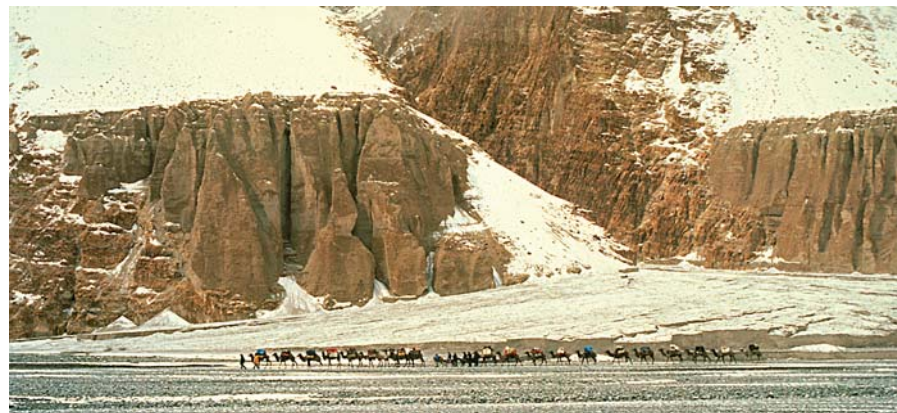


# From Tbilisi to Tianjin: Bookends of the New Silk Road

By Robert Jutson, Managing Director, Griffin Capital Partners

*The “New Silk Road” describes a web of trade routes crossing borders between Europe and Asia, much as they did in Marco Polo’s day. These multiple interconnected road, rail, pipeline and fiber optic networks span the Eurasian continent from China’s Bohai Bay to Georgia’s Black Sea ports. Landlocked Central Asian states and China share a common interest in access to westward markets by corridors free of interference by any sovereign. Investors will find a compelling destination in the offerings of dedicated funds and infrastructure project sponsors serving the dynamic, growing nations along this ancient and enduring trade route.*

Spanning thirteen time zones, the Eurasian continent is home to many of the world’s fastest growing and increasingly prosperous nations. This is due to rapid industrialization, increasing urbanization and dramatic increases in labor productivity and population growth, all of which weigh heavily on aging and inadequate infrastructure. The result is urban congestion, power outages, and lack of access to safe water and roads with adverse long term consequences for health, safety and the environment.



*“The earth’s economic center of gravity is shifting back to Asia at a pace never before witnessed.”*

– McKinsey Global Institute 2012

Infrastructure is the physical foundation of sustainable economic growth. Project finance is an established risk management technique for commercial enterprise and governmental agencies to fund long-lived, capital intensive infrastructure without exposing their balance sheet or agency budget. When properly implemented, project finance can generate premium risk-adjusted returns for infrastructure investors and deliver prosperity and a better life for all.

## BACK TO THE FUTURE

By the mid-16<sup>th</sup> century, Asia was the center of the world’s economy, accounting for roughly 2/3 of global GDP. Excessive tolls and capricious impositions by khanates along the Silk Road land routes (combined with their inability to provide security), and advances in navigation and marine technology, had by then compelled Europeans to secure commerce with India and China by sea.

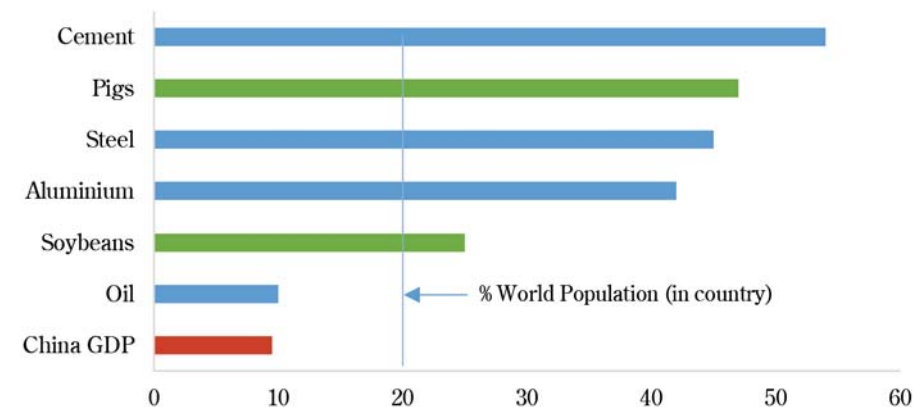
During the 18<sup>th</sup> and 19<sup>th</sup> centuries, urbanization and industrialization propelled the center of the world’s economic activity away from Central Asia toward Europe and the United States. As dramatically illustrated by McKinsey ([http://www.mckinsey.com/insights/urbanization/urban\\_world](http://www.mckinsey.com/insights/urbanization/urban_world)), we’re witnessing a decisive reversion of global economic momentum toward Asia, at a speed and on a scale never before witnessed.

Today, China’s economic transformation through urbanization and industrialization is happening at 100 times the scale of Britain’s industrialization in the 18th century and at ten times the speed. According to McKinsey, of the seven thousand new large companies (>\$1 billion revenue) expected to emerge in the next ten years, seven out of ten will be in emerging regions.

## MANY TRAVELERS, MANY ROADS

Just as America’s transcontinental railways catalyzed a national economy 150 years ago by linking ports on its Atlantic and Pacific coasts, the web of Eurasian land trade corridors will link the Mediterranean with the Western Pacific. These corridors will fundamentally re-configure global trade and commerce, shifting the focus of trade and geopolitical strategy to the

China’s % of Global Consumption vs. GDP (2013)



Source: Jeremy Grantham, GMO LLC (2013)

Eurasian landmass from the waters surrounding it. Land transit routes for energy and goods will diminish the threat to Eurasian trade of Pacific blue-water navies, reducing the effectiveness of any naval blockade of the Malacca Strait or South China Seas. The resulting trade liberalization and economic cooperation among connected nations will lead - in the words of President Xi Jinping - to “a sense of common destiny” among China’s neighbors and “answer the call of our time for regional and global co-operation”.

According to Goldman Sachs, as China has grown much faster than the rest of the world, so export markets have less value as a portion of Chinese GDP. While the rest of the world was roughly 28 times China’s GDP at market exchange rates in 1985 and 12 times China’s in 2000, it’s only 5 times larger now. Clearly, serving domestic demand driven by a growing middle class has become a priority of Chinese enterprise and the nation’s leaders.



Ghori Cement Plant, Baghlan Province, Pol-e-Khomeri District, Afghanistan

China’s “New Silk Road Economic Belt” is an economic and security program enunciated by President Xi during his tour of the Central Asian republics in October 2013. It describes various initiatives to open a land route between China and Europe to supplement sea lanes which might be threatened or closed. According to recent Congressional testimony by Professor S. Frederick Starr of the Central Asia Caucasus Institute: “The program systematizes and packages under a single heading and administrative body what China has been doing through diverse channels since the collapse of the USSR in 1992. Moreover, it elevates transport to the level of a geopolitical project of prime importance.” It is nothing less than a well-funded transcontinental program of “infrastructure diplomacy” with railroads, pipelines, and roadways.

Much of this activity anticipated China’s dramatic shift to a consumer driven economy from one driven by exports.

The geographic extent of President Xi’s “common destiny” includes the “India-Europe” Southern Corridor through landlocked Uzbekistan, resource rich Afghanistan and on to dynamic India and its numerous ports serving customers worldwide.

China’s participation in the Southern Corridor recently received America’s blessing when Deputy Secretary of State Antony Blinken announced: “We see an important role for China in supporting the transition in Afghanistan and advancing its own integration into the broader Asia region.”

Landlocked Afghanistan remains a challenging venue for all comers, and the Chinese are no exception. When we advised an international resource developer tendering for the Ghori III brownfield Afghan cement project in 2013, it became evident state-owned China Metallurgical Group sought to renegotiate the terms of a US\$3 billion contract it signed in 2007 (to mine Afghanistan’s largest copper deposit at Mes Aynak, south of Kabul) and stop building related infrastructure.

*Around 20-30 million Chinese relocate to urban areas [within China] each year, roughly equivalent to one-tenth of the United States’ population from the late 1960s up until the turn of the 21st century.*

- FT Alphaville, Goldman Sachs “Contextualising China’s cement splurge”, 22 October 2014

There are few more powerful symbols of the eastward drift of global power than the decision by America’s allies to join the Asian Infrastructure Investment Bank. After the United States pronounced the AIIB “off limits”, it was a major achievement when Britain, Germany, Australia, France, Italy, Austria and Luxembourg signed up. The rush by Europeans - and Taiwan - to join the AIIB demonstrate how much more nuanced China’s diplomacy has become as it parlays its economic stature into greater influence abroad.

*Landlocked Central Asian states and China have a shared strategic interest: a land route to western markets free of any single sovereign control to deliver large volumes of middle-weight goods in the event southern sea-lanes are threatened with closure*

China’s AIIB initiative does not imply any one nation controls Eurasia’s east-west land trade and transit. We should not view the AIIB as a covert means to extend Chinese suzerainty or establish a system of tributary relationships with Central Asian states. Many billion dollar projects were completed or underway years ago, funded by multilateral institutions, independent states and private companies. In total, completed projects exceed China’s AIIB commitment and thus represent a high degree of multi-national participation, active cross-border cooperation, management and a desire to maintain the status quo. This consensual state of play benefits all who rely on open borders and international customs and trade conventions such as the WTO, the Eurasian Economic Community Customs Union or the International Road Transport Union.

The AIIB is more akin to the Andean Development Corporation than a Chinese attempt to rival established development institutions like the ADB, World Bank/IMF or the EBRD. It’s also a natural and considered response to opposition by the US Congress to any increase in China’s capital contribution (and thus voting rights) at the World Bank. This response is consistent with China’s rank as the world’s second largest economy. India too has noted the erosion of the post-Bretton Woods consensus as it seeks a greater voice in global institutions.

**CAPTURING GROWTH:  
INFRASTRUCTURE INVESTMENT**

How can portfolio and inbound direct investors participate in the growth of Eurasian economies?

Many opportunities are on offer in transportation, energy, basic industries, telecommunications or soft infrastructure such as hotels. We find some of the most attractive long-term opportunities emphasize the following:

- Increase efficiency: Upgrade, improve or replace existing generation and production facilities. Such brownfield development does not require additional land, a critical bottleneck in planning consent and regulatory approval, particularly in India;
- Distribute power production capacity: Install “packaged” private power stations, a booming sector in India’s chronically unreliable electricity sector;
- Upgrade power transmission networks to enable “smart grid” distribution;
- Increase quality, durability and strength of basic construction materials (cement and ferroalloys); and
- Improve, apply and consistently enforce regulations of construction trades and industries.

Investors may participate in such programs directly or through dedicated funds, private equity or through collective schemes or multilateral institutions such as the World Bank, IFC, EBRD and ADB.

Pipelines for gas and oil – and fibre optic cable networks – are enduring examples of pragmatic, transnational development of infrastructure. They enable resource developers and communication service providers to serve the growing commercial demands of Eurasian economies.

Last year, Turkmenistan and Turkey signed a framework agreement to supply gas to the proposed Trans-Anatolian natural gas pipeline project (TANAP), which will ship gas from Azerbaijan’s vast Shah Deniz II field in the Caspian Sea.

Turkmenistan currently exports around 30-35 billion cubic meters of gas to China annually, a figure set to double by 2020. The 1,735 km TAPI pipeline will to transport gas along a southern route from Turkmenistan to Afghanistan, Pakistan and India.

Russia’s annexation of Crimea has added urgency to the EU’s search for gas from new sources. Russia currently provides about 29 percent and 37 percent of Europe’s natural gas and oil, respectively. Filling alternate pipelines is the job of national oil and gas companies, IOCs, and oilfield services companies. Griffin Capital recently advised Eurasian oilfield services clients operating in the United Arab Emirates, Turkmenistan, Kazakhstan and the Caspian Shelf.

Fibre optic cables have long been an essential “third leg” of global telecoms redundancy along with terrestrial and satellite communications networks. Linking secure land-based fibre networks enables Eurasian states to bypass submarine networks landing on shores monitored by outside parties. Over a decade ago, Antel Holdings Ltd., then controlled by Group Menatep, agreed to buy the Central European assets of KPNQwest, then Europe’s largest fiber-optic data network. Widespread anxiety about data integrity and vulnerability last year compelled Brazil and Portugal to lay a subsea cable bypassing US and UK shores. Linking Eurasia’s national fibre optic networks could achieve a similar secure outcome.

**SOFT INFRASTRUCTURE**

All of these networks and projects support interconnected communities and sustain their growth. They encourage local private sector “soft infrastructure” sponsors to develop and support long-term employment in high paying jobs in engineering, construction services, logistics, intermodal shipping and storage, communications, technology, hotels and hospitality, banking, insurance as well as legal, financial and accounting services.



Griffin Capital’s soft infrastructure clients reach the “bookends” of the New Silk Road and include project sponsors of the Renaissance Tianjin TEDA Hotel in China’s Tianjin Economic Development Area and Georgia’s Tbilisi Marriott Hotel.

*The foundation of a successful infrastructure project is a well-conceived financing program. Based on our decades of experience in the region, we know what investors seek. Infrastructure projects which support and sustain domestic markets along the “New Silk Road” can, if well-structured, attract global investors worldwide and ensure a successful outcome for all.*

*Griffin Capital Partners is a specialist project finance advisor with 20 years of experience advising enterprises across Eurasia including Russia, China, India, Kazakhstan, Kyrgyzstan, Uzbekistan, Afghanistan, Ukraine, Georgia and the EU. We provide strategic advice to our clients and develop and implement funding strategies for their projects, acquisitions and dispositions.*

*Learn more at: <http://www.griffincap.com> or contact us at: [partners@griffincap.ch](mailto:partners@griffincap.ch)*