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China's Belt and Road Initiative, Public-Private Partnership Model and State-Owned Enterprises: Considerations for the Philippines*

Introduction

All eyes are on the Belt and Road Initiative (BRI) as it unfolded in the last five years and provided a picture – although incomplete – of what it really is and how it works. Analyses, however, remain limited to perspectives that behind the initiative, a monolithic China is at work. Although it is, indeed, Xi Jinping – both as general-secretary of the Communist Party of China and president of the People's Republic of China – who has championed the initiative through consistent and intensive efforts to promote it, other actors such as state-owned enterprises and the private sector play an equally important role in the implementation of BRI.

The Philippine government remains receptive of the BRI given its congruence to the Philippines' domestic goal of ushering a "golden age of infrastructure" under President Rodrigo Duterte's regime. But while the Philippines and China have aligned goals when it comes to infrastructure plans, there remains a need to have a more thorough assessment of the risks and opportunities attached to Philippine participation in the BRI, especially in the face of a volatile geopolitical and economic environment. The Philippines has a number of practical considerations that still need to be addressed – an important one being the financial and operational aspect.

In a recent statement, He Lifeng, deputy head of the National Development and Reform Commission (NDRC), mentioned that China will

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make use of Public-Private Partnership (PPP) model to provide financial channels to the BRI participating countries.[1] The Department of Finance, earlier this year, declared the Philippine government's preference for "hybrid" PPP deals in carrying out its infrastructure plans.[2]

A hybrid PPP strategy entails that "the government completes a project then transfers it to the private sector for maintenance, operations, and marketing."[3] Following the same strategy, the Philippine government works with the advantage of having the means to borrow at lower rates through grants and concessional loans. A common PPP strategy is at view, but a number of considerations arise: what exactly does engaging in PPP with China entail? The BRI ground progress would show that despite China's declaration of preference of tapping its private sector, in reality, most project partners turn out to be Chinese state-owned enterprises (SOEs).[4] Recent proclamations from China's State-owned Assets Supervision and Administration Commission of the State Council (SASAC) stated that SOEs will play a leading role in the BRI.[5] With this, there surfaces a need to carefully examine what China's PPP Model is, and how SOEs work under the BRI PPP Model.

Understanding such will not only provide the Philippine government important information on how China envisions project implementation but also give insights on Chinese SOEs strategies and priorities, and on a more operational level, how to engage and communicate with them and foster the best enabling environment to maximize benefits and minimize risks in implementing individual projects. In context, this paper identifies SOEs as less recognized but equally important role player behind the BRI and attempts to explore how it works, what its strategies and priorities are, and what best ways to deal with it.

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[1] Council Information Office. (2017). "China to promote PPP model in Belt and Road Initiative." Retrieved from http://www.scio.gov.cn/m/32618/Document/1540101/1540101.htm.

[2] Department of Finance. "Gov to apply hybrid formula in implementing PPP projects." Retrieved from http://www.dof.gov.ph/index.php/govt-to-apply-hybrid-formula-in-implementing-ppp-projects.

[3] Oxales, Orlando. (2017). "Hybrid PPP." Retrieved from http://2040.neda.gov.ph/2017/04/10/hybrid-ppp.

[4] *Bloomberg News.* (2017). "In China, public-private partnerships are really public-public." Retrieved from https://www.bloomberg.com/news/articles/2017-02-27/in-china-public-private-partnerships-are-really-public-public.

[5] Zhong Nan. (2017). "SOEs to take lead role along Belt and Road." Retrieved from http://www.chinadaily.com.cn/business/2017-05/09/content_29258516.htm.

China's BRI and PPP Model

The BRI aims to relive the ancient Silk Road by building an overland route from China to Western Europe, sweeping through South Asia and South East Asia, Russia, the Persian Gulf, the Middle East, North Africa, and the Mediterranean. This first component is called the Silk Road Economic Belt (SREB) which consists of six economic corridors, namely: a) the New Eurasia Land Bridge, PRC-Mongolia-Russia, PRC-Central Asia-West Asia, PRC-"Indochina Peninsula," PRC-Pakistan, and Bangladesh-PRC-India-Myanmar corridors; b) a number of railroad connections; and c) a few gas and oil pipelines to be built.

The 21st Maritime Silk Road (MSR) is BRI's second component. It is 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. The concept of a Maritime Silk Road dates back to as early as the 19th century, when ancient merchants traveled the route of China's eastern coast, southernmost region of India, East Africa, the Persian Gulf, and the Red Sea to enhance economic and cultural relations.

The Chinese government, led by the National Development and Reform Commission, Ministry of Foreign Affairs, and Ministry of Commerce, issued the Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road in March 2015. In the document, the initiative's major goals were declared. These goals include policy coordination, facilities connectivity, unimpeded trade, financial integration, and people-to-people bonds. In a span of five years, China's BRI gained ground and grew even more popular than it originally was. Projects underway include Gwadar Port in Pakistan, sections of the Kunming-Singapore railway link, the Khorgos dry port between China and Kazakhstan, and the freight trains from China to Tehran and London.[6]

On the other hand, the 2016-2017 China National Image Global Survey released earlier this year by the Academy for Contemporary China-World Studies, Kantar Millward Brown, and Lightspeed reported a significant increase to 16 percent in the BRI global awareness, which was

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[6] Frank, Knight. "New Frontiers: Prospects for Real Estate Along the Belt and Road Initiative." (2018). Retrieved from http://content.knightfrank.com/research/1438/documents/en/new-frontiers-the-2018-report-2018-5216.pdf.

only eight percent in 2014.[7] What did not change much, however, are the questions associated to the initiative. To this day, one would have to battle the difficulty of looking for reliable sources in finding out which projects actually belong to the BRI and which ones are mere Chinese overseas infrastructure investments, and how arrangements and contracts are being finalized. Much of the literature would say that these questions more often than not result to apprehensions among partner states or even observers as to how and why China is implementing the initiative. The lack of clarity urges parties to look into what is observable. China's declared preference over a PPP Model but in reality uses SOEs appears to be another question.

China's PPP Model

Earlier this year, China's NDRC declared its preference over PPPs in carrying out BRI project financing. Following this mechanism, the process would involve PPP project operators directly soliciting money from the capital market. The process also entails that social security funds and insurance premiums would likewise be allowed to invest in projects. The use of a PPP mindset is not entirely new in China. PPPs in China were developed in the late 1980s, but it was only in 2014 that the financing mode seemed to have gained ground, propelled by the issuance of guidelines on how it was to be implemented. To date, there are more than 1,000 PPP projects in China, valued over $100 billion, providing services in transport and communication, energy, clean water, wastewater treatment, and a variety of social services.[8]

In the article "Public-private partnerships in China: A responsive participation," LooSoo Beh explained that there are three reasons behind China's utilization of PPP: 1) the inadequacy of investment in public facilities and services against a backdrop of high rate of urbanization and relatively low standard of public facilities and services; 2) insufficiency of funding sources for public facilities and services given that the main source is government funds; and 3) the slow reforming of state-owned enterprises (SOEs) and poor

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[7] Guo, Martin. "2016-2017 China National Image Global Survey." (2018). *Kantar.* Retrieved from https://us.kantar.com/business/brands/2018/2016-2017-china-national-image-global-survey.

[8] Asian Development Bank. (2014). "Public-Private Participation in Urbanization in the People's Republic of China." Retrieved from https://www.adb.org/sites/default/files/publication/42860/public-private-partnerships-urbanization-prc.pdf.

provision of public facilities and services.[9] Drawing on these, the Chinese government had made an evident switch from relying on traditional public procurement methods to looking into private entities as alternative means of providing public infrastructure and services. The same period of PPP development also captured how China's private sector evolved through time to become the present primary driving force of the Chinese economic growth, as argued by Nicholas Lardy in the book *Markets over Mao: The Rise of Private Business in China*.

Lardy pointed out that by giving up control of market prices for most consumer goods and permitting private firms to expand while the state somehow pulled back, the government has allowed for the share of industrial activity to become the domain of the private sector. However, he also underscored the important role of the state in facilitating and influencing such process. With this, the broader context of private sectors becoming more and more important in Chinese economy helps justify PPP as a model for its initiative.

A workshop organized by the Asian Development Bank (ADB)noted the wider scope of the PPP agenda in China, going beyond mobilizing financial resources and expertise to deliver public services. According to the ADB report, PPPs were agreed to be a means to integrate a performance-based management framework that can strengthen the quality of public services and reduce costs.[10] Apart from offering an efficient framework for project implementation, a number of factors also point out to PPP as China's best model for its BRI projects and these are infrastructure gaps, investment through equity interests, legal impediments, joint ventures and project financing as the driving factors making PPP the most viable option for BRI projects.[11]

To elaborate:

1. The BRI would be looking to nations with the appetite for infrastructure development but are aiming fill their infrastructure gaps through equity investments of which PPP model strongly supports;
2. The BRI would support the Chinese government's proactive advocacy

[9] Beh, LooSoo. (2010). "Public-Private Partnerships in China: A responsive participation." *Hournal of US-China Public Administration,* vol. 7, no. 8. Retrieved from http://unpan1.un.org/intradoc/groups/public/documents/UN-DPADM/UNPAN042408.pdf
[10] Asian Development Bank. (2014).
[11] Cuthbert, Neil, and Choudry, Atif. (2016). "One Belt One Road PPP Alchemy -Is the Silk Road Paved in Gold?" Retrieved from https://www.dentons.com/en/insights/guides-reports-and-whitepapers/2016/december/22/one-belt-one-road-ppp-alchemy-is-the-silk-road-paved-in-gold

of encouraging outbound investment in the form of equity stakes in projects and assets across the globe;

3. The PPP model would ease attaining ownership, or at least strict control, over infrastructure through awarding concessions;
4. The PPPs also provide a convenient way to promote projects to contractors who intend to get into joint ventures with foreign entities; and
5. Chinese companies becoming increasingly comfortable with a project financing model which provides for off-balance-sheet financing of the project.

The PPPs could also be appreciated as a complementary model for China's strategic partnership diplomacy of engaging the world through a non-alliance policy. Partnerships, not alliances, therefore, effectively serve as a significant policy instruments for China in realizing its strategies and goals. However, if one probes into the projects that have already commenced, it turns out that most project partners are not private Chinese firms but SOEs. One explanation to this is what analysts argue that with PPP, China defines the non-government partner as "social capital"[12] instead of "private capital," and this paves the way for SOE participation.[13]

State-Owned Enterprises

Chinese state-owned enterprises have played a significant role in the span of the country's economic history. These state enterprises took over the task of rebuilding the country in 1949 after having been devastated by a long period of war and poor economic development. The SOEs provided employment and a range of social services such as education, medical care and retirement benefits.[14] Chinese SOEs have also undergone long processes of transformation under the economic reform and opening up policy in 1978.

[12] *Xinhua.* (2016). "China to expand public-private partnerships." Retrieved from http://english.gov.cn/premier/news/2016/07/08/content_281475389117934.htm.

[13] *Bloomberg News.* (2017). "In China, public-private partnerships are really public-public."

[14] Fan Gang, and Hope, Nicholas. (2013). "The Role of State-Owned Enterprises in the Chinese Economy." In *Economic Relations in the Next 10 Years.* China-United States Exchange Foundation's US-China 2022. Retrieved from https://www.chinausfocus.com/2022/wp-content/uploads/Part+02-Chapter+16.pdf.

In 1999, the Chinese government was faced with the reality that it could no longer rely on growth from domestic markets alone. The government then promoted overseas Chinese investments through the "Go Out Policy," which mandated Chinese firms to invest and operate outside China's premises and take advantage of the booming world trade.[15] This prompted China to forge bilateral partnerships and cooperate on infrastructure development with many states. By 2003, China's overseas investments rose to US$35 billion from US$3 billion in 1999, primarily driven by state-owned enterprises (SOEs).[16]

Given such background, one could appreciate the long history and great value of SOEs to China. This time, it is being used to take a leading role in the implementation of the BRI. According to Xiao Yaqing, "SOEs are the market backbones. They have their own plans and strategies for the Belt and Road drive, in addition to the country's overall blueprint for the initiative."[17] The government believes that central SOEs project the ability, advantage and expertise as it have lengthy experiences in setting up and operating transportation, energy, telecommunication and power projects.[18]

These SOEs are supervised and managed by the SASAC State Council. Among the responsibilities of SASAC are "supervising the preservation and increment of the value of the state-owned assets of the supervised enterprises; establishing and improving the index system of the preservation and increment of the value of the state-owned assets, and works out assessment criteria; supervising and administering the preservation and increment of the value of the state-owned assets of the supervised enterprises through statistics and auditing; and it is responsible for the management work of wages and remuneration of the supervised enterprises and formulates policies regulating the income distribution of the top executives of the supervised enterprises and organizes implementation

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[15] China Policy. (2017). "China Going Global: Between Ambition and Capacity." Retrieved from https://policycn.com/wp-content/uploads/2017/05/2017-Chinas-going-global-strategy.pdf.

[16] Wijeratne, David, Rathbone, Mark, and Wong, Gabriel. (2018). "A Strategist's Guide to China's Belt and Road Initiative: A new global megaproject, unparalleled in scope and ambition, presents vast opportunities and risks for multinationals." *Global Perspective,* no. 90. Retrieved from https://www.strategy-business.com/feature/A-Strategists-Guide-to-Chinas-Belt-and-Road-Initiative?gko=a98e0.

[17] Zhong Nan. (2017). "SOEs to take lead role along Belt and Road."

[18] Zhong Nan. (2017). "SOEs to take lead role along Belt and Road."

of the policies."[19] In other words, SASAC was responsible for the reforms implemented on SOEs. It is also in charge of appointing top executives, consolidating any mergers or sales or assets, and crafting laws relevant laws.

What Does this Mean for the Philippines?

The issue presents an opportunity to understand what China's interests are behind BRI. With the SOEs' seven "strategic" sectors and seven designated "basic or pillar" industries, one would be able to see what China deems as most important to pursue. In 2006, China enumerated seven "strategic" sectors and held that the state would keep "absolute control." These include defense, electricity generation and distribution, petroleum and petrochemicals, telecoms, coal, civil aviation, and waterway transport.[20] The "basic" industries that also remains to be significantly promoted by the government include machinery, automobiles, information technology, construction, steel, base metals, and chemicals.[21] Clearly, these will be the priority sectors that China will or is currently looking for in partner countries.

A study by Amighini, Rabellotti and Sanfilippo in 2012 analysed determinants of Chinese outbound foreign direct investments (ODI) in the period from 2003 to 2008 and compared findings between SOEs and privately owned firms.[22] The findings discussed how strategic motivations is clearly characterizing the internationalization of both state-owned and controlled firms. The SOEs were distinguished as being more invested as resource-seekers, while private firms are more asset-seekers. The study stated that market size is a consideration for both firms groups but they respond differently to market affluence as SOEs are more inclined to partner with the poorest among the low-income countries whereas private

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[19] SASAC. "Main Functions." Retrieved from http://en.sasac.gov.cn/n1408028/n1408521/index.html.

[20] Development Research Center of the State Council and the World Bank. (2013). "China 2030: Building a Modern, Harmonious, and Creative Society." *World Bank Publications*. Retrieved from https://www.worldbank.org/content/dam/Worldbank/document/China-2030-complete.pdf

[21] Development Research Center of the State Council and the World Bank. (2013). "China 2030: Building a Modern, Harmonious, and Creative Society."

[22] Amighini, Alessia, Rabellotti, Roberta, and Sanfilippo, Marco. (2012). "Do Chinese SOEs and private companies differ in their foreign location strategies?" EUI Working Paper. Robert Schuman Center for Advanced Studies. Retrieved from http://cadmus.eui.eu/bitstream/handle/1814/22388/RSCAS_2012_27.pdf?sequence=1.

ones follow a more conventional location strategy. This explains why distance and political instability in partner countries does not hinder the SOEs to secure access valuable resources for China's development. This also reflects the SOEs leeway to expand abroad being led by broader national strategic priorities, instead of corporate strategies.[23]

This should not be surprising because China has always been open in expressing its need for resources. However, for the Philippines, one implication that needs strategic considerations is the fact that it would be dealing with Chinese owned firms and in a sense, the goals and strategies of these firms reflect that of the Chinese government's which is very much different from private companies. And with its different nature, the SOEs may just pose different risks – which could be political, financial, or operational. The Philippine government needs to formulate a nuanced way of dealing with SOEs as these are different from the "private" that it is used to interacting with in PPPs.

Conclusion

The underlying complexity of engaging with SOEs through BRI is seen because of different interpretations in China's definition of PPP Model, going beyond just the private sector to include state-run firms. This phenomenon presents challenges to partner states in formulating ways on how to deal with SOEs. The different nature of SOEs in terms of goals and strategies necessitates a nuanced response and a carefully thought out plan so as to ensure win-win deals with partner states. The Philippines have long employed regulatory rules and laws in carrying out PPP deals in the country. What it needs to do is ensure the continuous and judicious use of these institutional safeguards for the purpose of protecting Philippine interests.

It is imperative that a comprehensive understanding of the initiative and each specific project under it to be able to balance the risks and benefits. In the end, an enabling environment for good cooperation deals between the Philippines and China under the BRI would be one where risks and benefits are carefully assessed, feasibility studies conducted, and project contracts containing clear terms and agreement on how terms will be interpreted and implemented.

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[23] Development Research Center of the State Council and the World Bank. (2013). "China 2030: Building a Modern, Harmonious, and Creative Society."