EUROPE AND ASIA: FINANCIAL CONNECTIVITY, RISKS CHALLENGES AND OPPORTUNITIES

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EURO-ASIAN CONNECTIVITY FROM EU ANGLE – FIVE MAIN DIMENTIONS:

- TRANSPORT
- ENERGY
- DIGITAL
- FINANCIAL
- HUMAN

TRANSPORT

- Diversified trade and travel routes linking existing and future transport networks
- Simplified customs procedures
- Shorter transit times

ENERGY

- More interconnected regional energy platforms
- Modern energy systems
- Environmentally friendly solutions.

DIGITAL

- Increased access to digital services
- Maintaining a high level of protection of consumer and personal data

FINANCIAL

- Innovative financing initiatives
- Leveraging sustainable financing for investments through creating opportunities for private sector participation
- Fiscal and financial stability through long-term planning and prudent management

HUMAN

- Advanced cooperation in
  - Education
  - Research
  - Innovation
  - Culture
  - Tourism

OBOR

China's broadly sketched vision

vs

Treaty-based integration concepts where the geographical scope, partner countries, strategy, principles and rules were clearly defined at the outset

Boosting regional integration in China's wider neighbourhood

OBOR: PERCEPTIONS AND REACTIONS - MIXED

- Attractive idea of enhancing connectivity, given the huge infrastructure gaps across Asia
- Skepticism regarding China's potential hegemonic ambitions

FLEXIBLE, OPEN AND INCLUSIVE COOPERATION FRAMEWORK WHICH DOES NOT SEEK CONFORMITY BUT ENVISAGES DIVERSIFIED MODES OF COOPERATION TO ENABLE ALL OBOR COUNTRIES, BOTH DEVELOPED AND DEVELOPING, TO COOPERATE WITH GREATER PARITY

- **Policy coordination** (based on established or new bilateral or multilateral mechanisms)
- **Facilities connectivity** (building and upgrading overland and maritime transport, energy and communication infrastructure)
- **Trade facilitation** (simplifying customs clearance systems and quarantine processes; improving market access and eliminating trade barriers; simplifying foreign investment procedures; and creating more free trade zones. For the moment, this does not require the drafting of standard foreign trade agreements or the establishment of more elaborate forms of regional integration (customs union, common market, economic integration, and economic and political integration)
- **Deepening financial integration** (involving China-supported multilateral financial institutions and including the promotion of the Chinese currency in bilateral trade)
- **People-to-people exchanges**

OBOR SCALE

- potentially 65 countries
- 4.4 billion people
- roughly 65% of global economy
- 70% of global population
- 75% of known energy reserves
- 75% of global tourism

OBOR – TRYING TO CREATE FRAMEWORK FOR MULTILATERAL INSTITUTION-BASED COOPERATION

- Asian Infrastructure Investment Bank (AIIB) - China led institution
- European Bank for Reconstruction and Development (EBRD) - China's membership since January 2016
- European Investment Bank (EIB) - opening of an office in Beijing
- ADB

CHINA'S INJECTIONS OF CAPITAL INTO OBOR

- US$40 billion New Silk Road Fund
- US$20 billion China-ASEAN Investment Cooperation Fund
- US$3 billion Investment Cooperation Fund between China and the CEE countries
- US$746 billion - China's sovereign wealth fund
- Financial backing from China's policy banks: Export-Import Bank of China (EXIM), China Development Bank (CDB) and Agricultural Development Bank of China (ADBC)

FEARS AND SKEPTICISM OVER OBOR

- Analysts have pointed to the emergence of a new Sino-centric regional order as part of the 'rejuvenation of the Chinese nation'. The 'Chinese Marshall Plan' risks prolonging China's state capitalism, with Chinese SOEs and state-owned policy banks playing a major role in OBOR's implementation, even though China pledged to allow the market to play a 'decisive role' in resource allocation

OBOR'S ECONOMIC SIGNIFICANCE FOR CHINA

OBOR coincides with China's comprehensive economic reforms which seek to rebalance its economy towards the 'new normal' of lower yet more sustainable growth. The economic transition from a growth model driven mainly by exports and foreign direct investment (FDI) to one led by domestic consumption, innovative industries and services, has led to an economic slowdown which could derail into social instability following rising unemployment. Since the CCP's legitimacy is nowadays inextricably linked to the delivery of economic growth, OBOR's economic dimension consists in generating substantial foreign demand, notably for products manufactured by the heavy industries, which are being restructured in order to meet China's growth targets

OBOR'S GEOPOLITICAL SIGNIFICANCE FOR THE EU

- OBOR-induced investment and trade relations between China and countries in Eurasia, Africa and the Middle East are likely to result in China's growing political and economic leverage on these countries. What impact this will have on the EU's long-term geopolitical, economic and geostrategic interests will also depend on whether the EU responds to OBOR with one voice and coordinated policies.

OBOR'S ECONOMIC SIGNIFICANCE FOR THE EU

It could be advantageous for the EU to consider how its existing policy tools and strategies, such as the European Neighbourhood Policy (ENP) and the EU Maritime Security Strategy, could be linked with OBOR and how this strategic alignment could feed into the EU's new Global Strategy for Foreign and Security Policy which came out on 29 June 2016

GRADUAL CLOSING OF THE GAP

China's strong interest in investing in EU connectivity initiatives and in seeking synergies between them and OBOR, as voiced at the 2015 EU-China summit, could be a turning point. With the launch of the EU-China Connectivity Platform, the EU has created a common framework for European cooperation with China on OBOR with a view to defining cooperation strategies, plans and policies and to clarifying the rules and principles governing joint projects including governance and rule of law issues. As OBOR is a 'moving concept', it provides the EU with an opportunity to take part in shaping the agenda jointly with China and deepen EU-China relations

ASEM SUMMIT: EUROPE AND ASIA – GLOBAL PARTNERS FOR GLOBAL CHALLENGES

Brussels, 19 October 2018

President Jean-Claude Juncker: "Only a multilateral approach will enable us to confront global challenges. This is why I reiterate our commitment to support multilateral organisations in all their efforts, including the United Nations and the World Trade Organisation – a World Trade Organisation that we have to reform together, so that its rules correspond better to the new realities.

SUSTAINABLE CONNECTIVITY BETWEEN EUROPE AND ASIA

High Representative/Vice-President, Federica Mogherini at the Summit's press conference. "We come out of this two-day Summit with a reinforced global partnership between Europe and Asia. It has allowed us to translate our global weight into concrete policy initiatives – on regional and international security, foreign policy issues, climate change action, free and fair trade, and the digital agenda to name a few. Together, we can make a real difference for the world."

THE EUROPEAN UNION HAS ADOPTED A NEW STRATEGY ON CONNECTING EUROPE AND ASIA

Developing connectivity which is:

- Sustainable (economically, fiscally, environmentally and socially sustainable, open and inclusive, with high standards of transparency and good governance)
- Comprehensive (covering transport, energy and digital links as well as people-to-people connections
- Rules-based (level playing field, including in public procurement, and equal access for businesses while protecting intellectual property rights)

Advancing investment and trade based on:

- Upholding international law, multilateralism, transparency and accountability
- High standards of social and environmental protection
- Respect for individual rights

EU should pursue cooperation with partners on resource mobilisation and debt sustainability. It should strengthen its mechanisms for financing sustainable connectivity, fostering private and public investment, in close cooperation and coordination with its Member States and their public and private financial institutions and Multilateral Development Banks.

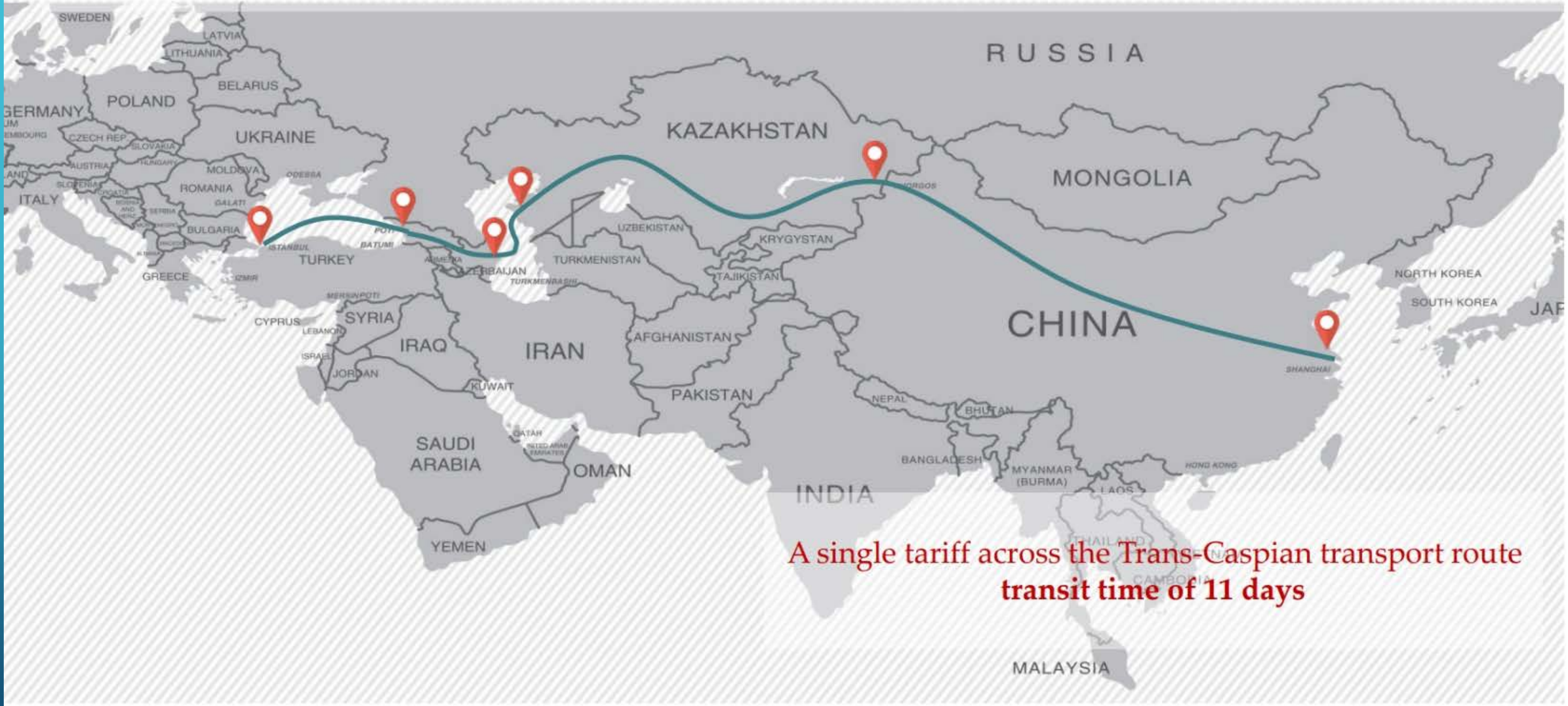
- The Council also underscores the link between the financial aspects of connectivity and the regional and global financial architecture. The Council supports strengthening the EU's cooperation and coordination with Multilateral Development Banks, in close collaboration with the Member States which already participate in those institutions. Alongside the European Investment Bank and the European Bank for Reconstruction and Development, the International Monetary Fund, the World Bank, the Asian Development Bank and the Asian Infrastructure Investment Bank are all of importance.
- The Council believes that strengthened cooperation between European public and private financial institutions and their counterparts in Asia will result in better corporate governance and higher lending standards, which would bring tangible benefits to lenders and debtors alike. More sustainable finance could also help maximize positive impact on society and help address issues such as climate change

Whether OBOR will be mutually beneficial for China and the EU will depend on the two sides agreeing on the 'rules of the game', including for joint projects in third countries. Potential synergies between OBOR and the EU connectivity initiatives are being explored under the EU-China Connectivity Platform

MACROECONOMIC IMPLICATIONS OF OBOR

OBOR is an enormous opportunity for small open economies, like Georgia, and many others in the Caucasus and Central Asia (CCA), those that represent middle corridor of the BRI, which we call Europe-Caucasus-Asia International Transport Corridor or TRACECA corridor

In 2015 Georgia became a founding member of the Asian Infrastructure Investment Bank (AIIB)



A single tariff across the Trans-Caspian transport route
transit time of 11 days

INFRASTRUCTURAL PROJECTS FOR ACCELERATING TRADE FLOWS IN THE REGION. ATTRACTING CAPITAL TO DEVELOP LOGISTICS AND TRANSPORTATION INFRASTRUCTURE, AMONG THEM:

- Construction of Anaklia Deep Sea Port that has been started in 2018
- Construction of Baku-Tbilisi-Kars Railway line, final stage
- Railway Modernization, which is going to finish in 2019
- East-West Highway Construction – to be finished in 2021
- Development of Modern Logistics Centers in Tbilisi and Kutaisi, the first and second largest cities in Georgia

OPENNESS FOR TRADE: ONLY COUNTRY IN THE REGION WITH FREE TRADE AGREEMENT SIMULTANEOUSLY WITH CHINA AND DCFTA AGREEMENT WITH THE EU

- Cohesion and coherence – main precondition for trade to become driver of growth in the region
- the latest research shows, the trade openness and participation in the global value chain of CCA countries have significant impact on economic growth. Current non-oil export of these countries is only $500 per capita on average, which is half of the level of non-oil export in emerging market and developing economies

FISCAL FRAMEWORK

- Countries have to finance large infrastructural projects through external sources that will accelerate capital inflows, achieve higher economic growth, but also have fiscal implications:
  - temporarily drive external debt upward;
  - larger external borrowing can cause higher risk premium
  - more vulnerability to shocks

(note – Georgia not at risk so far)

EFFICIENCY OF INVESTMENTS

- improvement of public investment efficiency
- Creating / revamping sound PPP framework to engage private sector

Addressing efficiency gaps will also enable countries to achieve better fiscal stance

NEED FOR FISCAL DISCIPLINE

Large infrastructural projects put pressure on the budget deficit and an exit strategy from this policy is essential since this will have implications for growth prospects and economic volatility as well. Therefore, although the need for public spending is high, countries still need to be cautious in order to maintain budget deficit on a sustainable level over the medium and long run

MONETARY POLICY FRAMEWORK

- Flexible exchange rate regime
- Free movement of capital
- Appropriate macroprudential measures
- In contrast, resistance to nominal exchange rate appreciation through FX interventions and capital control measures does not seem to have been successful in practice

Flexible exchange rate regime has served Georgia well, as we saw it during the last external shock in 2015, when after the drop in commodity prices many of our trading partner countries experienced economic slowdown that translated into a sizable negative demand shock. With flexible exchange approach, we recovered from the shock with limited losses. Georgia did not experience the contraction of the economy, just a moderate slowdown in economic growth and inflation being reasonably close to the target. Talking about flexibility of the exchange rate, it should also be mentioned that, together with free capital mobility, it is one of the main pre-requisites to deepen trade relations within the region

HEALTHY FINANCIAL AND BANKING SECTOR

- Prudent regulatory and supervisory framework
- Coping with high dolarisation
- Reducing open FX position in balance sheets of households, firms and banks

TO EXPLOIT FULL BENEFIT FROM LIBERALIZATION OF CAPITAL FLOWS AND TO BE A RESPONSIBLE PLAYER IN THE VALUE CHAIN, COUNTRIES SHOULD:

- Pursue sound macroeconomic and financial policies
- Promote credible institutions
- Establish attractive investment climate

Result: “soft landing” during and after the OBOR-related capital flows

CHRISTINE LAGARDE: OBJECTIVE THAT LIES AT THE HEART OF THE *BELT AND ROAD INITIATIVE*:

Harnessing the resources of governments, investors, financial institutions, and ordinary citizens requires a financial system that works for *all*

How can governments achieve this common goal?

Three policy priorities:

FIRST: STEP UP EFFORTS TO ATTRACT FOREIGN DIRECT INVESTMENT IN HIGH-QUALITY INFRASTRUCTURE

- The good news is that there is a large pool of institutional funds—about $120 trillion in global assets under management. But only a tiny fraction of that is allocated to infrastructure in developing countries, where projects are often seen as too risky.
- In 2017, emerging and developing countries received net foreign direct investment inflows of less than **1 percent** of their combined GDP, down from **2 percent** before the 2008 financial crisis. These countries can reinvigorate FDI inflows by pursuing sound macroeconomic policies, by increasing their openness to trade, and by improving their business and regulatory environment.

THE SECOND POLICY PRIORITY IS TO PUSH FOR MORE FINANCIAL INCLUSION , ESPECIALLY IN DEVELOPING ECONOMIES

By expanding Micro and SME access to financial services—by sharing the benefits of finance more widely—growth will be stronger, more durable, and more inclusive

THE THIRD POLICY PRIORITY IS TO HARNESS THE POWER OF FINANCIAL TECHNOLOGY, OR FINTECH

- A good example is the rapid growth of mobile banking, which has boosted the economic wellbeing of hundreds of millions of citizens—from Bangladesh, to Kenya, to Peru. In China—in cities like Beijing and Hangzhou—people can live without cash by using online payment platform such as Alipay and Wechat.
- Another example is the rapid increase in **cross-border payments** based on **virtual currencies.** For many companies and households, this is a faster and cheaper way of transferring money overseas.
- These benefits are significant—but so are the challenges, including the risk of money laundering and terrorist financing. Fintech providers, financial regulators, central bankers, and international organizations will need to work together to ensure that financial systems are safe and inclusive

- IMF analysis shows that having a more inclusive financial system makes it safer—and more beneficial—to relax restrictions on capital flows across borders . By liberalizing their capital account over time, countries can attract more foreign investment, increase the liquidity of local financial markets, and reduce their cost of capital.
- In other words, by developing deep, well-regulated financial markets, countries can better mobilize domestic and international resources for investment—while reducing the financial stability risks that come with large capital inflows.
- Debt sustainability, macroprudential policy, managing capital flow volatility

- Connecting Europe and Asia – Building blocks for an EU strategy - Council conclusions (15 October 2018)
- Briefing for European Parliament on One Belt, One Road (OBOR): China's regional integration initiative (July 2016)
- Joint Communique of the leaders roundtable of the Belt and Road Forum for International Cooperation (16 May 2017)
- The European way to connectivity – a new strategy on how to better connect Europe and Asia (19 Sept. 2018)
- Belt and Road Initiative: Strengthening Financial Connectivity Christine Lagarde, IMF Managing Director, Belt and Road Forum, Beijing (14 May 2017)
- Koba Gvenetadze: Macroeconomic Implications of the Belt and Road Initiative (12 March 2018)