern port of Gwadar, where part of a mooted US$46bn investment in the China-Pakistan Economic Corridor (CPEC) has been spent on a deep-water port that will eventually connect Western China with the Middle Eastern oil imports it so dearly craves. Pakistan's eagerness to protect the investment shows how important Chinese investment is, and the value to its own trade that such facilities would add.

Six months earlier, construction started on the biggest port in East Africa: Tanzania's colossal Bagamoyo terminal, which will include rail and road links, and handle 20 million containers every year from 2017. The port comes in at a cool US$11bn, with most of the money – once again – coming from China. Goods, mainly commodities, will flow from landlocked African countries, while consumer products from China will flood the African market at a rate unimaginable before. The project, sponsors say, will transform the regional trade economy. That it will take only two years to complete is startling, but once again speaks volumes about the efficacy of China's overseas investment machine.

One could be forgiven for thinking that with all these projects and all this money flying around, we were in the midst of a boom time – making hay while the sun glitters on the harbours of the world. But in fact, global trade is in decline. Official figures show that it fell 13% in 2015, from US$19tn to US$16.5tn. Weak consumer markets in the west and emerging east, as well as the dramatic downturn in commodity prices, have made trade a net drag on GDP in many markets. For most of the 20th century, as trade found new markets to devour, its growth outstripped GDP perennially. Those days, it would seem, are over. But even in the worst of times China continues to do what China does: spend ridiculous amounts of money around the world.

There are a number of pertinent questions to be asked here. The first is whether all this infrastructure is required. The second: why is China doing this, and can it afford it? Finally, is there enough capacity in the global market to accommodate all these facilities? In other words: is there enough trade?

> "The investments into ports are a good example of China taking a long-term economic, strategic view."
>
> **Sam Boyling**, Pinsent Masons

The gap years

The Asian Development Bank (ADB) has been banging the infrastructure gap drum since 2009, when it estimated that in Asia alone, there would be US$8tn required in investment in basic infrastructure from 2010 to 2020. Indonesia alone, the ADB estimates, has a gap of US$700bn. Huge swathes of Central and Southeast Asia remain off the electricity grid, while in many countries, it costs more to get a cargo from source to port than it does to export it to its foreign destination.

"In some parts of Asia, the lack of basic infrastructure from roads, rail, to ports still pose as a challenge for the logistics industry," confirms DHL's Asia Pacific CEO Charles Kaufmann, who tells **GTR** that the company is in the process of expanding its road, rail and sea freight networks connecting Asia and Europe. Already the company runs freight lines linking Zhengzhou with Hamburg; Suzhou with Warsaw and Chengdu and Lodz.

The Asian picture can be extrapolated for much of emerging Africa and Latin America, where years of underinvestment, or investment concentrated in a few key commodity sectors, have left trade infrastructure gaps amounting to billions. So, yes the investment is certainly needed. It is essential, though, that investment is made in the right way and for the right reasons.

For many years, China's infrastructure investment programme was dominated by short-term goals: securing access to commodities overseas, stimulating GDP growth at home. While there were certainly plenty of worthy infrastructure projects (some of which facilitated the lifting of millions of Chinese out of poverty), there were plenty of white elephants too: roads leading to nowhere, ghost cities in Inner Mongolia, railway lines that weren't fit for purpose.

In the rolling out of its One Belt One Road (OBOR) initiative, surely the biggest trade story of the last decade, and the establishment of the Asian Infrastructure Investment Bank (AIIB), China experts are now backing it to play the long game. The AIIB was first thought to be a direct rival to the ADB and its parent World Bank (it was almost certainly set up as an affront to both), which are dominated by Japan and the US. However, in recent weeks and months, talk of collaboration has been rife, with the AIIB and ADB set to announce a joint lending facility imminently, as **GTR** went to press.

"If it was investment for investment's sake there are a lot of other things they could do of a short-term nature. If you look at the kinds of investment they're making into the likes of ports, it's a good example of where China is taking a long-term economic, strategic view. The sort of investments they're making, you're talking 30 to 35-year concession agreements. It's not short-term, this is long-term, over the horizon stuff," Sam Boyling, a Beijing-based partner at Pinsent Masons, who is working with Chinese companies on projects in Pakistan (including the US$2bn Thar power plant which will benefit greatly from the CPEC), toll roads in Ecuador and construction projects in Rwanda, tells **GTR**.

While China will never reveal the motives behind its change in tack – if indeed it has one – those most commonly cited are soft power and energy security. China is determined to counter US influence in its backyard, as evidenced by the militaristic build-up on the disputed South China Sea islands. Its desire to connect its transport infrastructure with the Middle East, South Asia and

Africa will allow it to secure energy and commodity supply chains in the event of any interruption to trade in the Andaman or South China Seas.

The money men

What is clear, though, is that China is putting its money where its mouth is and following up on capital pledged with actual capital commitments. Research by Grison's Peak, a merchant banking firm, shows that China's pledged-versus-committed capital ratio to countries in Africa is much higher than that of the US or Japan. Meanwhile, the firm's research into China's investment activity in Q1 of 2016 emphasises President Xi Jinping's eagerness to court countries that he views to be key to the OBOR programme."It is worth noting that President Xi's visits to each of the four countries this quarter represented the following time passages between the last visit by a Chinese president: Czech Republic: 67 years, Iran: 14 years, Egypt: 12 years, Saudi Arabia: seven years. Clearly, President Xi and China wanted to send a message to each such country of their importance to OBOR and to China," reads the firm's latest report.

As of March 2016, China held US$3.2tn in foreign exchange reserves, almost three times the second largest (Japan) and more than four times the entire US dollar savings of the eurozone. So yes, China can afford to splurge on infrastructure and this year, has pledged hundreds of billions in bilateral loans to the likes of Pakistan, Kazakhstan and Brazil. It will provide US$30bn of the initial US$100bn capital of the AIIB and has refinanced its policy banks, ready for outbound investment along the belt and road.

But that's not the whole story. Much has been made of the relative slowdown in China and the ripple effect on global trade. This port binge may have a positive impact, but given the high level of corporate and regional government debt in China, it may not be sustainable in the long run.

"It can be sustainable, but it depends. It should be embedded into a prudent macro strategy. It already has high and rising debt levels, but they could and they have prioritised infrastructure. At the same time, they should be aware of the fact that levels of credit are growing faster than GDP," Arjen van Dijkhuizen, senior economist at ABN Amro, tells **GTR**.

There is almost certainly, then, a role to be played by non-Chinese banks – development or otherwise. In an interview in Hong Kong recently, Agatha Lee, head of trade for JP Morgan in Asia Pacific, outlined the potential role her bank could play in future infrastructure projects with China.

She said: "I think the success of OBOR will not be relying only on the Chinese. As it expands you need to go into new countries, new markets… it could be Middle Eastern, it could be a European or a fellow Asian country that gets involved in this whole Silk Road initiative. In these locations, if you want to build a port or power plant, the local government might say: 'I want a bank that comes in to be the lender, or the issuer of a guarantee that's required to support the whole project.' And that's where an international bank can come in to provide the issuance that's required locally."

In the Republic of Georgia, US contractor Conti Corporation is in the process of raising finance for the US$2.5bn Anaklia deep sea port, which the country's government hopes will transform it into a regional hub. Conti is part of a consortium developing the project, and its CEO Kurt Conti tells **GTR** down the phone from New Jersey:

"It's not been easy, we've been working on it for more than a year, but we've been able to put a finance package together, combining debt and equity. If a project is bankable, then you can raise the finance – but yes, it has been more difficult since 2008."

As well as negotiating with the AIIB, the consortium is in talks with a number of other development banks, although Conti says that commercial banks tend to steer clear of such projects "until there is a refinancing opportunity" further down the line. As Lee implied, banks are unlikely to get involved unless there's a heavy guarantee.

A magic pill?

There's a consensus that there is enough trade for all these additional hubs to absorb, so long as the infrastructure is in the right place. Developers such as Conti have to take the long view: if the situation deteriorates, perhaps the project will be put on hold. But when embarking on something on that scale, you don't look at yearly forecasts, but the potential to transform a region.

David Huck is the port director at Peel Ports, which is about to bring the new £300mn Liverpool 2 port online in the north of England. He echoes this view: "First of all, it's important to recognise that this is part of a long-term strategy. The group has created a diverse portfolio of investments which are deeply rooted in the North-west of England, and we are highly committed to the region.

"While there are clearly many major, global economic problems just now, we are looking to the future with this investment," he says, adding that the 70-mile (112km) radius around Liverpool has the largest volume and density of large warehousing of any UK region, and that more than 28% of the UK's large warehousing and industrial property is located in that area.

> **"In newly-emerged markets where consumer demand has reached the inflection point, there is less capacity than is needed."**
>
> **Ben Simpfendorfer**, Silk Road Associates

If planned and targeted properly, then new infrastructure can plug gaps in development and boost trade. But it must also address the existing imbalance: global capacity is poorly distributed and regions all over the world have not seen enough investment: be it Liverpool, Vietnam or Rwanda.

"Around port capacity, there are two elements: the first is there is a risk of overcapacity in in key trading markets; China in particular. A fall in volumes will leave many import operators running below capacity. But the other story is that in newly-emerged markets where consumer demand has reached the inflection point, there is less capacity than is needed," Ben Simpfendorfer, the CEO of Silk Road Associates, a consultancy, tells **GTR**, stressing the need for better air, road and rail routes intra-Asia.

The phrase "If you build it they will come" (actually a misquote of the "If you build it, he will come" line from Kevin Costner's *Field of Dreams*) suggests that every grand undertaking requires a leap of faith. For too long, this seemed to be official policy in Beijing. But with more diligent planning, realistic aims and engagement with the rest of the world, the next stage in China's great infrastructure adventure will be a crucial factor in the future of global trade. GTR