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On March 21, the Central Committee of the Communist Party of China released a plan on deepening the reform of Party and state institutions. This is a move to give shape to the principle of "ensuring Party leadership over all work," as presented at the 19th CPC National Congress. At the third plenary session of the 19th CPC Central Committee held at the end of February, which is an unusual timing, the reform was explained as "modernizing China's system and capacity for governance" and offering a guarantee and creating conditions for achieving two centenary goals. The presence of the CPC Central Committee under the general secretary will further increase compared to the State Council and other bodies.

News from the China Advisory Division	Potential for Sino-Japanese Collaboration on the Belt and Road Initiative

Moves among Japanese companies seeking to participate in Belt and Road Initiative infrastructure projects are on the up. Chinese authorities have given top priority to the national strategy and awarded infrastructure contracts with no regard for cost, however there are signs that they are reviewing their policy; experts, too, are emphasizing the importance of ensuring that such projects are marketable. The wave of positive opinion on tie-ups with foreign companies is also beginning to spread. This report examines the potential for collaboration between Japanese and Chinese companies on third-country infrastructure projects and explores the various schemes available on the assumption that such collaboration is feasible.

Economic Policy in the Post-reform of Party and State Institutions

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On March 21, the Central Committee of the Communist Party of China released a plan on deepening the reform of Party and state institutions (hereafter referred to as the "institutional reform plan"). This is a move to give shape to the principle of "ensuring Party leadership over all work," as presented at the 19th CPC National Congress. At the third plenary session of the 19th CPC Central Committee held at the end of February, which is an unusual timing, the reform was explained as "modernizing China's system and capacity for governance" and offering a guarantee and creating conditions for achieving two centenary goals.

・Embodying the principle of "ensuring Party leadership over all work"

At the beginning, the institutional reform plan states that a strong institutional guarantee will be offered for achieving China's dream of national rejuvenation, led by stronger Party leadership over all work.

The latest reform is the embodiment of the principle of "ensuring Party leadership over all work" presented in Xi Jinping's report to the 19th National Congress of the CPC (hereafter referred to as the "19th NCCPC") held in October 2017 in the form of "reform of Party and state institutions." In his report, Xi Jinping pledged to firmly maintain Party leadership in all areas of work and to establish a more-perfect structure and mechanism to achieve this, by saying, "The Party exercises overall leadership over all areas of endeavor in every part of the country," rendered in Chinese as "党政军民学、东西南北中、党是领导一切的." This is an expression used by Mao Zedong.

・"Improving China's governance level and capacity"

The institutional reform plan was adopted by the third plenary session of the 19th CPC Central Committee (hereafter referred to as the "third plenary session"), which was closed on February 28. A third plenary session is usually held in the autumn of the following year of the CPC National Congress, and various important reform policies have been decided at past third plenary sessions, including: the "four modernizations" decided at the third plenary session of the 11th CPC Central Committee in 1978; the CPC Central Committee's decisions on a number of problems regarding the establishment of a socialist market (50 articles) adopted at the third plenary session of the 14th CPC Central Committee in 1993; and the CPC Central Committee's decision on major issues concerning comprehensively deepening reforms (60 items) adopted at the third plenary session of the 18th CPC Central Committee in 2013. "Deepening reform of Party and state institutions" endorsed by the latest third plenary session could be positioned as a turning point for China to: put an end to the separation of Party and state (separation of Party and government), which was promoted in the 1980s and 1990s in the 20th century; strengthen Party leadership over the government and other agencies; and improve governance capacity.

According to a communique issued at the end of the latest third plenary session, the goals of the deeper reform of Party and state institutions include "promoting coordinated actions and resultant forces among the people's congresses, governments, political advisory bodies, and supervisory, judicial and prosecutorial organs, people's organizations, enterprises, public institutions, and social organizations under the unified leadership of the CPC" and "improving China's governance level and capacity."

Furthermore, the communique called for "efforts to reform the institutional setting, optimize function disposition, and improve efficiency and effectiveness to provide an institutional guarantee to secure a decisive victory in building a moderately prosperous society in all respects," based on the realization of the first centenary goal of building a moderately prosperous society by 2021 when the CPC celebrates its centenary. In addition, the communique calls for focusing on achieving the second centenary goal of developing China into a great modern socialist country by the mid-21st century, or in 2049, the 100th anniversary of the People's Republic of China, placing emphasis on resolving long-term problems on structures and systems and creating favorable conditions for building a more-complete socialist system with Chinese characteristics.

・Institutional reform plan submitted to the National People's Congress

The institutional reform plan consists of eight parts and 60 items, covering a wide range of issues. The eight parts are: CPC Central Committee institutions (Part 1); National People's Congress (equivalent to the Japanese Diet, hereafter referred to as the "NPC," Part 2); reform of State Council institutions (Part 3); the Chinese People's Political Consultative Conference (CPPCC) National Committee (Part 4); the administrative law enforcement system (Part 5); military (Part 6); civilian organizations (Communist Youth League of China, All-China Federation of Trade Unions, Red Cross Society of China, etc., Part 7); and local institutions (Part 8).

Of the institutional reform plan, the "reform of State Council institutions" (Chapter 3) was adopted at the first plenary session of the 13th NPC. A State Council reform plan, which was unveiled on March 13, changed the names of four ministries and a commission to "Ministry of Natural Resources," "Ministry of Ecology and Environment," "Ministry of Agriculture and Rural Affairs," "Ministry of Culture and Tourism," and "National Health Commission" and newly created "Ministry of Veterans Affairs" and "Ministry of Emergency Management."

Subordinate institutions of the State Council were also restructured. Newly established institutions are as follows: a state market regulatory administration, a state radio and television administration, the China Media Group, the Banking and Insurance Regulatory Commission, the International Development Cooperation Agency, a state medical insurance administration, a state grain and reserves administration, a state immigration administration, a state administration of forestry and grassland, and the State Intellectual Property Office.

The reform of Party and state institutions is supposed to be carried out by the end of 2018, while the reform of local institutions will be completed by the end of March 2019.

・Three key areas discussed at the first meeting of the Central Committee for Financial and Economic Affairs

In Part 1 of the institutional reform plan, the CPC Central Committee's four central leading groups for deepening overall reform, cyberspace affairs, financial and economic affairs, and foreign affairs are transformed and upgraded so as to act as central committees. As for economic policy, in addition to the policies formulated by State Council institutions, the importance of policy decisions made by the Central Committee for Financial and Economic Affairs will obviously increase going forward.

The first meeting of the Central Committee for Financial and Economic Affairs was held on April 2. According to Xinhua, the meeting was presided over by General Secretary Xi Jinping, who concurrently serves as the chairman of the Central Committee for Financial and Economic Affairs. At the meeting, Xi Jinping made the following remarks: (1) "Preventing and defusing financial risks is relevant to national security, overall development, and the security of people's property, and is a key threshold that the country must cross to achieve high-quality growth"; (2) "The country has made progress in its fight against poverty, a battle that must be won"; and (3) "Environmental issues are a major concern for the public and are decisive to Chinese people's judgement of the success of building a moderately prosperous society in all respects." [Numbers added by the author] Xi Jinping again mentioned three key areas that he described as "three tough battles by 2020" at the 19th NCCPC.

At the meeting, the People's Bank of China (hereinafter referred to as the "PBOC" or "PBC"), the State Council's office of poverty alleviation, and the Ministry of Ecology and Environment presented reports.

(1) As for preventing and diffusing financial risks, they referred to: reducing the leverage ratio of local governments and companies, especially state-owned enterprises (asset compassion); promoting high-quality development, increasing total-factor productivity, and resolving problems through reform and development; having the Financial Stability and Development Committee (established in July 2017, with its first meeting held in November the same year) play its role; and better coordinating financial supervision at the state and local level with stronger responsibility of local governments for controlling local financial risks.

(2) As for targeted poverty alleviation, points regarding anti-poverty measures were specified from the five perspectives of: industry (combination between agricultural production and sales); displacement and relocation (consideration for industry and employment); working (creation of labor affairs organizations); education (increasing the quality of compulsory education); and health (reducing the burden of medical expenses).

(3) As for environmental issues, a policy of "four reductions and four increases in four structures" was presented, namely: (1) industrial structure: reducing outdated industrial capacity and increasing new growth drivers; (2) energy structure: reducing the use of coal and increasing the use of clean energy; (3) transport structure: reducing road transport and increasing rail transport; and (4) agricultural investment structure: reducing the use of chemical fertilizers and pesticides and increasing the use of organic fertilizers.

The meeting was attended by Li Keqiang, Wang Yang, Wang Huning and Han Zheng (members of the Politburo Standing Committee of the CPC Central Committee), while members of the Central Committee for Financial and Economic Affairs and the heads of divisions related to the CPC Central Committee and State Council institutions were present.

・Lectures delivered at the Central Committee for Financial and Economic Affairs communicated at a meeting of the CPC PBC Committee

On the following April 3, Guo Shuqing, who is the party secretary of the PBOC, presided over a meeting of the CPC PBC Committee, and communicated the spirit of important lectures at the Central Committee for Financial and Economic Affairs. According to the bank's website, Yi Gang, who is governor and deputy party secretary of the bank, and other committee members attended the meeting. At the meeting, they mentioned the following issues: (1) having the Office of the Financial Stability and Development Committee play its role and making clear timelines and route maps; (2) reducing leverage ratio and credibility risks in key areas with focus placed on supply-side structural reform, defusing shadow banking risks, and maintaining financial order; and (3) firmly maintaining the principle of marketization and law-based governance, having the market play its decisive role in resource allocation, and having the government play its role more strongly so as to definitely maintain minimum requirements for the prevention of systemic risks.

As mentioned above, policy lines have been communicated and decided through Party organizations, and other government bodies likely will do the same. The presence of the CPC Central Committee under the general secretary will further increase compared to the State Council and other bodies.

Potential for Sino-Japanese Collaboration on the Belt and Road Initiative

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1. Changes in the Political and Economic Environment surrounding the Belt and Road Initiative

China's Belt and Road initiative is drawing increasing interest in Japan. This was triggered by a statement from Japan's Prime Minister Shinzo Abe in June last year when he expressed Japan's readiness to cooperate with China on the Belt and Road initiative, albeit under certain conditions. In November, Abe met separately for high-level talks with both Chinese President Xi Jinping and Premier Li Keqiang and agreed that business-level cooperation between Japanese and Chinese companies in third countries would be beneficial to both nations within the context of the Belt and Road initiative.

In December, the Japanese government released guidelines encouraging Japanese firms to cooperate in the fields of energy conservation and the environment, advancement in industry (including industry parks and power infrastructure), and logistics (including a trans-continental railway linking Asia and Europe). The necessity of striving for close cooperation in third-country projects, including China's Belt and Road initiative, was also confirmed at a meeting of Japanese and Chinese businessmen and former government officials held the same month.

In January this year, however, the Chinese government expressed its intention to extend the Belt and Road initiative into Latin America at the second ministerial meeting of the China and the Community of Latin American and Caribbean States (CELAC) Forum, which was led by Venezuela. That same month China also released a white paper on its Arctic Policy in which it referred to Arctic shipping routes as a "Polar Silk Road" and positioned this as part of its Belt and Road initiative. The Belt and Road initiative is a government-led strategy comprising a "belt" and a "road" that will link the great Eurasian continent from east to west, transcending geographic boundaries in a bid for China-based globalization with a clear eye to the massive response this move will generate from the international community.

These substantive shifts in the political and economic environment surrounding the Belt and Road initiative have triggered an increase in the number of Japanese firms that are actively seeking to join projects related to China's Belt and Road infrastructure development initiative. Many are curious about the nature of the projects involved and are asking specific questions about ways to get involved in Belt and Road infrastructure projects.

This report thus explores the potential for Sino-Japanese collaboration on China's cross-border infrastructure development project.

2. The Role Played by Chinese Financial Institutions in the Belt and Road Initiative

Before examining the feasibility for collaboration between Japanese companies and their Chinese peers, it is first necessary to take a look at the financing for the Belt and Road infrastructure development project that is being promoted by China. Chinese financial institutions play a massive and occasionally decisive role in the contracts won by Chinese firms for international infrastructure projects. Moreover, this role will have significant bearing on the feasibility of Japanese involvement on these projects.

China Development Bank (CDB) and the Export-Import Bank of China (EXIM), both of which are state-owned policy banks under the direct jurisdiction of the Chinese government, play a key role in raising funds for the Belt and Road infrastructure development project. According to its annual report, as of the end of 2016, CDB had outstanding international business loans of US$ 277.9 billion (approximately 30 trillion yen).

EXIM, meanwhile, offers two categories of so-called Preferential Loans: Concessional Foreign Aid Loans and Preferential Buyer's Credit. According to a hearing with EXIM officials, as of December 2017, EXIM was financing 1,200 projects in fifty countries along the Belt and Road route, with outstanding loans reaching RMB 670.0 billion (approximately 11 trillion yen).

By comparison, the Japan Bank for International Cooperation had outstanding loans amounting to approximately JPY 14.6574 trillion as of the end of March last year, which should give some idea of the scale of the presence of China's two policy banks.

Specifically, EXIM is reportedly funding the majority of the projects that are being undertaken in both Sri Lanka's famous Hambantota port and Pakistan's Gwadar port, including the development of related infrastructure. Moreover, CDB has committed funding to a high-speed rail project linking Jakarta and Bandung in Indonesia, which was awarded to China at the expense of Japan (though the loan had yet to be executed as of the end of March due to delays in land acquisition).

CDB and EXIM funding for infrastructure development projects is far reaching and covers the construction of roads, power infrastructure, airports, water supply infrastructure, resources, and telecommunications, in addition to ports and railroads. A substantial percentage of the financing extended by these two banks for foreign infrastructure development projects is in the form of tied loans, a type of foreign aid, that are conditional upon the awarding of construction contracts to Chinese firms or the introduction of Chinese equipment. In addition, some loans require the guarantee of the Chinese government or the government of the borrower country.

Financing from Chinese policy banks is a lifesaver for emerging countries that lack the financial resources needed for their infrastructure development projects. This is especially true for projects that are rejected for funding under the conditionality applied by international development banks such as the World Bank (WB) and the Asian Development Bank (ADB) due to concerns about their feasibility and/or environmental and social impact. The cost competitiveness of Chinese firms in combination with the financial backing of these two banks offers some explanation for the volume of infrastructure contracts these firms are being awarded in emerging countries.

By contrast, the Asian Infrastructure Investment Bank (AIIB) has failed to make its presence felt despite all the initial publicity it received. In 2016 and 2017, the AIIB extended a mere US$ 4.2 billion on 24 projects (approximately 450.0 billion yen), which is substantially less than the US$ 28.9 billion (approximately 3 trillion yen) in credit that was granted by the ADB in 2017 alone. Moreover, seventeen of those projects were jointly financed by either the WB or the ADB. The AIIB has yet to establish the systems needed for project identification, review and monitoring, and has single-handedly financed a mere handful of projects.

As of the end of 2017, membership of the AIIB had reached 84 countries, which is higher than the number of ADB member countries (67). For Japan, the AIIB is a worrying presence since it represents part of China's efforts to expand its global clout. The fact that it attracted an unexpected amount of publicity and that it is an international financial institution that is bound by the principles of accountability and transparency, however, is why it continues to operate stably.

On the other hand, the AIIB is providing infrastructure financing on the basis of the global standard for international banks and it deserves some credit for its operations thus far.

The Silk Road Fund is another organization that was established to support the construction of the Belt and Road infrastructure development project. This fund is an equity investment fund that was established in December 2014 under the leadership of the People's Bank of China to utilize China's foreign exchange reserves. As of December 7, 2017, the fund had committed approximately US$ 7.0 billion (approximately 750 billion yen) in investment on seventeen projects.

Starting with Pakistan's Karot hydropower plant, the Silk Road Fund has also invested in an Italian motorway company. It has additionally acquired a 9.9 percent interest in the Yamal liquefied natural gas development project located in northern Russia, a project that also has JGC Corporation and Chiyoda Corporation involvement. It should be noted, however, that the Silk Road Fund generally has a minority stake in its investments and its operation appears to be sound.

3. Chinese Expert Opinion on the Current State of the Belt and Road Initiative

Whilst Japan's expectations with regard to Sino-Japanese collaboration on China's Belt and Road cross-border infrastructure development project are mounting, the next issue that needs to be examined is the current state of the project and China's take on the feasibility of Sino-Japanese cooperation on this project. Mizuho Bank has recently conducted hearings with Chinese financial institutions and think tanks on the subject, but all the experts and analysts that were consulted in Beijing stress the importance of ensuring that the project is undertaken in accordance with market principles and that, since Chinese firms stand to benefit from the involvement of Japanese companies in this project, as with other foreign companies, their participation in the Belt and Road infrastructure initiative is broadly welcome.

Officials at both CDB and EXIM explained that, as development banks, protecting the principal and making a profit, however small (referred to as "securing a thin profit margin", in Chinese), are key missions. Again, asked about the nature of Belt and Road project financing at a briefing on economic trends that was hosted by the Chinese embassy in Japan on March 20 this year, a Chinese expert stressed that: "The Belt and Road project is being advanced on the basis of its marketability (to global investors)".

This emphasis among Chinese experts on the marketability of the project is thought to be grounded in the awareness among Chinese firms of the many risks they face in taking on what amounts to a project that is a top national priority on which profitability is given no account.

Venezuela, which is the recipient of massive CDB loans, has descended into economic chaos as the result of falling oil prices, whilst the China-financed road construction project that is being undertaken in Pakistan has been halted due to economic corruption. Added to which, work on Indonesia's high-speed railway project has been heavily delayed due to the slow land acquisition process by local authorities. Meanwhile, development work on the Hambantota port in Sri Lanka has drawn criticism for the decision by Sri Lanka to grant China a long-term lease on its operating rights in exchange for the repayment of its debt.

In consequence, even state-owned enterprises that receive government support are finding it difficult to take on projects that are not expected to generate any revenue down the line. A Chinese analyst has pointed out that, from a strategic perspective, these circumstances will likely result in a gradual drop off in Belt and Road projects going forward.

The emphasis on marketability can also be seen as a nod to Japanese and other foreign companies, as China seeks to attract global investors. The globalization of the Belt and Road initiative means that collaboration at the international level is more imperative than ever before. Moreover, Chinese firms that are being exposed to international business risk through their involvement in the Belt and Road project look to be shedding their self-sufficiency principles and becoming increasingly positive towards the formation of international consortiums.

4. Patterns of Sino-Japanese Belt and Road Collaboration

There is no place for Japanese involvement on projects that are being financed by low-interest tied loans, but Japanese firms could participate in Belt and Road projects that are marketable, i.e. those that are based on the principles of economic rationality. What, then, are the options for Sino-Japanese cooperation on such projects?

There are, essentially, three possible options for Sino-Japanese collaboration on the Belt and Road cross-border infrastructure development project: 1) participation by Chinese firms on contracts awarded to Japanese companies; 2) joint-venture contracts involving both Japanese and Chinese firms; and 3) participation by Japanese firms on contracts awarded to Chinese companies.

With regard to the first option, a leading Japanese trading company has already seen some success with Chinese cooperation. In March 2015, when Mitsui & Co., the Saudi Arabian power giant, ACWA Power, and a third company won a contract from Oman's government for the Salalah-2 power generation project, they chose Shandong Electric Power Construction Corporation III (SEPCO III), which is controlled by a state-owned enterprise, as its turnkey EPC (engineering, procurement and construction) contractor. Here, the Japanese stakeholder can be said to have selected a leading Chinese firm to partner on the project on the basis of optimization and rationality, thus future cooperation on other projects will likely be free and unbiased.

With the second option, the Japanese (or Chinese) firm selects a Chinese (or Japanese) partner with a view to winning the contract on a specific project. Last May, Marubeni Corporation joined forces with JinkoSolar Holding Company, a major Chinese solar panel manufacturer, winning the contract on the Sweihan Photovoltaic Independent Power Plant Project in the United Arab Emirates; the two companies are providing 20 percent equity funding each for this special-purpose entity. The cost performance of Chinese firms means that China is far and away the global leader in solar panel manufacture, and Marubeni is thus seen as having successfully harnessed that competitiveness.

General Electric (GE), the American multinational conglomerate, is actively seeking the cooperation of Chinese firms in its bid to win power plant contracts in the emerging countries of the world. In September 2015, for example, GE and Sinomach (China National Machinery Industry Corporation) entered into a strategic partnership agreement to collaborate on wind power generation and other clean (renewable) energy projects in Sub-Saharan Africa. The first project undertaken by this consortium was a wind power generation project in Kenya with Sinomach-controlled China Machinery Engineering Corporation (CMEC). On this project, CMEC was responsible for the EPC, whilst GE supplied the blades and wind power generators and provided technical training for operating personnel.

GE was looking to expand its business opportunities in the region by leveraging the cost competitiveness of its Chinese partner's EPC and its network of bases in Africa, as well as the fund-raising capabilities of Chinese-owned banks with their ample financial resources. Sinomach, meanwhile, is thought to have been looking to build on its EPC contract award performance by leveraging the power of the GE brand amidst an increasingly intense bidding environment amongst Chinese EPC contractors. Japanese manufacturers could also profit from looking into cooperative schemes of this nature.

The second option offers another derivation, wherein the project owner encourages Sino-Japanese cooperation on the contract. A leading Japanese trading company and a Chinese power generation equipment manufacturer both bid on a contract for a thermal power plant project in Vietnam, but through the mediation of the Vietnamese authorities (i.e. the project owner), the two firms formed a consortium and were awarded the contract as a result. Moreover, the project was jointly financed by JBIC and EXIM, which agreed to take on the corporate risk of their country's firm. The Vietnamese authorities are believed to have proposed the cooperative scheme in consideration of the balance of power between Japan and China.

Cooperation of this nature has merits for all stakeholders. For the project owner, pursuing cost performance by encouraging Sino-Japanese cooperation makes it possible to hedge the risks involved, whilst the Chinese partner can compensate for its weaknesses by drawing on the project management capabilities and international creditworthiness that are the strengths of Japanese firms. There is a growing wariness in China of excessive dependence on finance, which suggests that more Chinese firms will be seeking Japanese cooperation on projects in the years ahead.

The third option involves projects that are being promoted by China in emerging countries in cooperation with the relevant local authorities, and with theBelt and Road representing the stronghold of Chinese infrastructure development projects, so to speak, there is no denying that Japanese firms will struggle to make inroads on projects that are wholly financed by the Chinese. Even given that foreign participation is an option, Japanese firms would need to undertake a careful study of the project's nature, profitability and compliance before coming to a decision on its involvement.

Broadly speaking, Chinese firms have an overwhelming competitive advantage in terms of construction work and equipment manufacture cost, but Japanese firms have the edge in engineering knowhow, project management capabilities and solution proposal capabilities. The potential for Japanese involvement in schemes that allow them to compensate for Chinese weaknesses in areas such as plant design, process management and consulting, for example, is thus considerable (see inset).

Figure: The Strengths and Weaknesses of Japanese and Chinese Firms in the Field of Infrastructure Development

	Japanese Firms	Chinese Firms
Strengths	• Technical capabilities, quality • Solution proposal capabilities • Project management capabilities • Creditworthiness in terms of fund raising, etc. • Ample experience doing business overseas • Industry clusters overseas	• Cost competitiveness in manufacturing and construction • Decision making capabilities • Ample funds and government guarantee • A strong political commitment to risk taking
Weaknesses	• High costs • Decision making capabilities • Risk taking capabilities	• Risk assessment capabilities • Project management capabilities • Overseas business experiences • International creditworthiness

There is scope for cooperation in fields where Japanese corporate strengths can be leveraged to compensate for the weaknesses of their Chinese peers.

Source: Compiled by the Global Strategic Advisory Department of Mizuho Bank, Ltd.

With this third cooperative scheme, committing to supply those Chinese EPC contractors that are bidding on international infrastructure development projects offers one option. A leading Japanese manufacturer, armed with the power generation equipment it was manufacturing as a joint venture in China, was jointly awarded a power plant project with a Chinese EPC contractor and is participating in Belt and Road business by supplying power generation equipment.

As a supplier, there is little need to worry about the risks involved in the project, and whilst attention needs to be given to keeping such projects separate from the overseas business development strategies of head office, the idea has merits in that it allows the Japanese partner to draw on existing experience of doing business in China and the domestic network of its Chinese partner.

5. Conclusion

This report has examined three schemes for Sino-Japanese cooperation on China's Belt and Road infrastructure development project. Whatever the scheme, the enthusiasm that is being manifested by Chinese companies towards international cooperation represents a golden opportunity and Japanese firms will need to actively approach their Chinese peers if they are to be successful. Failure to build relations with Chinese firms will make it difficult to acquire information on up and coming projects in a timely manner and will rule out future cooperation. The author hopes that this report will be of assistance to Japanese firms that are looking into Sino-Japanese cooperation.