

One Belt One Road: PPP Alchemy – is the Silk Road paved in Gold?





Contents

OBOR and PPP Projects	4
What is OBOR? – an overview	5
What are the objectives of OBOR?	6
Current Investment in OBOR	9
Types and locations of OBOR projects so far	9
OBOR and the PPP Model	11
Types of PPP	12
Key Challenges for OBOR	14
China's true agenda	15
Funding	15
Political	16
Legal	17
Competition or cooperation	17
Resourcing and quality	18
Security	18
OBOR Case Studies	19
Karot Hydropower Project – Pakistan	20
Almaty Ring Road Project (BAKAD) – Kazakhstan	21
Conclusion – is the Silk Road paved in gold?	22
Biographies	24
Neil Cuthbert	25
Atif Choudhary	26

OBOR and PPP Projects



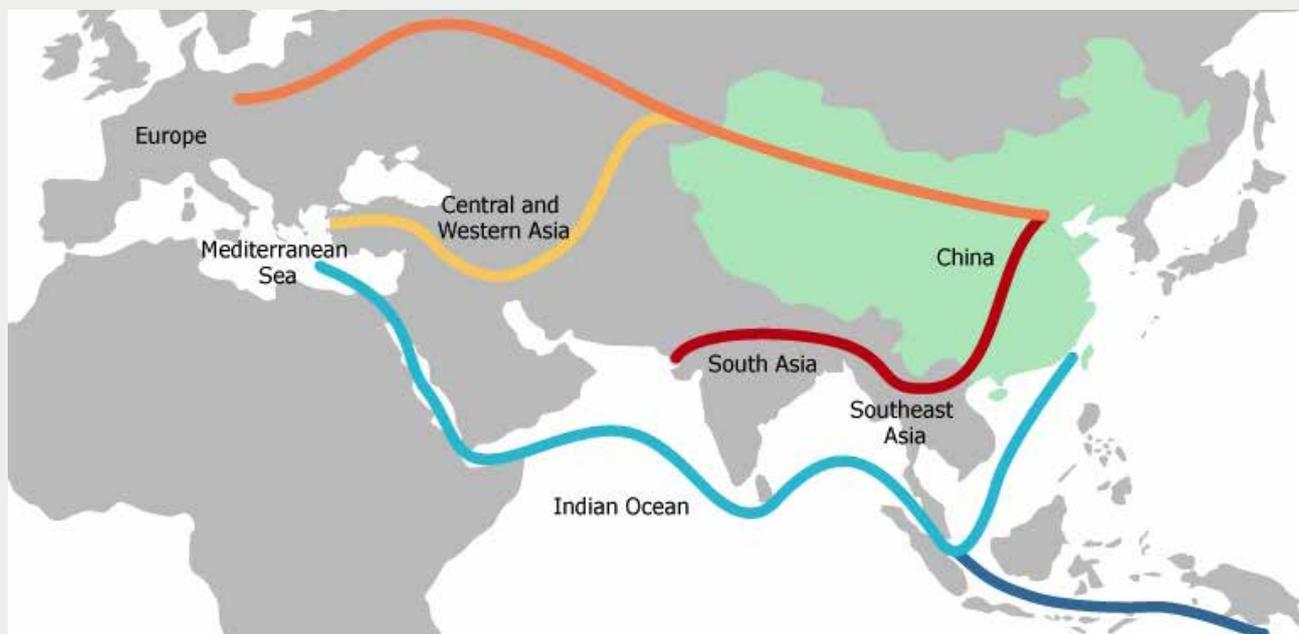
What is OBOR? – an overview

The “One Belt One Road” project (OBOR) is one of China’s key initiatives as part of its plan to assert its position as one of the world’s strongest economic powers. OBOR was initially launched by China’s President Xi Jinping in late 2013 as one of the Asian superpower’s ambitious plans to accelerate outbound investment and to consolidate its position generally across the globe. Physically, OBOR is best understood with reference to its two key tangible cornerstones. The first is an overland route from China through to Western Europe, sweeping through South and

South East Asia, Russia, the Persian Gulf, the Middle East, North Africa, the Mediterranean and in between. This has been dubbed the New Silk Road Economic Belt (Silk Road). The second comprises a maritime route which runs southbound down the east coast of China, through the South China Sea and into the South Pacific before heading westbound through the Indian Ocean and Mediterranean Sea to Europe (Maritime Silk Road).

OBOR is China’s ambitious economic road map which seeks to link Asia and Europe and most quarters in

between. It will encompass in excess of 65% of the world’s population and include over 65 countries, which have a combined GDP of over US\$20 trillion and growing. The primary purpose of OBOR is to create a gateway for China’s burgeoning capital and other resources in a manner and on a scale not seen before. Once the wheels of OBOR are fully set in motion it will lay a platform for economic investments in almost every sector, but with an inclination towards infrastructure and trade. However, while it is easy to consider OBOR as a project focused



on tangible outcomes in the form of roads, railways, airports, ports, oil pipelines, power plants and the like, it is just as important to recognise that it is in fact modelled on a much wider premise. It is intended that OBOR, once fully fledged, will create everything from cooperation and collaboration between members in sectors of technology sharing and flow of financial capital to wider economic, political and social co-operation between its members.

Following the launch of OBOR, many nations along its path have rushed to enter into bilateral treaties and agreements with China. To date, China has entered into well over 30 such agreements and trade negotiators are working on overdrive to increase this number. In some cases these agreements have already gone through rounds of extension and expansion, such has been the early success for all involved. It should be noted that we are talking here of significant deals with countries such as Russia, Turkey, India and Pakistan, which goes some way to showing just how seriously OBOR is being taken among some of the regions and the world's economic heavyweights.

In a show of its intention that OBOR will not just be a series of bilateral deals throughout the wider Eurasian region, but something much more far reaching and global, earlier this year China

entered into a letter of intent with the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP). For the United Nations to throw its support behind OBOR in this manner goes some way to showing just how powerful this strategy is.

Some commentators, mostly in the west, have likened OBOR to the Marshall Aid programme introduced by the US after the Second World War to energise and relaunch the economies of Europe battered by the devastating impact of six years of war. There are similarities with some of the overall goals of OBOR and the Marshall Aid programme, but there are many structural, economic and political differences that make such a comparison somewhat superficial.

What are the objectives of OBOR?

Although the true extent and detail of the objectives of OBOR can only be known within the corridors of power in Beijing, the following are some of the key objectives which are apparent in a programme of this scale:

Connectivity

OBOR seeks to map out and construct more developed and efficient physical routes to support China's unparalleled export market. The same routes would be used to facilitate imports from the same trading partners. What is envisaged is all manner of transport

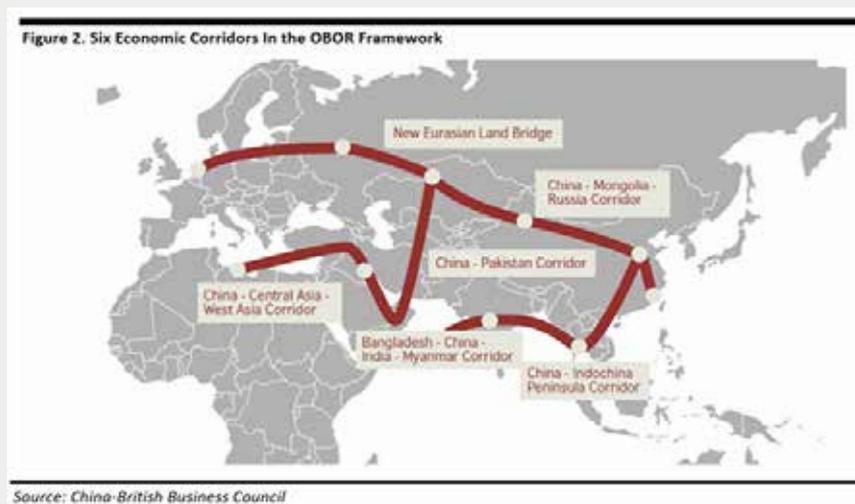
corridors, whether it be roads, rail, pipelines, airports, ports and more which will not only link China with other OBOR nations but also OBOR nations themselves.

The Silk Road and Maritime Silk Road can be broken down into six specific "economic corridors" which have been identified by China, being the New Eurasian Land Bridge, the China-Pakistan Corridor, the China-Central Asia-West Asia Corridor, the Bangladesh-China-India-Myanmar Corridor, the China-Mongolia-Russia Corridor and the China-Indochina Peninsula Corridor. These corridors identify sectors of special importance along the route; however, the reach of OBOR has no defined footprint per se and no country (or body of ocean) should be considered as being outside its potential scope.

However, it is not only physical connectivity which the Chinese are concerned with. OBOR seeks also to connect people along the route through cultural understanding, financial integration, social integration and interaction, educational ties and other intangible connections.

Export markets

OBOR will assist Chinese enterprise in tapping new markets and strengthening China's position in existing markets. Many, but by no means all, of the OBOR member



nations are underdeveloped nations with huge demand for new infrastructure and materials which China is uniquely well placed to provide. China would be primed to provide an “end-to-end” solution in that it can put up the required finance (through debt and/or equity), construction expertise, provision of raw materials and goods and operational services.

While China has traditionally been strong in Asia, the Middle East and Africa, it has not been able to force its way as deep into the European market as it would like. Through OBOR, China will eventually be able to present itself as a viable partner in European markets, which is the next frontier for them in many respects.

Over capacity

OBOR will provide an outlet for the release of China’s vast amounts of economic capital and production capacity which have built up both domestically and overseas. China is the world’s largest producer of many sought after commodities, including cement and steel. However, at the present moment there is not enough worldwide demand for the level of supply which China is able to provide. The launch of OBOR-driven projects should see levels of utility increase in order to close that gap and see China’s export markets begin to live up to their true potential.

Political

All states which sign up to OBOR undoubtedly have something to gain out of the strategy. For most, it will be

the provision of vital infrastructure investment, the scale of which no other country currently has the same appetite for as China. Beijing has made it clear to all and sundry that OBOR is intended to facilitate collaboration and cooperation between China and its neighbours (and beyond). A natural outcome of this is that China’s geopolitical power along the route will consolidate and strengthen.

By also providing the majority of the required financing for such investment China is encouraging and stimulating growth along OBOR that otherwise might take decades to realise. As with the Marshall Aid programme in Europe, the beneficiaries of the aid programme became inextricably “connected” to the US and nowhere was this more

apparent than the collaboration on historical projects such as the General Agreement on Tariffs and Trade (GATT), the International Monetary Fund (IMF) and NATO. It will be interesting to see if there is a similar alliance of interests flowing from OBOR and how this manifests itself.

Chinese growth

One of the key objectives of OBOR is that it should serve for the general betterment of the Chinese population generally, particularly on the Western side of China which has long grappled with the influence of unruly neighbours, lack of coastal access and lack of investment generally. Western China is an important part of OBOR's plans and OBOR will increase the quality of life whether it be through job creation, education or other new opportunities.

Internationalisation of the renminbi

Development of China's financial sector both at home and abroad will be an important by-product of OBOR. In particular, OBOR will provide a platform for the further internationalisation of the renminbi (RMB), a strategy which China has been actively pursuing over the last decade.

Significant ground has already been made on this front. As recently as October 2015, the IMF added the RMB to the basket of currencies

which make up the Special Drawing Rights (SDRs). This takes the RMB into the elite class of currencies of which the only other members are the US Dollar, the Euro, the Japanese Yen and the Great British Pound.

In addition, China has entered into over 30 bilateral swap agreements with jurisdictions all over the world, including a number of states on the OBOR route and significant players such as the EU, Great Britain, Russia, Switzerland and Canada. Supplementing and complementing these agreements are some 20 offshore RMB clearing centres, including in hubs such as New York, London, Hong Kong, Paris, Frankfurt and Zurich.

So while this financial infrastructure is continually evolving in support of RMB internationalisation generally, it is widely expected that OBOR will provide a further significant boost to Beijing's efforts to increase the RMB's influence across the financial world. With the sheer scale of numbers being thrown around in the context of OBOR-related investment, it is expected that both outflows and inflows of RMB capital will be significantly boosted, which will have a very positive impact for Chinese importers and exporters.

Financial markets and Islamic finance

In light of the level of spending foreseen by OBOR projects in the

coming years and decades, there is a clear opportunity for financial markets both domestically in China and abroad to develop and flourish in sectors of the financial world where China has so far been a less significant participant. A prime example is that of Islamic finance debt and equity capital markets in the Middle East. Today the finance sector in the Middle East, led by the financial gateway of Dubai, is experiencing growth in numbers which makes it a serious challenger to the likes of London and Kuala Lumpur, certainly in the Islamic finance space. It is already clear that there is a significant role for Chinese financial institutions to play here and Dubai's International Financial Centre has already attracted interest with four of China's largest banks (Industrial and Commercial Bank of China, Agricultural Bank of China, China Construction Bank and Bank of China) having established there. OBOR will ensure that such financial footprints in new markets will only get larger.

To date a number of Chinese banks have listed conventional bonds on Dubai's NASDAQ and it is touted that it is only a matter of time before this evolves to their listing of Islamic bonds (known as sukuk) and other Islamic finance instruments. OBOR projects are already starting to see direct benefits of Islamic finance with the financing package of the 660MW

coal-fired power plant in Tharparkar, Pakistan including Islamic finance tranches of funding in its structure.

Current Investment in OBOR

Although OBOR has been met with pessimism in certain quarters, the government has already taken steps to show just how seriously OBOR is being taken as one of its centrepiece initiatives. In pursuit of OBOR objectives, a new US\$40 billion fund (the Silk Road Fund) has been established and is earmarked to receive a further boost to US\$100 billion. With the backing of the likes of the China Investment Corporation, Export-Import Bank of China and China Development Bank, it is easy to see that the Silk Road Fund means serious business.

The ink has barely dried on the establishment of the Silk Road Fund, yet it has already kicked into gear with its first investment being in the multi-billion dollar Karot hydropower project in Pakistan in early 2015 (discussed further below). Later that same year the Silk Road Fund entered into a formal agreement by way of a Memorandum of Understanding with Russia's Vnesheconombank and the Russian Direct Investment Fund for the construction of energy infrastructure projects. Subsequently it has also taken a stake in Novatek Inc's Yamal LNG project in Russia and made an investment in Italian tyre producer, Pirelli.

Although not formally tied to OBOR, the establishment of the Asian Infrastructure Investment Bank (AIIB), with headquarters in Beijing, can naturally be seen as an institution which will back OBOR with some strength. The AIIB was established with the backing of 57 prospective founding members, although this number is set to rise with other states who do not hold such status showing an interest in becoming members. These states include influential powers such as Great Britain, France, Italy and Germany. With initial capitalisation to the tune of US\$100 billion and room to grow significantly, the AIIB is already being spoken of in the same breath as the Asian Development Bank (ADB) and the World Bank.

After formally opening in early 2016, the AIIB has not wasted any time in announcing projects it is willing to fund. The first raft of projects were finalised in the middle of 2016 and the geographical spread of these, and the diversity of the sectors in which these projects are located, go some way to showing how broad the mandate of the AIIB will be. These initial projects include road projects in Pakistan and Tajikistan, an electricity project in Bangladesh and a housing scheme in Indonesia. It is no coincidence that there is a distinct alignment between these projects (particularly the roads in Pakistan and Tajikistan) and the OBOR philosophy.

Although the establishment of the AIIB was met with a degree of hesitation and some suspicion from the likes of Japan and the US, it has already shown that it is willing to be collaborative and cooperative with other institutions of similar stature and standing. The M4 road project in Pakistan, for example, is being jointly financed with the ADB in what can only be a positive sign for relations between the institutions.

Outside the headline-grabbing figures being bandied about when discussing the larger funds such as the Silk Road Fund and the AIIB, numerous small funds are being established by individual institutions, the sum of which will have a serious impact. Earlier this year the Industrial and Commercial Bank of China launched a GBP 10 billion fund to facilitate infrastructure projects in Central and Eastern Europe.

Types and locations of OBOR projects so far

OBOR does not have an explicitly stated mandate in terms of the types of projects it will provide and support. However, it is inevitable that it will strongly back all sectors in the wider infrastructure space, with a focus on the transport sector i.e., roads, rail, ports, airports and pipelines. As geographical connectivity is one of the key objectives of OBOR, it is natural that the transport sector will be a major beneficiary. However, this

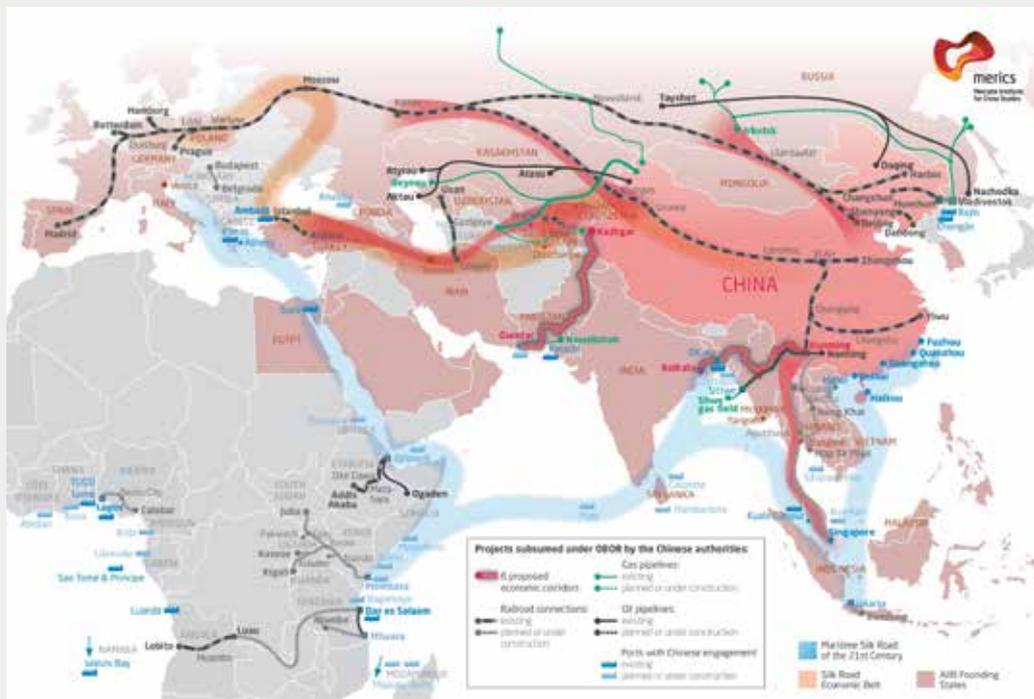
is not to say that other sectors will miss out. In taking into consideration the various objectives of OBOR as referred to earlier in this article, one can foresee that the energy, petrochemicals, education and healthcare sectors will all benefit, whether directly or indirectly.

Out of an increasingly large bloc of nations showing a very keen interest, Pakistan has been a major beneficiary of OBOR in its early years. This is a nod to the strong and enduring relationship the two countries have and, by some measure, Pakistan is becoming an

advertisement of what OBOR has to offer its member nations. By way of example, the pioneer project for the Silk Road Fund is the 720MW Karot hydropower project which is currently under construction on the Jhelum river in Pakistan. The project forms part of the China-Pakistan Economic Corridor (CPEC) and is a significant investment with US\$2 billion currently allocated by the Silk Road Fund to finance its completion. The project has been structured under the BOOT model with a construction period of five years to be followed by a 30-year concession period which is underwritten by way of

a power purchase agreement entered into with one of Pakistan's national utilities providers. At the conclusion of the concession period the asset will be transferred to the government of Pakistan.

CPEC generally is one of the initial offshoots of OBOR. It is a series of projects flagged between the Chinese and Pakistani governments, with the overarching goal being to link China's Xinjiang region with the strategically located Gwadar deep sea port on the southern tip of Pakistan (which is already under operation by Chinese



Source: Mercator Institute for China Studies (<https://www.merics.org>)

interests). Over US\$45 billion has already been committed by the Chinese to kick start CPEC which will eventually connect the two countries with over 3,000 kilometres of highways, railways, pipelines, fibre-optic cabling and other connections. Such is the size of this initial investment in CPEC that some figures put it within the region of 20% of Pakistan's overall GDP.

CPEC presents a world of opportunity for both nations with potentially game-changing benefits on offer. Upon completion of CPEC, the distance which most of China's oil imports currently travel (through the Strait of Malacca) could be reduced by around 70%. In the other direction it will act as a gateway for Chinese exports going through to Asia, the Middle East, Africa, Europe and beyond.

On the flipside, CPEC is seen as an unprecedented opportunity for Pakistan. Pakistan is the world's eighth largest state with a population nearing 200 million, and CPEC will provide much needed infrastructure in the form of utilities and transport assets which should see job growth boosted significantly and a positive impact on its own export markets, which are a key economic driver of their own.

Other projects already earmarked, under construction or completed include the Tharparkar coal project in

Sindh, the M4 highway project, which will connect Faisalabad and Multan (two key manufacturing hubs), the Chashma nuclear power project in Mianwali and the Karot hydropower project on the Jhelum river.

Further afield, in February 2016 the first train carriages from China began arriving in Iran, having travelled across new segments of rail lines running through Kazakhstan and Turkmenistan. The China-Thailand railway project appears to be back on track following a false start earlier in 2016 and other landmark rail projects under consideration are the China-Uzbekistan-Kyrgyzstan rail project and high-speed rail line from Kunming to Singapore.

OBOR and the PPP model

With many OBOR projects being regularly launched, issues and questions will arise as to how best to structure them. Some of the more difficult large-scale projects will be funded through government-to-government grants, others will utilise the traditional export credit models, such as buyer credits and supplier credits, and, some will use the increasingly popular "EPC+F" structure (engineering, procurement and construction plus financing). However, many will utilise the Public Private Partnership model (PPP) for structural, economic and legal reasons, including the following:

Infrastructure gaps

Many of the nations along the Silk Route are underdeveloped nations with a need for foreign investment, with a particular emphasis on infrastructure, particularly through the Asia/South Asia segments of the route. With growing populations and failing infrastructure, many of these nations are crying out for partnerships with those who currently have the appetite for financial investment on a similar scale to China. This can be coupled with the arduous position in which many of the oil-based economies find themselves, with the stagnation of international oil prices, particularly in the Arabian Gulf and wider Middle East region. The outcome of these factors is that many of the projects in such nations which are looking to fill their infrastructure gaps are looking for equity investments of the kind which the PPP model strongly supports and which the OBOR strategy will encourage. This is of course a move away from the traditional procurement methods which used to see the engagement of Chinese enterprise solely for their construction capabilities.

Investment through equity interests

The Chinese government itself is now aggressively advocating and encouraging outbound investment in the form of equity stakes in projects and assets across the globe. We

have already mentioned some of these diverse investments in places such as Russia and Italy above. A further prime example of this is in the agriculture sector. Where previously China would rely on importing food products at market prices to feed its large population, it is fast learning that it makes far more strategic sense to simply acquire agriculture assets in foreign lands and operate them themselves. By doing so it is effectively annexing the farm land of other countries as part of its own agriculture sector (which suffers as a result of a very small proportion of mainland China being productive agricultural land). The OBOR strategy and PPP model complement each other considerably in this respect.

Legal impediments

In many of the nations along the Silk Route the mandatory position for one reason or another is for the host nation to have ownership (or at least strict control) over its own infrastructure. Without the resources to go it alone, the PPP model is an obvious choice for them to meet their infrastructure needs without ceding rights they wish to retain. By awarding a concession they can attract foreign know-how and investment while maintaining ownership (or the right to ownership at a later time).

In certain regions (for example, parts of the Middle East and Africa) we are now

seeing that PPP laws and regulations are being implemented and developed in order to support and facilitate the PPP model. In some cases the legal impediments are being broken down in a way which will support the use of the PPP structure. This will, in turn, support OBOR growth.

Joint ventures

PPPs are one of the more convenient and workable project models for contractors who are looking to get into joint ventures with foreign entities. Increasingly in recent times, Chinese enterprises are looking to commit to countries beyond just contracting work. They are now looking to invest with, and in, the nations which are looking to them for their expertise. By becoming a partner to governments, rather than mere employees, there is scope for significant mutual benefits to arise. Governments are seeking investors who are willing to commit to their countries for longer terms, and Chinese enterprises are looking to become part of the decision-making process rather than being hindered by it as they historically have been in some countries. PPPs strongly support these objectives. Although it must be recognised that there is a possibility that doing business in partnership with host governments can increase risk-sharing on the part of the private sector (for example, in the case of political risk which would otherwise exclusively lie with the host government), the goal

is that in the longer term through constructive collaboration, these risks can be reduced across the board for both partners.

Project financing

Significant development of late in the project financing arena means that governments, financial institutions and the private sector are becoming more and more comfortable with project financing PPPs. Although numerous PPPs have suffered wobbles in the early days where participants failed to plan and understand the structure adequately, this model is slowly but surely being refined and made more robust to the point where PPPs are now regularly achieving a successful financial close, including many involving Chinese interests. Chinese companies are becoming increasingly comfortable with this model, helped in a small part by the explosion of PPP projects within China over the last 24 months.

The further development and refinement of project financing techniques will be an important factor in the successful implementation of OBOR projects.

Types of PPP

Given the importance of the PPP structure in the OBOR context, and the expected uptake of the PPP model in facilitating OBOR projects, it is

worthwhile to touch on what exactly is meant by the term “public-private partnership”. It does not have a fixed legal meaning per se, nor is there one clearly defined framework for a project to be deemed to fit within the PPP model. The general premise is that it is a term used to describe a wide variety of arrangements involving the collaboration and cooperation between the public and private sectors. There is no single or “standard” form of PPP project or structure. A PPP project can essentially take whatever form the parties desire in order to meet the objectives of the project in question. Below we describe some of the common variations of the PPP model which have evolved over the years and of the use of the broader PPP structure.

BOT (build-operate-transfer)

Under a BOT mandate the contractor will take the asset right from the construction phase through a fixed operating life, typically for a period of 20-25 years, following which the asset is transferred to the host government. BOTs tend to be favoured by governments as design, construction and operating risk are all transferred to the private sector. Similarly, for the private

sector there are incentives towards efficiency in terms of both time and cost. They can also have certainty around revenue streams with a single offtaker/customer in the form of the relevant government. On the downside, the private cost of financing a BOT is often seen as an impediment vis-à-vis the publicly funded models which can be cheaper on the back of the availability of cheap public finance.

BTO

Conceptually the key difference between a BTO and BOT project is that the relevant asset is transferred to the government from the time construction is completed. Following transfer of the asset the private party still maintains rights to operate the asset for a fixed period of time in order to recover its investment and make a profit. The BTO model is often employed over the BOT model where there are legal or regulatory impediments to the private party owning the assets over a long period of time.

BOO

The BOO structure is similar to BOT and BTO; however, at the end of the relevant concession period the

private party does not automatically have to transfer the asset to the government. Likewise the obligations of the government will usually cease at the conclusion of the concession period. At this point the private party can assess the relevant options at the time, which includes extending the contract in place, negotiating a new contract, selling the asset or ceasing operation altogether where the asset is no longer able to produce a meaningful output. As a general rule BOOs are more common where the project is deemed to be a higher risk project and/or where significant future investment is likely.

ROT (rehabilitate-operate-transfer)

This is similar to the BTO arrangement; however, it involves the rehabilitation or upgrade of an existing facility rather than the construction of a new facility. Following rehabilitation or upgrade, the concessionaire operates the facility in the same way as a BOT and then transfers it back to government at the end of the agreed period.

Key Challenges for OBOR



China's true agenda?

A key challenge already being faced by China is doubts over what the true motivations are behind its OBOR vision. Although OBOR has been able to garner support from global heavyweights such as Russia and India, there has been no shortage of questions around what its real objectives are. The reality is that OBOR is of a scale unlike anything seen in recent generations when it comes to international or regional development programmes. Further, it is being spearheaded by China, one of a small cluster of geopolitically significant nations which is constantly competing with others in the global power stakes. A consequence of this is that OBOR is and will continue to be the subject of much speculation.

However, the Chinese government has been very clear on what their broad agenda is.

"The orderly and free flow of economic factors, highly efficient allocation of resources and deep integration of markets; encouraging the countries along the Belt and Road to achieve economic policy coordination and carry out broader and more in-depth regional cooperation of higher standards; and jointly creating an open, inclusive and balanced regional economic cooperation architecture that benefits all." – China State Council, March 2015

In trying to determine the true agenda, it must be remembered that OBOR encompasses hybrid and complex ideas which combine both philosophical and economic elements. Notwithstanding this complexity, however, the overarching intention appears to be that through the execution of OBOR, the world will be positively guided to think in a different way which will be mutually beneficial to all. The geopolitical narrative which plays out will promote a more inclusive governance regime where developed and developing countries alike are encouraged to work together with greater equality and prosperity. As such, China is sending out a clear message that OBOR will help developing countries benefit in a way that existing global political and economic order currently does not. In the words of Foreign Minister Wang Yi "the initiative is China's idea, but the opportunities it has created belong to the world".

It is important to note that this vision not only applies to how China seeks to deal with other governments, but how it sees the entire OBOR "system" integrating and interfacing with international organisations and the international community at large. As such, China is and will be seeking to work within existing international systems and not outside them or adverse to them. A good example is that they envisage and encourage cooperation of their own financial

institutions with the likes of the Asian Development Bank, the International Finance Corporation, the World Bank and others.

So it is ultimately important to remember that OBOR is so much more than being about just infrastructure and economics. It also encompasses China's future role in the world, promoting its ideas and philosophies and demonstrating how China can cooperate with the rest of the world and build mutually beneficial partnerships with other countries.

Funding

A strategy such as OBOR is almost impossible to quantify from a financial perspective. As it continues to be rolled out over the coming years, its true extent will evolve, as will an understanding as to the scale of resources (financial and other) which are required to be allocated to it. However, it does appear clear that when OBOR is considered in its totality, we must cease discussions about billions or even hundreds of billions of dollars – OBOR is well and truly in the elite "trillions" category when it comes to cost and impact. As such a central question surrounding OBOR is how can China afford it? The short answer is that it cannot do it alone. Although strides have been made through the establishment of the Silk Road Fund, the AIIB, the New Development Bank and other

similar financial initiatives, the reality is that the amounts contributed so far fall well short of what is and will be required in the coming years. And all this is at a time when things are becoming fiscally more challenging for China, whether it be through the flight of capital offshore, record consumer debt levels or a marked slowdown in economic growth when compared to recent years.

In addition to the funding challenges which any project of the scale of OBOR would have, there are certain specific challenges that OBOR will face. For example, how does one attract investment to high-risk countries such as Pakistan, Afghanistan and Syria? The status quo in countries such as these is already an issue of much concern. Will investors be willing to take the plunge on projects which will span possibly decades of uncertainty? Will Western financial institutions, shackled as they are by European Union (EU) and US regulations, collaborate with Chinese institutions to help finance OBOR?

Political

While many of the countries which have embraced or at least shown an interest in OBOR are strategically important to China, a number of them find themselves in a tenuous position in the world from a political and geopolitical perspective. It awaits to be seen whether diplomacy can allay fears currently held in relation

to doing business with certain of these countries. That being said, the Chinese do have a track record of taking their enterprise to places others may be more reluctant to in terms of risk appetite.

By way of example, the current vision for CPEC sees its run through the region of Kashmir which has been disputed between Pakistan and India since partition in 1947. Tensions between the neighbours over this issue have been frosty ever since and military action has the potential to flare up at any time. So while CPEC forges through the Pakistan-controlled side of Kashmir, there are no guarantees that India will stand by and let it run its course.

In India generally, the rollout of OBOR has been watched with a degree of caution. From some quarters the view appears to be that getting onboard with OBOR can only offer India marginal benefits and that it may be better served trying to forge its own path, given its own size and economic might. However, the reality is the two Asian heavyweights will need to forge a path together as the mutual benefits are obvious. China has excess capacity and capital flows which are primed to be put to use, and India has a thirst for new infrastructure which cannot be kept up with domestically. Arguably, if minds are able to meet, the

relationship between the two can be among the most complementary of any two nations when considered in the OBOR context.

Changing of the political guard is also a major risk factor facing OBOR, particularly in the infrastructure projects space where contracts can be awarded for decades at a time, and the periodical changing of administrations presents challenges which should not be underestimated. A very recent example of this and its impact on Chinese businesses was seen in Sri Lanka when the government of Mahinda Rajapaksa was replaced in early 2015 with the administration of Maithripala Sirisena. One of the first acts of the new administration was to suspend various projects implemented by the Rajapaksa regime, including the Colombo Port City project. The Mattala Rajapaksa International Airport in Hambantota has not fared much better under the new regime which refuses to pump more capital into the failed project and in fact is now asking the Chinese to enter into a debt-for-equity swap arrangement, which has been firmly rejected.

Beijing and Moscow have long had a solid relationship with one another, strengthened in part by solidarity through their similar adverse treatment by the West on certain fronts. At a time where the

rouble is flailing and oil prices are recovering from record lows, early sentiment from Russia is that OBOR is being seen as complementary to Moscow's own Eurasian Economic Union vision rather than a threat to it. These and other factors should see the two nations form closer ties in what is a critical segment of the belt for China, with Russia wielding significant influence throughout the Commonwealth Independent States and beyond.

Legal

Inherent in the vastness of the OBOR project is the fact that it will include a large number of countries which have underdeveloped, misunderstood, complex or politically partial legal systems (and, in some cases, all of the above!). This means it is inevitable that large numbers of OBOR projects will proceed on the premise of legal uncertainty and with a degree of scope for failure. This issue has already come under the spotlight as OBOR sets foot in Indonesia, where just days after Indonesian President Joko Widodo broke ground on the US\$5.5 billion high-speed rail network connecting Jakarta to Bandung, the project was suspended because of inconsistencies with the issuance of the required permits and licences. Although the project is now back on track, it demonstrated some of the challenges China can expect

to come up against from a legal perspective as it pursues OBOR going forward.

Even in parts of the OBOR map which have well-established legal systems it is being envisaged that the Chinese could find themselves in a minefield of legal and regulatory problems. A perfect example of this challenge concerns those countries who look set to embrace OBOR but which are members of the EU. Not only will the Chinese need to understand the implications of their own domestic regulations when dealing with EU nations, but they will also need to properly understand the implications of the applicable EU laws and of course the laws of the host nation. Clear and detailed advice in relation to the legal and regulatory environments where OBOR will take Chinese enterprise will be of utmost importance.

Competition or cooperation?

OBOR and its affiliated institutions (such as the AIIB) are arguably the latest entrants in a somewhat crowded market of multilateral development institutions. There are of course a myriad of other international organisations/alliances which have a similar mandate to that of the OBOR programme. The World Bank, Asian Development Bank, European Bank for Reconstruction and Development, and International

Finance Corporation are some of the better known such institutions. A key challenge for OBOR will be whether it and China will be perceived as competition or a threat to these well-established institutions.

The early signs coming out of China are positive and signal China's intent that it will cooperate and collaborate with its peers. As young as OBOR is, China has already shown material progress in firming up its relationships with some of these multilaterals. In May of this year the AIIB and ADB signed a memorandum of understanding to set out their intention to work together for the purposes of financing projects in Asia. The memorandum provides for the institutions to work together at a strategic level in order to execute what are, in many cases, common objectives and interests. As mentioned above, the M4 highway project in Pakistan is the first project which the AIIB and ADB will be co-financing, with plans of many more to come.

The AIIB has also entered into a similar arrangement with the World Bank. In April 2015 the two banks entered into a framework agreement in relation to the co-financing of projects throughout Asia.

So, while the best of intentions are being shown by players both old and new, results are what will ultimately matter to those watching.

Resourcing and quality

As ambitious as the OBOR vision is, it is inevitable that questions will arise as to whether China does in fact have the capacity to deliver projects they have and will commit to implementing, on time and to the required standards of quality. We have discussed above that financing of the required volume of projects will be a major challenge; however, even if those challenges are overcome there will be questions as to whether OBOR is asking for too much to be done too quickly. Is there a risk that projects will be

rolled out at a pace whereby quality is compromised? In the short term, at least, the answer should be in the negative. There is well-publicised excess capacity in the Chinese market at present and there will be a focus on ensuring this is used wisely. However, the challenge will likely come to the fore as and when that capacity is used up and the supply/demand matrix starts evening out.

Security

It is only natural for a project which encompasses much of Asia, the Middle East and Africa that security

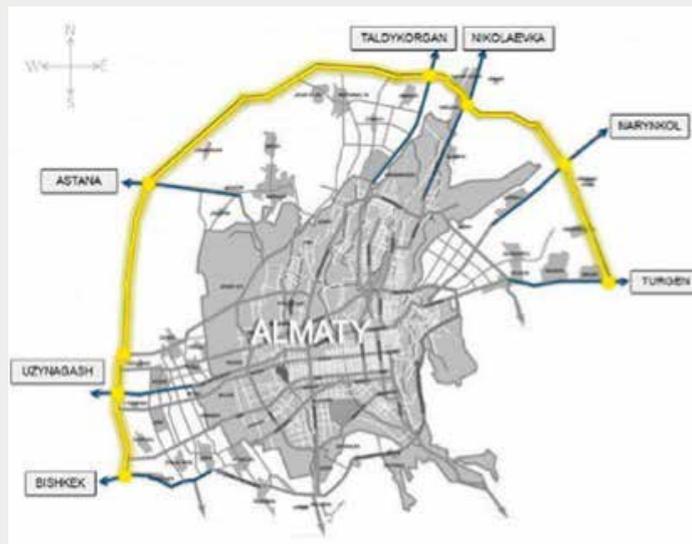
is and will continue to be one of the key challenges which OBOR will face. Afghanistan, Iraq and Syria are all countries which are on the OBOR road map and it goes without saying that, certainly at this point in time, this will present a myriad of issues for the Chinese on the security front.

OBOR Case Studies



Karot Hydropower Project – Pakistan

- 720MW hydroelectric power project on the Jhelum river in Rawalpindi, Pakistan.
- Following completion it is expected to deliver power sufficient to run 7 million households.
- Is part of the “China-Pakistan Economic Corridor”, which is a flagship subsection of the road and belt.
- Developer is Karot Power Company, in which China Three Gorges South Asia Investment Ltd (a subsidiary of China’s state-owned China Three Gorges Corporation) is the majority shareholder.
- Approximately US\$1.6 billion EPC contract has been awarded to Yangtze Three Gorges Technology and Economy Development Co., which will largely handle engineering and construction aspects, and China Machinery Engineering Corporation, which will largely handle procurement.
- Implemented as a build-own-operate-transfer (BOOT) project with a 35-year concession period. This includes a five-year construction period which is due to complete by 2020, followed by an operation period of 30 years.
- Subject to a 30-year PPA with Pakistan’s Transmission and Dispatch Company.
- Debt and equity funded by the Silk Road Fund (one of the fund’s first investments), International Finance Corporation and other Chinese financial institutions including the Export-Import Bank of China and China Development Bank.
- Implemented in accordance with Pakistan’s Policy for Power Generation Projects 2002 which encourages entry into PPPs and offers support to foreign investors seeking to invest in Pakistan’s power sector.



Almaty Ring Road Project (BAKAD) – Kazakhstan

- 66 km toll road which will bypass Almaty city with a population of over 2 million citizens.
- The first PPP and priority project in the road sector for the GoK and is included on the “List of Concession Projects of Special Importance”.
- First launched in 2012, preferred bidder was announced in 2016 as Alsim Alarko (Turkey) / Makyol (Turkey) / SK Engineering and Construction (Korea).
- Part of Western China/Western Europe transnational highway.
- Subject to a 25-year concession period. This includes a five-year construction period, followed by an operation period of 20 years.
- Concessionaire will receive “Availability Payments” from GoK, which retains traffic risk, i.e. it will only act as collection agent in respect of tolls and will not retain tolls collected from users.
- “If successful, the Almaty Ring Road PPP will serve as a blueprint for new public-private partnerships in Kazakhstan in the transport infrastructure sector and possibly in other sectors that need to attract private funding. This will be the first PPP structure of its type not only in Kazakhstan but in the whole of Central Asia.” – EBRD Managing Director for Infrastructure, Thomas Maier



Source: [http://www.karotpower.com/index.php?action=About Project](http://www.karotpower.com/index.php?action=About+Project)

Conclusion – is the Silk Road paved in gold?



Whichever way one looks at it, the OBOR initiative is arguably the most globally far-reaching and impactful economic strategy since the US Marshall Aid Programme, which was implemented after WWII. Many commentators have and will continue to share their theories as to whether OBOR will be as successful as Beijing is hoping. As with anything of this nature, it will ultimately be judged and its legacy will be formed based on the results it achieves. What can be said at this point, however, is that China will not be found wanting in terms of the resources and planning it is throwing behind OBOR. The tenure of President Xi will to some extent be judged on the level of success OBOR achieves and, where many might shy away from this kind of pressure, he and his administration have made

it clear that they are not of that ilk. This certainly bodes well for those along the belt and road and other stakeholders who are pinning high hopes on the success of this mega project.

Despite the best of intentions and efforts, it is without doubt that there are numerous challenges which lie in OBOR's path. Some of these which we have touched on can be considered somewhat obvious and inherent in a project of this scale. Others will emerge and evolve, as OBOR itself emerges and evolves in the years and decades ahead.

What is clear, however, and has been since OBOR was announced, is that the potential benefits for all involved are immense to the point of being immeasurable or accurately

estimated at this point in time. Not only will these benefits be in favour of China and its people, but also to those along the OBOR route who choose to engage with China and its vision. The benefits will be economic, political, strategic, cultural and social. In the case of some countries these benefits are likely to be "game-changers" in their own modern history. Crucial infrastructure which otherwise might take decades to deliver is now seemingly in a position to be delivered on an accelerated timetable and the consequential benefits this can bring about are endless.

So yes, it is submitted that the Silk Road is potentially paved in gold, both for China (for the reasons stated), and for those countries that embrace this initiative and the potential benefits that it brings.

Biographies



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Neil is a banking and finance partner focusing on project and infrastructure financings. He has been based in Dubai since 2001. He has extensive experience of advising banks, governments, borrowers, sponsors and others in project financing transactions covering a wide range industries, including the oil and gas, electricity, water, mining, leisure, transportation and telecommunications industries. He also has a general banking practice that includes advising banks, borrowers and others on a wide range of banking products, including lending, structured finance, derivatives, trade finance, development finance and restructurings. He has lectured extensively on a wide range of banking subjects including at the Euromoney Winter and Summer Schools of Project Finance. He is

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Neil was head of the Dubai office from 2001 to 2010. He was Managing Partner of the Firm's Middle East offices from 2005 to 2011 and is currently Senior Partner of the Firm's Middle East offices. He is also a member of the Policy and Planning Board of Dentons UKMEA LLP and sits on the General Advisory Committee of Dentons. He was also a member of the Global Board of Dentons from 2011 to 2015.

Neil is recognised as one of the world's leading practitioners in Banking (2015), Project Finance (2014) and Public Procurement (2014) as nominated by his industry peers, Who's Who Legal series. Neil is also recognised by peer nominations in

Banking, Finance and Transactional Law by Expert Guides (2015). He has also been recognised in:

- Euromoney's Guide to the World's Leading Energy and Natural Resource Lawyers
- Euromoney's Guides to the World's Leading Project Finance Lawyers
- Chambers Global Guide to the World's Leading Lawyers
- Chambers Global Guide to the World's Leading Project Lawyers
- The Guide to the World's Leading Project Finance Lawyers
- Legal Experts – Guide to the World's Leading Emerging Market Practitioners (Project Finance).

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He has experience in advising governments, sponsors and others

in project financing transactions with a focus on the transportation industry. Recent experience includes working with clients (including Chinese sponsors) on infrastructure PPP projects in Africa and Asia.

He also has general banking and finance experience, both within the

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