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A strategy to straddle the planet

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Anil Ambani was in ebullient mood last October when he arrived at a luxury hotel in Shanghai to sign one of the biggest business deals of the year. The Indian billionaire's Reliance Power had just agreed to purchase $10bn of power generation equipment from the state-owned Shanghai Electric.

"It is the largest order in the history of the power sector," proclaimed Mr Ambani, "and the largest single business relationship between India and China."

The size of the deal was not its only notable aspect. Shanghai Electric was offering its equipment at about 30-40 per cent below the cost of an equivalent turbine from General Electric of the US. With the generous financing deal offered by China Development Bank and a group of other Chinese banks, the discount was in fact closer to 60 per cent.

Welcome to a new era of globalisation, China-style. As the financial crisis recedes, one of the big fears is that the process of increasingly closer links among big economies worldwide will go into reverse as governments and countries look inward. The message coming from the world's second-largest economy for the past year has been clear: China wants to accelerate the integration of the global economy, but on its own terms.

Over the past few decades, China has benefited hugely by hitching itself to a process of globalisation where the rules were written in Washington and the American consumer was the buyer of last resort. China prospered by making first the socks, then the washing machines and finally the iPods sold at Walmart.

Coming out of the crisis, China wants to forge a new phase of globalisation where many of the roads – financial, commercial and perhaps eventually political – converge on Beijing. China is not seeking a rupture with the international economic system (although some foreign companies are fearful of a technology grab). But it is looking to mould more of the rules, institutions and economic relationships that are at the core of the global economy. It is trying to forge post-American globalisation.

In recent years, a range of important countries have found that China rather than the US is their principal trading partner, from neighbouring Japan and South Korea to commodity-

rich Australia and Brazil. At times over the past year, Chinese imports of oil from Saudi Arabia have exceeded Riyadh's shipments to the US.

With the help of its considerable financial firepower, China is deepening these links. Beijing is establishing trade relationships that allow it to sell not just clothing and consumer products but more sophisticated goods such as power equipment. Its banks are helping to expand infrastructure and energy supplies in other developing countries in ways that will accelerate their growth, boost two-way trade and bind them closer to the Chinese economy. Beijing is also looking to establish a role for its currency in the international monetary system, in part at the expense of the dollar.

"China will boost its role at the centre of a growing web of economic and financial connections. These links are gradually, but inexorably, integrating east Asia," says Evan Feigenbaum, head of the Asia practice at Eurasia, a consultancy. "China will continue to seek to reshape the region's trade and investment architecture, largely on a pan-Asian basis and without the US." It is not just Asia: Africa, Latin America and the Middle East are all being touched by China's global push.

Central to a great deal of this activity is China Development Bank, which has become the financial muscle in the country's overseas drive. In the energy sector alone, CDB has awarded loans to other developing country governments or companies of more than $65bn in the past two years, according to Erica Downs at the Brookings Institution in the US. Including China's EximBank, Beijing has made more than $110bn in long-term loans to developing countries over that period, a number that exceeds the World Bank's lending.

Development by design

Run by Chen Yuan – son of Chen Yun, one of the country's most powerful officials in the 1980s – CDB is a unique hybrid of the Chinese party-state: a "policy" bank whose mission is to assist the development goals of the nation but which has managed to forge an enviable record of profitability and commercial savvy. When Mr Chen took the helm in the late 1990s, CDB's lending had been so abused by local governments that its bad debt ratio approached 43 per cent. Last year Dragonomics, a Beijing consultancy, described it as "China's best-managed bank".

Ahead of the crisis, Mr Chen flirted with several big investments in western banks (and CDB did buy a small stake in Barclays of the UK). But over the past two years, he has thrown the bank's weight behind investments in other developing countries, especially those that are energy or commodity-rich. "Everybody is saying we should go into the market and buy up low-priced [financial] assets," he told an interviewer last year. "But I think we should be thinking about partnerships in natural resources."

To organise its global push over the past decade, CDB designated each of its branches as having responsibility for a different part of the world. The Henan branch thus took on southern Africa and the Chongqing office was told to develop contacts in the Balkans. By

the end of 2009, the bank had teams in 141 countries, including all but a handful of Africa's 50-plus nation states.

In a book about his experiences working overseas for the bank, Shi Jiyang recalls looking at a map of the world in his office in Shenzhen in 2006 and wondering if he would ever get a chance to visit South America: a month later, he was sent there to find new business. "South America is going to be the hot spot for Chinese investment in the coming 10 years," he writes. "Entrepreneurs who want to 'challenge the blue ocean' should be ready to go to South America."

In the process, CDB and EximBank have operated at a scale and speed that cannot be matched by most other financial institutions. Brazil's Petrobras signed a $10bn loan agreement with CDB in 2009, shortly after agreeing with the US Ex-ImBank on a $2bn line of credit. According to José Sergio Gabrielli, Petrobras chief executive, it was considerably easier to secure credit from the Chinese than the Americans. The US needs to think much more about its strategic interests, he adds.

Some of these loans are helping to accelerate the integration of the rest of Asia with China through energy and infrastructure projects – such as oil pipelines from Russia, Kazakhstan and Burma, which are under construction or already operating, or railway lines linking Vietnam, Laos and Burma with south-west China.

In the Reliance case, the combination of low-cost finance and competitive Chinese manufacturing is helping India to expand its creaking energy network faster than would otherwise have been possible – and has enabled Mr Ambani to gain an edge over more cautious rivals. Reliance Power is buying 30,000 megawatts of boiler, turbine and generator packages, which Shanghai Electric will provide over three years. Banks in India are reluctant to lend beyond five to seven years but Reliance has won terms as long as 12 years under the China deal. Reliance Communications, another of Mr Ambani's companies, is using a $1.9bn loan from Chinese banks to pay down more expensive Indian debt.

Chinese policymakers see this sort of deal as the start of a powerful trend that will deepen integration with the rest of the developing world. "China is now working closely with all these fast-growing emerging market economies and I see a big future," says Li Daokui, an adviser to the People's Bank of China, the central bank. "All the forces are working in the same direction. They have resources and need capital. We have extra capital to invest. So why not?"

Beijing's global push is helping to open new markets for Chinese goods and also serves a broader strategic goal for Beijing, reducing dependence on the US. The American consumer may still be one of the main driving forces in the global economy, but about half of China's exports now go to developing countries. The big ticket loans also further China's efforts to diversify foreign exchange reserves away from the dollar.

Some of China's post-crisis objectives represent a more explicit challenge to US leadership of globalisation. Take, for instance, China's long-term plans to internationalise its currency, which have been sharply accelerated over the past year. The immediate goal is to make the renminbi the main currency for trade in Asia, reducing costs for Chinese exporters. Some of the loans to Mr Ambani's empire are in renminbi – with the Chinese offering to help hedge the currency exposure.

But among Chinese officials and scholars, there is a widely held view that the US has been abusing its position as controller of the main reserve currency by pursuing irresponsible economic policies. Nor do they hide the underlying geopolitical objective of the currency push – to place limits on the role of the dollar in the international monetary system. "The financial crisis ... let us clearly see how unreasonable the current international monetary system is," Li Ruogu, head of China EximBank, said last year. Jiang Yong, at the China Institutes of Contemporary International Relations, puts it more starkly: ending US dominance of the monetary system is "as important as New China's becoming a nuclear power".

Risks and roadblocks

Yet several obstacles could derail this new phase of China-led globalisation. For a start, India and many other developing countries are aware of the risk of being steamrollered by China's manufacturing machine, especially when it is bolstered by a quasi-mercantilist economic strategy that keeps the Chinese currency undervalued against those of many of its emerging peers.

One Indian executive reflects that his country ships plastic pellets to China that are then made into buckets. If India cannot even make plastic buckets competitively, he implies, its battle will be tough.

Dilma Rousseff, Brazil's new president, has meanwhile indicated that one of her first priorities will be holding talks with China about its currency and trade policies. "This is an issue not only for Brazil but for all emerging countries," says Fernando Pimentel, her new trade minister.

China's investment largesse also risks sparking a backlash. In some resource-rich nations, such as Australia, its form of state capitalism raises fears that the mining sector will be the Trojan horse that leads to Beijing's control of commodity prices. In Africa, where China has done deals with some of the weakest governments, there are signs of a backlash by groups protesting at corruption or poor working conditions. "Western companies [in Africa] have cleaned up their act in the past decade, but China is turning the clock back," says Paul Collier, an Oxford Africa expert. "It is no defence to say: 'You plundered the poor, so now it is our turn'."

Perhaps the biggest risk to China's ambitions lies in the security tensions they are provoking in its own backyard. Just as quickly as Asian countries are integrating with

China's economy, they are also rushing into the arms of the US for military protection against a more assertive Beijing.

Vietnam invited the US navy to hold a joint drill in the South China Sea last summer. During a bruising diplomatic dispute between Japan and China in the autumn after the Japanese coast guard arrested a Chinese fishing boat captain, China appeared to halt exports of rare earths to Japan. For the rest of Asia, it was a chilling reminder that their economic links with China could leave them exposed if they have a political falling-out with Beijing.

For all the economic optimism coursing through Asia at a time when much of the developed world is still struggling, it is worth reflecting on another important difference: while defence spending is under pressure in the west, in Asia it is rising strongly. China is the reason for that, too.