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China's Belt
and Road Initiative
Changing the Rules
of Globalization
Edited by
Wenxian Zhang, Ilan Alon, Christoph Lattemann

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From Wenxian Zhang: To Karen, Michelle, and Nathan
From Ilan: To Anna, Kareen, Maya, and Noa
From Christoph Lattemann: To Zize, Florian, and Linnea

Foreword

The Deep-Level Substance of the Belt and Road Initiative

This is a timely book about the Belt and Road Initiative (BRI) by a diverse team of experts across geopolitical, economic, and organizational management domains. From such varied perspectives and with multiple analytical lenses, the current BRI profiles have been broadly delineated, and future directions of development broadly projected. This book is thus both informative and instructive for researchers, policymakers, and practitioners on BRI at a general level.

However, just as reflected by Alon, Zhang, and Lattemann in their introduction to the book in Chap. 1, "consensus has not been reached about what BRI is, how it may affect others, and how it may evolve" (2018: 12), but a major impact of BRI on the world is generally assumed to be inter-regional cooperation, inclusive participation, and a new era of globalization.

For the purpose of elucidating the multilevel nature of BRI, we propose a three-level framework of analysis: surface, middle, and deep. While most researchers, policymakers, and practitioners have recognized the features of BRI at both surface and middle levels, we argue that the

deep-level substance of BRI as a global ecosystem for long-term symbiosis has not yet been adequately articulated.

First, at the surface level BRI has been perceived by most Chinese researchers, policymakers, and practitioners as a China-centered effort to help China solve the problem of overcapacity in its infrastructure and manufacturing sectors by expanding export to potential markets in the less-developed regions of Central Asia, Middle East, South Asia, Southeast Asia, and Africa. Such a view is widely shared in both China and those less-developed regions, but is rarely held in Europe and the USA, where a different perspective is generally adopted.

Second, at the middle level, most European and American researchers, policymakers, and practitioners tend to believe that BRI is an inevitable course for China—still an emerging power—as it rises on the global scale in the new era. From this perspective, BRI is the "natural" or inevitable by-product of China's fast-growing wealth and power and its increasing influence over the rest of the world. Framing BRI as a China-centered effort, this view is analyzed by Schortgen and Lairson in their respective chapters concerning China's new leadership role in the global economy and the need for new institutional rules and structures. However, by capturing only part of BRI (arguably the less critical aspect), this perspective is far from complete and thus seriously biased.

Third, at the deep level, it is our strong belief and central argument that BRI represents a joint effort involving multiple parties, especially the three major ones: (1) China, (2) Europe, and (3) all the countries in between. Even though China initiated it, BRI is by no means China-centered, but rather is a multiparty cooperative platform for long-term inter-regional symbiosis. This can and should be the deep-level and long-term vision for BRI. It is no accident that BRI starts in China, but finishes in Europe, not only historically but also currently and into the future. It is worth noting that this deep-level view has never been clearly articulated before, neither by China nor anywhere else.

Strategically speaking, we can envision a three-stage pattern of BRI evolution to capture the *deep-level substance of BRI as a global ecosystem for long-term symbiosis*. At the first stage, BRI starts with a strategic cooperation between China and Europe, as the two ends of BRI. With help from

Europe, China can upgrade and transform itself from a middle-level manufacturing base into a world-class, top-level manufacturing power. In other words, China can leverage Europe, often via the merger and acquisition (M&A) of so-called *hidden champions* in Europe (especially in Germany, Northern Italy, and the Nordic region via a novel mode of post-M&A integration, which we call invisible touch integration in terms of there being little integration in governance structure on the surface, but accelerated integration in the domains of business function and cultural alignment behind the scenes), to uplift Chinese industries and firms and successfully implement China's supply-sided reforms in the special context of China's *new normal*. This is the first leverage, or *seesaw*, of our envisioned deep-level substance of BRI. From this perspective, it is clear that BRI is by no means China-centered; rather, it is inter-regional partnerships that matter most.

At the second stage, BRI can continue the strategic cooperation between China and Europe as the two strategic ends and expand it to the regions between, including Central Asia, the Middle East, South Asia, Southeast Asia, and Africa. Here BRI will take the form of establishing diverse industrial parks and other forms of three-party cooperation between China, Europe, and local partners. This is the second leverage, or *seesaw*, of our envisioned deep-level substance of BRI. Again, from this perspective, it is clear that BRI is by no means China-centered; rather, it is the inter-regional partnerships that matter most.

At the third stage, BRI can finally expand its inter-regional cooperation beyond the traditional scope to the rest of the world, including Australia, New Zealand, North America, and Latin America. This is the third leverage, or "seesaw." Again, there is no doubt, from this perspective, that BRI is not China-centered. In particular, BRI bears a far-reaching political implication that G-3 (i.e., USA, China, and Europe), rather than G-2 (either USA and China; USA and Europe; or China and Europe), is the most stable and constructive geopolitical and geoeconomic ecosystem of global powers as both competitive and cooperative forces for long-term symbiosis.

Figure 1 summarizes and illustrates our three-stage pattern of the *deep-level substance of BRI as a global ecosystem for long-term symbiosis*.

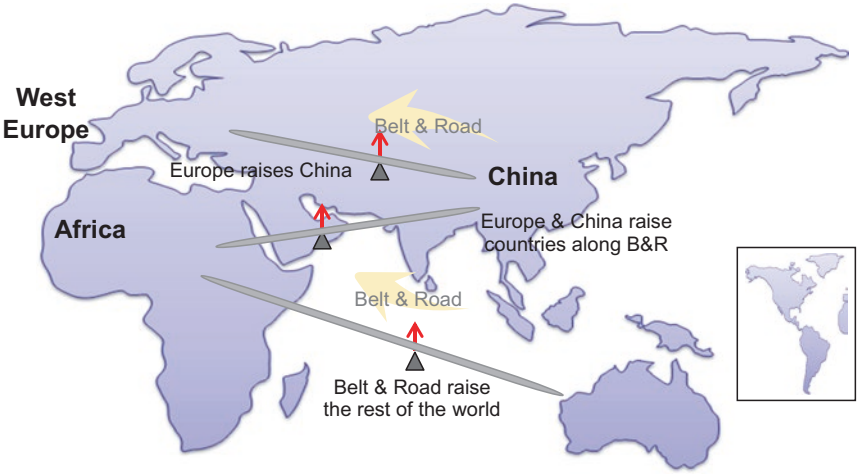

Fig. 1 The three stages of BRI as a global ecosystem for long-term symbiosis

The final point is that the notion of a "second home" approach is salient in the three-stage pattern of BRI applicable to all the firms involved. First, both Chinese and European businesses must firmly establish themselves in each other's region as their second home with the status of local insider, rather than external intruder. Second, Chinese and European firms must establish themselves in the regions or countries along the BRI route in the same way. Third, all firms in the world in the future must firmly establish themselves in other regions in this manner. This is the *deep-level substance of BRI as a global ecosystem for long-term symbiosis*.

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Introduction

Ilan Alon, Wenxian Zhang, and Christoph Lattemann

Altogether, the aftermath of the 2008 global financial crisis, the WTO's Doha Development Round breakdown, the collapse of the Transatlantic Trade and Investment Partnership, and the Trans-Pacific Partnership, so-called Brexit, and Donald Trump's promise to protect and "Make America Great Again," mark a critical milestone for the global economy, trade, and the political order as determined by the United States over the past 70 years.

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Since 2001, China has been emerging in the world economy; and more recently with the BRI, China is expanding its government-sponsored "Going Global" development programs in size and in scope as part of the global "China Dream" objective. The BRI, with its "Silk Road Economic Belt" and "the Twenty-First-Century Maritime Silk Road," is now the largest platform for international cooperation, reflecting the new approach of China's development and diplomatic strategy.

The basic idea of the Belt and Road Initiative (BRI) is to consolidate and upgrade a dense network of bilateral Free Trade Agreements (FTA) into a multilateral arrangement, anchored by China's gravitational pull and vast open market (see Chap. 5). The BRI focuses on using the "belt" to link China to Europe through Central Asia and Russia; to the Middle East through Central Asia; and to Southeast Asia, South Asia and the Indian Ocean. The "road," meanwhile, aims to connect China with Europe through the South China Sea and the Indian Ocean; and with the South Pacific through the South China Sea. Covering 65 countries and reaching more than 60% of the global population, accounting for nearly a third of global GDP and global merchandise trade, and 75% of its known energy reserves, the BRI is the most ambitious example of global economic statecraft in the twenty-first century.

The BRI is essentially a new global architecture designed by China to frame its new role as a leading world power. It is also a massive project involving the funding and construction of an infrastructure system of roads, railways, oil and natural gas pipelines, fiber-optic and communication systems, ports, and airports. But the BRI is far more comprehensive since it covers cooperation in all aspects, from policy dialog to trade, from financial cooperation to people-to-people exchange. The costs of the BRI, an estimated US$800 billion, will mainly be funded by China and supported by the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB).

By May 2017, 22 countries had signed the BRI Memorandum of Understanding, and 29 heads of state attended the first BRI forum in Beijing. Most of the attendees were from small developing states in Asia, such ASEAN and Central Asian countries. This gives early signs of China emerging as a great power. Because BRI threatened the Western political framework, the major great powers—in contrast to the smaller and poorer countries—rejected or objected to the BRI, including the United

States, the EU, Japan, India, and Australia (see Chap. 10). Their common primary concern is about the BRI's strategic role and the political purpose of infrastructure building. Also raised are economic concerns about debt and financial risk, and environmental and social concerns.

This book is among the first to examine the BRI, or One Belt, One Road (OBOR, for consistency and to reflect the latest name change by the Chinese government, we will use BRI as the main term throughout), in a systematic, multiperspective, and politically and ideologically unbiased way. Authors from East and West present the most prominent facets of the BRI through geopolitical, economic, business, legal, and social lenses. Over 30 scholars with roots in five continents—Asia, America, Africa, Europe, and Oceania—analyze the BRI and provide insights to its past, present, and future, and its impact on the world economy, regions, and specific countries along the BRI.

This gives a comprehensive overview for practitioners, academics, and politicians on BRI in terms of: (1) major fields of interest; (2) purposefully selected countries; and (3) effects and their causes. This book can also be used as a multiperspective China-developed countries and China-developing countries case study for teaching in the field of geopolitics, business, economics—in particular on FTAs, foreign direct investments, and culture. Following this logic, the book is organized into four broad sections: Part I—Contextual Overview of the Belt and Road Initiative; Part II—Regional and Geopolitical Perspectives; Part III—International Trade, Foreign Direct Investment, and BRI; and Part IV—Financial, Legal, and Cultural Perspectives on the BRI.

1 Part I: Contextual Overview of the Belt and Road Initiative

Chapters 2 and 3 are by political scientists and experts in international relations and provide the geopolitical context for this study. Francis Schortgen from University of Mount Union (USA) discusses how BRI marks a new era of Chinese economic global leadership. This leadership was created to some extent by a power vacuum left by Washington's withdrawal from the TPP in 2017. Xi Jinping's defense of economic globalization at every major international event marks a new doctrine in a Chinese desire

to rise peacefully and powerfully. Francis Schortgen concludes that the BRI is nothing less than a new global economic order with China at the helm, reflective of an underlying repositioning of great power relations.

Dovetailing with Shortgen's research is Thomas Lairson's chapter, which examines the interdependence of structural power in China's relations. Thomas D. Lairson—a political scientist with both Jindhal Global University (India) and Rollins College (USA)—develops a framework of deep interdependence and structural power as a primary feature of the strategic environment affecting the design and eventual outcome of the Chinese BRI project. Deep interdependence is a result of the liberal global system established by the United States and is posited to create both opportunities and constraints on China, including the formulation of goals, the design of the BRI, and its ultimate success or failure. Lairson suggests that China needs to develop a nuanced and accommodative set of policies and actions relating to mutual gains, governance through accommodative rules and institutions, and management of internal and inter-state conflicts within the region. He compares the BRI to the post-World War II order of the Marshall Plan. Together with the AIIB, China has the potential to reorganize the Asian security apparatus and its relationship to India, Vietnam, Japan and the United States. Lairson asserts that the BRI project will succeed or fail in creating structural power for China based on its ability to operate within a system of deep interdependence and structural power.

Both Shortgen and Lairson provide a big picture analysis of global and regional geopolitical forces based on the BRI that have the potential to change the world for years to come. The third chapter focuses on China's most important relationship, and perhaps the most influential one for the entire world. The China–United States relationship has been dubbed the G-2, and is seen by some as the cornerstone for the G-7. Xiaohua Yang, Don Lewis, and Steve Roddy from the University of San Francisco (USA), and Diana Moise from the Public International Law Advisory Group (UK) analyze the BRI in relation to the United States in Chap. 4, which examines US business connectivity with China's BRI and provides insights into global cooperation between the world's two largest economies in the emerging digital age. Informed by resource-based and institutional-based views, the analysis shows how potential US connectivity to the

current BRI could provide windfall gains for US firms possessing a competitive ownership advantage with the advent of the Cyber/Digital and Maritime Silk Roads. Their analysis also reveals the potential costs and risks of such an involvement in the uncertainty of United States–China bilateral relations. Notwithstanding the geopolitical differences, nation-state boundaries, resurgent protectionist movements, and regional markets, BRI partner countries are likely to experience much deeper connectivity as a result of intensifying international trade and investment integration, and concomitant cyberspace developments in countries such as the United States and China.

2 Part II: Regional and Geopolitical Perspectives

Part II begins with a case study from Switzerland by Tomas Casas i Klett (China Competence Center, FIM-HSG University of St. Gallen, Switzerland) and Omar Serrano Oswald (University of Geneva, Switzerland) that shows how FTAs are used by the BRI as stepping-stones for multilateralism. They propose that China's FTAs are part of a long-term multilateral approach with the potential to be included in the institutional infrastructure of the BRI. By developing a *BRI Initiatives Dynamic Evaluation Framework*, they emphasize that initiatives under BRI will be subject to decision and evaluation mechanisms that transcend China proper. This means that rather than being static, FTAs are dynamic. The key element in this iteration is the FTA upgrade, which includes trade impact analyses, business agent surveys, utilization rates, and signaling effects. The Sino–Swiss FTA is evaluated as part of this long-term strategy of upgrading bilateral relationships into a comprehensive system that relies on institutional outsourcing of the upward kind from nations with deep institutional building experience.

By analyzing a small but advanced and strategic set of economies (the Nordics), Camilla T. N. Sørensen, from the Institute for Strategy in the Royal Danish Defense College (Denmark), examines how BRI affects the Arctic and Northern Europe. Sørensen offers a much-needed analysis of how the development of the BRI links to China's growing interests and

ambitions in the Arctic, showing how China is using the BRI to further intensify and strengthen relations with the Nordic countries in the Arctic. By conducting a comparative analysis, Chap. 6 further draws attention to how geography and certain domestic circumstances and considerations play into how the Nordic countries' see and engage with the BRI as it broadens to the Arctic and Northern Europe. She concludes with a critical discussion of why the Nordic countries are not cooperating to a higher degree, despite growing Chinese efforts in recent years to introduce a 5 + 1 mechanism high-level Nordic–China interactions.

Analyzing another strategic region for China, Jędrzej Górski, a research fellow at the City University of Hong Kong looks at China's strategy toward Central and Eastern Europe (CEE) within the Framework of the Group 16 + 1 through the lens of Poland, one of CEE's largest and most important economies. The idea of China's cooperation with the CEE within the framework of the 16 + 1 Group, rather than bilaterally, first came forth in December 2011, when China and Poland signed a declaration on strategic partnership relations. The obvious purpose of the 16 + 1 Group is to pave the way for the development of land components of the BRI known as the Silk Road Economic Belt. Chapter 7 considers relations between China and Poland in terms of demographics, territory, and economy, and presents a context for the Sino–Polish Comprehensive Strategic Partnership, which concluded in 2016. The chapter assesses the prospects for the development of the land components of BRI in the CEE region, and explains Chinese priorities toward, and Poland's role in, this region by mapping up-to-date activities of the 16 + 1. The author compares an optimum policy for Poland toward the BRI and 16 + 1 Group initiatives determined by the historical and geopolitical conditions, with the policies currently pursued by the Polish government.

Analyzing the BRI in relation to Central Asia in Chap. 8, Fabio Indeo, a non-resident research fellow at the Center for Energy Governance and Security (South Korea) and analyst on Central Asian security at the NATO Defense College Foundation (Italy), shows that China has undertaken a concrete strategy to extend its influence in Central Asia. In the BRI, Central Asia holds a strategic relevance because it is crossed by

two important land corridors that will promote economic development and regional cooperation, and preserve security and socio-political stability. For Central Asian republics, the BRI represents an attractive undertaking, benefiting from huge Chinese investments aimed at boosting infrastructures and developing national economies. The BRI will continue to affect Central Asian economic evolution, foreign policy, and security. Enhanced cooperation between China and Central Asian countries allows them to diversify away from Russian projects and economic dependence. By analyzing the Eurasian Economic Union and the BRI, it appears that the geopolitical goals of these Sino–Russian initiatives might clash, even if Beijing and Moscow attempt to cooperate. The evaluation of the potential long-term impact of the Chinese initiative in the changing geopolitical landscape of Central Asia requires an in-depth and continuous analysis focused on the region's challenging issues, thus representing an added value to understanding the political evolution of the five post-Soviet Central Asian republics.

Chapter 9 is written by the African-born American Emmanuel Kodzi from Rollins College, who examines Africa's response to China's BRI. African countries are an important link and this chapter examines how they might respond to China's business engagement, given the imbalance of economic power in China's favor. Kodzi first explores industry-level adjustments by which African countries may increase the strategic value of their contribution in BRI exchanges, and then examines the nature of previous and ongoing Chinese engagement to identify any patterns in the impact of Chinese engagement on local businesses. Through analyzing flows of product, information, and capital, Kodzi explores dimensions of this impact in the specific context of Africa. Using the resource dependence theory and the supply chain practice view, he conceptualizes pragmatic responses by African industry sectors to the competitive pressures associated with Chinese business engagement, which include targeted specialization and reorganizing industry supply chains. By formulating a proactive and responsive approach, African businesses and countries are more likely to receive tangible benefits, allowing managers and policymakers to reorganize any businesses, industries, and business clusters that might be affected by increased competition.

Jake Lin, from the Institute of Global Studies at the Tokyo University of Foreign Studies (Japan) offers a close look at New Zealand's proactive and pragmatic participation in China's BRI. Contrary to conventional wisdom, he argues that New Zealand, as an exemplar of a small liberal state, has the ability to shape and influence a great power's foreign policy initiative, such as the BRI. Nonetheless, he contends that despite any power and influence exercised in the early stages, New Zealand should be cautious about its increasingly vulnerable position under the BRI, and the limits imposed on it by China. New Zealand's long-established trade engagement with China has been successful by and large, but not without cost. The research shows that China has a track record of managing free trade and connectivity projects in which profit and political influence trump other broader issues, such as human development and environmental protection. There are limits to New Zealand's free trade strategy with China, given the potentially negative impact on New Zealand's social and political integrity, and the potential erosion of its ties with traditional allies. China's increasing interest in trading with a small liberal state is an understudied area in the literature and Chap. 10 contributes to the limited knowledge on how far China would like to go with a developed nation under the BRI, and what New Zealand's opportunities and challenges are.

3 Part III: International Trade, Foreign Direct Investment, and BRI

Part III focuses on international trade, foreign direct investment, and the impact of China's new undertaking on the economic development of the BRI countries. In Chap. 11, Biliang Hu, Qingzhong Pan, and Shuyu Wu, all from the specialized Emerging Markets Institute and The Belt and Road Institute at Beijing Normal University (China), measure, rank, and evaluate the overall development of affiliated countries to come up with a ranking of the 65 countries and their development levels. Among them, Singapore, China, and Malaysia have the highest rankings, while Afghanistan, Syria, and Yemen have the lowest level of development. The

authors found that political stability and good governance are extremely important for supporting the development of the Belt and Road countries. While there is huge potential for energy cooperation among the countries along the BRI routes, serious challenges remain, such as food security, financial markets, structural reform, and climate change, therefore some new policies and strategies are needed to stimulate overall development of these countries.

Shifting away from economic assessment and into trade, Juan Zhang and Zhouhong Wu from the Institute of International Business at Shanghai University of International Business and Economics (China), show the effects of trade facilitation measures on trade between China and countries along the BRI. Connectivity and unimpeded trade are two key areas of collaboration along the BRI, which have important implications for policymaking and economic development. Chapter 12 builds an index system and uses gravity models to assess the trade facilitation measures of 64 countries between 2011 and 2014 and their effects on trade flows with China. The authors show that trade facilitation has the biggest positive impact on bilateral trade, specifically that regulatory and financial environments have no significant impact on bilateral trade, while port efficiency is a key factor. BRI countries might highlight their trade facilitation by guiding investment and management in infrastructure and improving administrative efficiency.

How BRI will affect China's investment patterns is still a vexing question. Ping Lv and Xuchang Chen (University of Chinese Academy of Sciences, China) and Chenxi Guo (School of Economics, Peking University, China) offer an analysis of the impact of the BRI on Chinese OFDI (outward foreign direct investment). By using Chinese OFDI data of listed companies from 2010 to 2015, Chap. 13 examines how BRI affects the international strategy of two types of firm: independent firms and corporate groups. The empirical results show that the BRI can advance both types of Chinese OFDI. Specifically, corporate groups and BRI-induced improved external institutions have co-evolved as complementary rather than as substitutes. The empirical results show that the BRI has a greater push effect on corporate groups' OFDI than on independent firms' OFDI. The chapter confirms that Chinese firms are growing by leveraging BRI policy in their international expansion strategy. Due to

both the availability of data and the sophistication of the analysis, the chapter makes a singular contribution to our understanding of corporate groups and independent firms in levering this new geopolitical restriction.

Building on the chapters on investment and trade, Vasilii Erokhin and Tianming Gao, both from the School of Economics and Management, Harbin Engineering University (China), examine the competitive advantages conferred on China's agricultural products as a result of the BRI. As the previous chapter suggested, BRI is partly motivated by trade facilitation, as it increases a country's competitiveness. Erokhin and Gao suggest that China does so through the development of an open, rule-based, and predictable trading system. Chapter 14 analyzes changes in the comparative and competitive advantages of China's agricultural trade between 1995 and 2015, by employing the Balassa and Vollrath indexes to identify both competitive and non-competitive products in China's agricultural trade portfolio. It weighs each product's contribution to China's export portfolio using the Lafay index. The chapter concludes with a grouping of agricultural and food products according to their competitiveness, providing a framework for analysis at industry and product levels for those interested in promoting trade and competitiveness in selected sectors.

4 Part IV: Financial, Legal, and Cultural Perspectives of BRI

Part IV surveys the financial, legal, and cultural aspects of the BRI. Stephen Thomas and Ji Chen of the University of Colorado (USA) start this section by examining the role of China's Sovereign Wealth Funds (SWF) in the BRI. Since 2013, China's two largest SWFs, the China Investment Corporation (CIC), and the State Administration of Foreign Exchange Investment Company (SAFEIC), have been given new roles in support of the BRI and other domestic initiatives. Globally, President Xi has mobilized the personnel, organizational experience, and vast financial resources of CIC and SAFEIC to invest in and lead his ambitious BRI. To

finance the BRI, two important financial funds were established: the Silk Road Fund (2014); and the AIIB (2015). Domestically, Xi has called on CIC and SAFEIC to join his "National Team" in providing capital and expertise to rescue China's domestic equity markets after their 2015 meltdown. Both CIC's and SAFEIC's new global and domestic programs have been largely successful, so far. BRI is to provide 65 countries with infrastructure investments, an initiative larger in scope than the US Marshall Plan. Eighty countries worldwide have joined the Chinese-led AIIB's multilateral alternative to the US-centered World Bank. The AIIB will offer US$200 billion of badly needed infrastructure investments and loans in Asia. Chapter 15 shows how Chinese SWFs' post-2013 active participation in the BRI and domestic initiatives has changed CIC's and SAFEIC's personnel, practices, and goals, and made the CIC a more government policy-oriented than mostly commercial SWFs.

Writing from a legal perspective, Jingzhou Tao and Mariana Zhong from the law firm of Dechert LLP (China) show how the BRI is changing the rules of dispute resolutions for both states and companies. Chapter 16 studies the political and policy background of the BRI and the basic macroeconomics rationale behind it; it analyzes the specific impact of the BRI on dispute resolution mechanisms for states, companies, and other entities involved in its implementation; and it advises how companies can afford protection when navigating the BRI in terms of designing their dispute resolution clauses and handling any potential disputes. Given the analysis, the authors anticipate disputes relating to commercial activities between companies, investment disputes between investor and state, and interstate disputes. They suggest dispute resolution mechanisms, including commercial arbitration (institutional versus ad hoc), local court litigation, investment arbitration (ICSID, ad hoc, other institutions, etc.)—with bilateral investment treaties (BIT) and without BIT. The authors also ponder local remedies, China's new generation BITs, WTO dispute resolution mechanisms, and diplomatic efforts. They explore the legal perspectives of recipient states, investors/companies, general counsels and practitioners, as well as salient issues pertaining to international commercial litigation, arbitration, and enforcement. The chapter makes a singular contribution with practical advice for legal practitioners and businesses working within the BRI framework.

The final chapter in Part IV, Chap. 17, is written by the Chinese-born, American scholar of communications, May Hongmei Gao from Kennesaw State University (USA). She analyzes the BRI from the perspective of a new wave of globalization led by China and understands globalization as the process of international integration of worldviews, products, ideas, culture, people, and economies. The chapter studies the effect of the BRI on globalization from a communications point of view. The author argues that BRI creates a new wave of globalization: Globalization 5.0. In her perspective, this new wave is more pragmatic and less ideology driven, more multilateral, and less imperialistic. She bases her analysis on over 3000 Chinese and English webpages, as well as her systematic observations through organizing Asia business conferences and participating in social media discussions. Five frames are shown as being used by Chinese government and state-run media: "Development," "Mutual respect and mutual trust," "Power of narratives in Ancient Silk Road Story," "Action speaks louder than words," and "China as a partner, not as a colonialist." The fundamental approach by China to the international community while selling BRI is via the frame of "win-win." The chapter also points out the weakness of the new wave of globalization: China's soft power deficit.

5 Final Reflections

Through the chapters collected in this book, we have started to develop a deeper and wider understanding of the BRI. Using a multiple lens for analysis, scholarly disciplines, and country/regional perspectives, we can see that consensus has not been reached about what BRI is, how it may affect others, and how it may evolve. What is clear, however, is that BRI will have a large and significant impact beyond the Asia-Pacific region. BRI will have cultural, administrative, physical, and economic effects that will be felt for years to come. Culturally speaking, more people will study Chinese, interact with the Chinese, and learn to respect their culture. Cyber connections and satellite communications will connect more people, products, and countries in new ways. Economically speaking, as many of the chapters in this book demonstrate, BRI will have a great

impact on trade, foreign direct investment, portfolio investment, and industry structures (within and outside specific countries). AIIB and SWFs will provide much-needed access to capital, especially to impoverished countries. BRI will affect the governance of countries and the world economy. Maritime, rail, and road transport systems will be improved and expanded. The political ramifications will be also felt in areas of national security, energy security, geopolitics, and the military, but the jury is still out about how these changes will affect specific countries and regions, and whether all of those affected will welcome the changes.

Part I

Contextual Overview of the Belt and Road Initiative

2

China and the Twenty-First-Century Silk Roads: A New Era of Global Economic Leadership?

Francis Schortgen

"May you live in interesting times." Purportedly a translation of an ancient Chinese curse, this saying offers a very relevant perspective on early twenty-first-century geopolitical and geoeconomic realities.[1] The anticipation of a seemingly inevitable shift in the global distribution of wealth and power has always coincided with speculation about the prospects of an Asian Century (Mahbubani 2008), the implications of China's rise (Jacques 2009), and ultimately the nature and dynamics of a twenty-first-century international system (Rachman 2016).

Since the early 2000s, the prediction of "interesting times" has undisputedly become a reality, even if the underlying developments have proved rather more unsettling than benign and are likely to prove highly consequential for the existing international order. Arguably the most consequential fallout from the 2008 Global Financial Crisis was the resulting weakening of the United States-centric global economic order,

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as evidenced most vividly by the dramatic rise to prominence of the G-20 during the Summit on Financial Markets and the World Economy, held in Washington, DC on November 14–15, 2008, in the aftermath of the collapse of Lehman Brothers.

As a critical milestone for the global economic order, the fallout from that crisis seemed to open the door to two possible future directions for the global economy. The first scenario would lead to "an economic cold war between rich, developed nations and poor, developing nations" given the distinct possibility that the former "rather than adjust to a new global landscape and accept their diminished relative role in the world economy, deny reality and cling to the old order" (Quinlan 2011: xv). The prediction by Chi Fulin, President of the China Institute for Reform and Development, that "the contribution of China's economic growth to the world economy is expected to maintain at 25–30 percent" (Xinhua 2016) reinforces the overarching importance of integrating China into the global political economy as comprehensively and seamlessly as possible.

In a second scenario, the world could see a reincarnation of globalization, provided it becomes an accepted fact that "we have reached the end of globalization as determined and designed by the United States but not the end of globalization if America and the West can embrace a new configuration with different characteristics—Chinese, Indian, Brazilian, Egyptian and many others" (Quinlan 2011: xvii). To be sure, globalization backlash has assumed worrying social and political proportions, as evidenced by the populist reactions to globalization and the nascent flourishing of anti-establishment movements and political parties in many Western societies. Prominent examples include: the United Kingdom's European Union membership referendum (Brexit) of June 23, 2016; and the electoral success of Donald Trump in the United States, having championed an economic nationalist message that resonated powerfully with voters.

1 A Leaderless World Order?

If the emergence of a new economic model and an increasingly negative view of trade agreements is not already disconcerting enough for the future of the global economic order, the added reality of the United

States' global leadership crisis merely reinforces concern about the nature and dynamics of a twenty-first-century international system.

The domestic political, economic, and social challenges that have consumed the attention of political elites from the G-7 to the G-20, meanwhile, have left precious little time for coordinated efforts to address international and global challenges. The inevitable result is a glaring absence of global leadership when it is most needed to convey a sense of stability and certainty. In light of the United States' expanding global leadership crisis, and heated debates about the end of the American era (Acharya 2014; Kupchan 2002; Mason 2010; Panzner 2009)—all of which will concomitantly weaken the hegemonic stability that had sustained the geopolitical order since 1945—the questions of whether the world is bound to transition from a *Pax Americana* to a *Pax Sinica* or whether it might be on the cusp of a G-Zero era (Bremmer 2012), given the peerless nature of the American order (Suominen, 2012), are well worth pondering.

Will China be able and willing to transform its leadership role in the G-20 (Kirton 2016) to a new level of global economic leadership to compensate for the United States' retreat? How does China's championing of the BRI feature in the unfolding change–continuity dynamic of the twenty-first-century global economic order?

2 China's "Great Rejuvenation"

In remarks delivered to the National Committee on United States–China Relations on September 21, 2005, Deputy Secretary of State Robert B. Zoellick called on China to become a *responsible stakeholder*, for, as he put it: "China has a responsibility to strengthen the international system that has enabled its success" (Zoellick 2005). Over the past decade China's expanding global engagement has left comparatively little doubt about its willingness to assume greater responsibilities in the international system.

To properly understand this evolution, it is imperative to recognize that, more than the exhortation to become a responsible stakeholder, it is the legacy of the "Century of Humiliation" (百年国耻, *Bǎinián guóchǐ*) that has come to define much of China's twenty-first-century foreign policy grand strategy (French 2017; Wang 2012). This historical legacy

was on the mind of Xi Jinping when he addressed the "Road to Revival" exhibition at the National Museum of China on November 29, 2012:

> Everybody has their own ideal, pursuit and dream. Today everybody is talking about the Chinese Dream. I believe the *greatest dream of the Chinese nation in modern history is national renewal*. This dream encapsulates the long-cherished wishes of several generations of Chinese people, embodies the interests of the entire Chinese people, and corresponds to the hopes and expectations of all the sons and daughters of China. *History tells us that our personal future and fate are closely linked to the country's and the nation's*. (emphasis added)

Subsequently referred to as the "China Dream" (中国梦, *Zhōngguó mèng*) speech, it offers a very perceptive window on China's twenty-first-century ambitions and motivations. By invoking the notion of *national renewal*, Xi Jinping clearly intended to frame the China Dream as the dream of China as a great power in the twenty-first-century international system—a power that is determined to never again allow itself to be victimized. Chinese foreign policy has been refashioned to engage with the international community in a way that will secure and maximize China's national interests, wealth, and power within the existing system.

Brzezinski opined that "China, even if it succeeds in maintaining high rates of economic growth and retains its internal political stability (both are far from certain), will at best be a *regional power* constrained by an impoverished population, antiquated infrastructure and limited appeal worldwide" (2005: 3, emphasis added). By refashioning its foreign policy to deepen its institutional involvement (Lanteigne 2005), however, China has been quietly but deliberately laying the foundation to stake out a claim for a greater global leadership role at an auspicious moment and with high-impact policy tools.

3 Still Waiting for Godot?

In his "24-character strategy", Deng Xiaoping exhorted China to "Observe calmly, secure our position, cope with affairs calmly, hide our capacities and bide our time, be good at maintaining a low profile, never

claim leadership" (冷静观察, 稳住阵脚, 沉着应付, 韬光养晦, 有所作为, 决不当头, *lěngjìng guānchá, wěn zhù zhènjiǎo, chénzhuó yìngfù, tāoguāngyǎnghuì, yǒu suǒ zuòwéi, jué bù dāngtóu*). Over time, however, the maintenance of a low profile has evolved into an exhortation to "continuously keep a low profile and proactively get some things done" (Chen and Wang 2011).

In recent years, China's embrace of multilateralism (Wu and Lansdowne 2008) has become an indelible, continuous, and proactive feature of a global strategy in a multipolar world (Clegg 2009). True to its pragmatic nature, China has not only "begun to take a less confrontational, more sophisticated, more confident, and, at times, more constructive approach toward regional and global affairs" but has also downplayed concerns over its willingness to accept the international status quo by embracing "much of the current constellation of international institutions, rules, and norms as a means to promote its national interests," all the while seeking to "shape the evolution of that system in limited ways" (Medeiros and Fravel 2003: 22).

When the Chinese leadership first began to refer to a "period of strategic opportunity" (战略机遇期, *Zhànlüè jīyù qī*), its focus was on strengthening domestic development in the first 20 years of the twenty-first century. Over the years, however, it gradually signaled that it viewed the geopolitical, geostrategic, and geoeconomic environments as presenting an *international* period of strategic opportunity to help it achieve its goal of expanding and consolidating its great power status.

Just when China appeared to have squandered that international opportunity through what appeared to be an overly aggressive assertiveness in diplomacy and territorial disputes (Johnston 2013; Thayer 2011), a rising tide of anti-globalization sentiment compelled China to reassess not only its period of strategic opportunity but also its readiness and willingness to play a more consequential leadership role in the global economy (Medeiros 2009).

The extent of the crisis of global leadership that has befallen the world in the wake of the election of Donald Trump (Bremmer 2016), and to a lesser extent the Brexit vote, is perhaps most pointedly captured in the words of a United Press International columnist who opined that "[T]he only leaders who seem to have answers are Russian President Vladimir

Putin and China's Xi Jingping [*sic*]. The prospect of an emerging future Lincoln who saved the Union; a Franklin Roosevelt who navigated the Great Depression and World War II; or a Churchill who led wartime Britain seems very remote" (Ullman 2017).

Against that backdrop, however, the 2017 World Economic Forum meeting in Davos, Switzerland, may well represent a critical juncture in the history of geoeconomic leadership. For, speaking at that meeting, Xi Jinping unflinchingly seemed to take on the mantle of global leadership with a spirited defense of economic globalization, noting:

> Some blame economic globalization for the chaos in the world. Economic globalization was once viewed as the treasure cave found by Ali Baba in *The Arabian Nights*, but it has now become the Pandora's box in the eyes of many… The point I want to make is that many of the problems troubling the world are not caused by economic globalization… It is true that economic globalization has created new problems, but this is no justification to write economic globalization off completely. Rather, we should adapt to and guide economic globalization, cushion its negative impact, and deliver its benefits to all countries and all nations… Whether you like it or not, the global economy is the big ocean that you cannot escape from. Any attempt to cut off the flow of capital, technologies, products, industries and people between economies, and channel the waters in the ocean back into isolated lakes and creeks is simply not possible. Indeed, it runs counter to the historical trend.

Reassuring his audience of China's commitment to economic globalization and common development, Xi closed by outlining his country's most prominent economic and trade initiatives—the Regional Comprehensive Economic Partnership (a free trade agreement centered around ASEAN + China, Japan, South Korea, Australia, New Zealand, and India); and most importantly, the BRI, which unquestionably is China's most comprehensive and most ambitious international economic initiative to date. The economic charm offensive was in large part intended to present the BRI as a promising and credible alternative to Western initiatives in the quest for global economic influence and power.

But what are the underlying motivations for and potential implications of the BRI? How and to what extent might it be an integral part of

a "premeditated grand strategy" (Zhang 2012: 318) pursued by Beijing? In other words, is it a purely geoeconomic initiative or does it have geostrategic underpinnings?

4 BRI and Chinese Grand Strategy

China's expansion of influence and power on the global stage, however, has coincided with a healthy skepticism about its stated commitment to "peaceful development" (和平发展, *hépíng fāzhǎn*) (Buzan 2010; Jia 2005; Yue 2008);[2] as well as growing concern about potentially revisionist leanings (Feng 2009; Johnston 2003), even if it has taken pains to pursue "a strategy that combines power with reassurance and change with acceptance, a balancing act designed to secure a positive interactive process between its rise and world politics" (Deng 2008: 3). In fact, Xi Jinping's call for a "new great power relationship" (新型大国关系, *Xīnxíng dàguó guānxì*) model (Deng and Moore 2004; Zeng 2016; Zeng and Breslin 2016) is perhaps the most overt effort to date of China's quest for status. The fact that the phrase has largely fallen into disuse—no reference to it has been made in 2017—should not be viewed as China giving up on a path to global power.

It is hardly surprising that China's growing international presence fuels an expanding debate around the geopolitical/geostrategic motivations, exercise, and constraints of Chinese power. As Walter Russell Mead (2014: 69–70) argues, "China, Iran and Russia never bought into the geopolitical settlement that followed the Cold War, and they are making increasingly forceful attempts to overturn it. That process will not be peaceful, and whether or not the revisionists succeed, their efforts have already shaken the balance of power and changed the dynamics of international politics." And yet, while not impossible, it also deserves to be acknowledged that China's unpeaceful rise need not be inevitable (Mearsheimer 2006). In fact, Beijing's commitment to balancing revisionism and status quo make an unpeaceful rise highly improbable, provided established powers (i.e., the United States) accept, adjust, and accommodate to China's rise.

As Xi Jinping noted back in 2014 at the "Meeting Marking the 60th Anniversary of the Initiation of the Five Principles of Peaceful Coexistence":

> China is guided by the principle of boosting amity, sincerity, mutual benefit and inclusiveness in deepening mutually beneficial cooperation with its neighbors and strives to deliver greater gains to its neighbors through its own development. Relations with other developing countries underpin China's foreign policy and China pursues a balanced approach to upholding principles and pursuing interests. China will remain a reliable friend and sincere partner of other developing countries. China places high importance on the standing and role of other major countries and is committed to growing relations of all-round cooperation with them. We are actively working towards building a new model of major-country relationship with the United States, forging a comprehensive strategic partnership of coordination with Russia and building partnerships for peace, growth, reform and civilization with Europe. In short, we are ready to work with all others to uphold world peace and boost common development. (Xi 2014)

Indeed, under Xi Jinping's leadership, China has consistently stressed its commitment to push for a comprehensive global engagement based on "amity, sincerity, mutual benefit, inclusiveness." The scope and nature of global economic statecraft currently pursued by China appears well-suited as an alternate path to global power. Meanwhile, it is well worth noting that the extent to which China's economic statecraft and "major-country diplomacy"—of which the BRI is undoubtedly the most ambitious manifestation to date—ought to confer on China certain geostrategic or geopolitical advantages, it is as much, if not more, a consequence of US global retrenchment, as it is an indelible feature of twenty-first-century geostrategic economics (Schortgen 2017).

From a geoeconomic perspective, China is exhibiting obvious signs of embedded multilateralism. Embedded multilateralism denotes a commitment to a multipolar international system, but China's embrace of multilateralism is tempered by a "realpolitik foreign policy based on national sovereignty, national interest, national power, and national wealth" (Christensen 2015: 21). At the same time, it is a pragmatic way of countering (perceived or real) American efforts to constrain China's

rise—whether geopolitically, geoeconomically, or geostrategically—and, most importantly, of achieving the Chinese dream of national rejuvenation.

From the beginning of the twenty-first century, China has been unrelenting in launching a truly global network of multilateral economic and trade initiatives, including: the Forum on China–Africa Cooperation in 2000; the Forum for Economic and Trade Cooperation between China and Portuguese-speaking countries in 2003; the China–Arab States Cooperation Forum in 2004; the China–Caribbean Economic and Trade Cooperation Forum in 2005; and the Forum of China and Community of Latin American and Caribbean States in 2014.

On an institutional level, China's initiatives have been no less ambitious and focus on deepening regional cooperation. The launch of the Asian Infrastructure Investment Bank (AIIB)—together with the BRICS-led New Development Bank—is not only a sign of China's determination to secure greater input in global financial governance. It also lays bare China's frustration with continued Western dominance of the World Bank and the International Monetary Fund (IMF) and Japanese dominance of the Asian Development Bank.

The combined reach of the AIIB and the BRI confers on China a heretofore unparalleled breadth and depth of geopolitical and geoeconomic clout (Yu 2017). The BRI focuses on using the Belt to link China to Europe through Central Asia and Russia; to the Middle East through Central Asia; and to Southeast Asia, South Asia, and the Indian Ocean. The Road, meanwhile, aims to connect China with Europe through the South China Sea and Indian Ocean; and with the South Pacific Ocean through the South China Sea (HKTDC 2016).

Covering 65 countries and reaching 62% of the global population, all the while accounting for nearly a third of global GDP and approximately 35% of global merchandise trade, the BRI is arguably the most ambitious example of global economic statecraft in the twenty-first century. Notwithstanding the obvious potential for facilitating economic cooperation between East and West, and fostering broader and deeper connectivity with the expanding global middle class, it is bound to (re-)shape the global economic order in consequential ways.[3] According to Stuart Gulliver, formerly Group Chief Executive for HSBC Holdings plc, "Belt

Table 2.1 Number (millions) and share of the global middle class by region

	2015		2020		2025		2030	
	#	%	#	%	#	%	#	%
North America	335	11	344	9	350	8	354	7
Europe	724	24	736	20	738	16	733	14
Central and South America	285	9	303	8	321	7	335	6
Asia-Pacific	1380	46	2032	54	2784	60	3492	65
Sub-Saharan Africa	114	4	132	4	166	4	212	4
Middle East and North Africa	192	6	228	6	258	6	285	5
World	3030	100	3766	100	4617	100	5412	100

Source: Kharas (2017)

Table 2.2 Spending by the global middle class, purchasing power parity (PPP), (constant 2011 billion US$ and shares)

	2015		2020		2025		2030	
	#	%	#	%	#	%	#	%
North America	6174	18	6381	15	6558	13	6681	10
Europe	10,920	31	11,613	27	12,159	23	12,573	20
Central and South America	2931	8	3137	8	3397	8	3630	6
Asia-Pacific	12,332	36	18,174	43	26,519	51	36,631	57
Sub-Saharan Africa	915	3	1042	2	1295	2	1661	3
Middle East and North Africa	1541	4	1933	5	2306	4	2679	4
World	34,814	100	42,279	100	52,234	100	63,854	100

Source: Kharas (2017)

and Road may be a Chinese initiative, but it is a global effort involving developed and developing countries, and international organisations" (HSBC 2017).

Between 2015 and 2030, the percentage contribution to the global middle class by the Asia-Pacific and Middle East and North Africa regions is projected to increase from 52% to 70% (see Table 2.1), whereas their share of the global spending contribution is expected to reach 61% by 2030, up from 40% in 2015 (see Table 2.2).

Beyond the obvious economic potential, the BRI also provides a pathway for accelerated *renminbi* (RMB) internationalization, following its official addition to the basket of currencies that constitute the IMF's special drawing rights on October 1, 2016. The RMB is expected to become more prominent in foreign trade "as the commercial activities between

China and countries along the BRI become more prominent" (HSBC 2017). This, in turn, will raise the prospects of China taking aim at reforming the international monetary system (Overholt et al. 2015) centered around Bretton Woods institutions (IMF and World Bank), and possibly advocating an alternative "Beijing Woods" model (Marsh 2015). The BRI may yet evolve into a conducive channel to promote alternative political economy, development and governance paradigms for developing economies, and effectively usher in a post-Washington Consensus era (Breslin 2011; Chan et al. 2008; Halper 2010; Williamson 2012; Zhao 2010).

From a purely geographic perspective, meanwhile, the trajectory of the planned land-based New Silk Roads (the Belt) aligns to a significant degree with Mackinder's "Heartland theory" (1904). Considering that it was subsequently summarized as "Who rules East Europe commands the Heartland; Who rules the Heartland commands the World-Island; Who rules the World-Island commands the world" (1962 [1919]), the Belt component of the BRI begets the obvious question as to whether it might herald China's Eurasian century (Roland 2017; Xiang 2004). On the other hand, the Road component is likely to be linked to concerns about China's naval strategy, especially considering simmering tensions in the South China Sea and (more recently) China's opening of its first overseas military base in Djibouti in July 2017 (Holmes and Yoshihara 2008; Xu 2006). Moreover, the Road also appears to straddle what Spykman called "Rimland" (i.e., regions surrounding Eurasia), and which he considered more critical than the "Heartland" for the purposes of securing ultimate control. As he put it, "who controls the Rimland rules Eurasia, who rules Eurasia controls the destinies of the world" (Spykman 1944: 43). Irrespective of one's theoretical preference, China has effectively hedged its bets by targeting both areas and is poised to maximize the influence and impact of the BRI on the global economy.

5 Geoeconomics as the New Geopolitics?

On October 5, 2015, the White House issued a statement by President Obama on the Trans-Pacific Partnership (TPP) in which he stressed that "when more than 95% of our potential customers live outside our

borders, we can't let countries like China write the rules of the global economy. *We should write those rules*, opening new markets to American products while setting high standards for protecting workers and preserving our environment" (White House 2015, emphasis added). Since then, however, the United States has walked away from the TPP and, in doing so, has opened the door for China to further extend its global economic clout.

Is China's New Silk Roads project an effort at disguising its geostrategic ambitions? China's expanding global engagement (Shambaugh 2013) has dramatically increased the stakes of competition and cooperation, and raises new questions about change and continuity in the international balance of power (DeLisle and Goldstein 2017). Whether the twenty-first-century Silk Roads will usher in a new era of cooperation or competition in the international system is too early to tell. After all, the economic impact of China's globalization and embrace of the mantle of a heightened level of global economic leadership, supported by an ambitious vision of economic cooperation and common development, is just beginning to reverberate through the global political economy structure. And although speculation about China's ulterior motives and the nature of the inevitable power transition are looming large, cautious optimism about China's ambitions might perhaps be just as warranted as unbridled alarmism is misplaced.

If the history of great power transitions is any indication, the twenty-first century is likely to witness just as much, if not more, change as it is likely to ensure continuity. It should be noted, however, that change by itself need not lead to increased competition and rivalry by default. There is no denying the fact that China is stepping up a foreign policy of economic statecraft and geoeconomic contest in the twenty-first century (Blackwill and Harris 2016; Norris 2016). Yet only time will tell if the leadership in Beijing will be successful in ushering in—and sustaining—a new era of global economic leadership, focused on economic cooperation and common development, with its signature economic initiative. The structure and dynamics of interactions of the twenty-first-century global political economy are beginning to be defined and debated amid an irresistible power transition in the international system. Interesting times indeed!

Notes

1. It is a widely accepted fact that there is no actual Chinese expression that literally translates into this widely quoted English expression. The closest Chinese approximation—*Níng wèi tàipíng quǎn mò zuò luànlí rén* (宁为太平犬莫做乱离人), translated as "Better to be a dog in a peaceful time than to be a human in a chaotic (warring) period"—is traced to *Stories to Awaken the World* (醒世恆言, *Xǐng shì héng yán*), a collection of stories published by Feng Menglong in 1627.
2. Having originally used the term "peaceful rise" (和平崛起, *hépíng juéqǐ*), the Chinese authorities subsequently opted for "peaceful development" (和平发展, *hépíng fāzhǎn*) as a way of deflecting concerns about the comparatively more aggressive and assertive connotation of the term "rise" and reassuring other nations of Chinese intent to emerge peacefully and integrate into the existing international order.
3. According to a 2017 Brookings Institution study, the global middle class will increase by 160 million people per year for the next five years. By 2028, the global middle class is expected to reach 5.2 billion (up from 3.2 billion in 2016, and a projected 4.2 billion in 2022). Based on this upward growth trajectory, the study projects that by 2020 the majority of the global population will, for the first time in history, be part of the global middle class, which is expected to increase its annual spending (in real terms) from US$35 trillion to US$64 trillion by 2030, accounting for a whopping one-third of the global economy. For more details, see Kharas (2017).

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3

The Global Strategic Environment of the BRI: Deep Interdependence and Structural Power

Thomas D. Lairson

1 Introduction

The growing turbulence in the global economy of recent years has come to be matched by turbulence in the Asian regional system of strategic, political, economic, and military relations. Unprecedented strategic interactions among great powers and emerging powers proliferate as part of and in response to the rapid ascendance of China. Perhaps the most striking is the Chinese initiative in creating the Belt and Road Initiative (BRI), a project that promises to reconfigure economic and strategic relations across much of Central Asia and the Middle East.[1] Missing from recent research on the BRI has been a sufficient consideration of the role of the global strategic environment that influences the purposes and outcomes of this effort.

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The strategic calculations for an aspiring dominant power today are distinctive from those in the past, largely as a result of the actions of the current dominant state, the USA, over the past 80 years (Ikenberry and Lim 2017). The nearly global scope of the liberal international order—based on complex globalized systems of capitalist production, trade, capital movement, and knowledge exchange, framed by global institutions, regimes, and norms—has created a strategic environment defined in many ways by deep interdependence and the importance of structural power. This chapter explicates this theoretical framework and applies it to understanding Chinese purposes, strategies, and potential outcomes from the BRI project.

The strategic implications of a global system defined by deep interdependence will be used to understand Chinese strategy in the BRI, specifically, advancing regional dominance in Asia through building structural power and leveraging this to advance additional political and economic goals. However, to be successful this effort requires a nuanced and accommodative set of policies and actions relating to mutual gains, governance, and managing internal and inter-state conflicts within the region. These propositions will be examined through a discussion of Chinese objectives for the BRI; the strategic interactions in the closest analog of the BRI, the Marshall Plan of 1947–1950; the overall capacity of the Chinese government to formulate, manage, and execute the BRI project; the creation and management of the institutional analog of the BRI, the Asian Infrastructure Investment Bank (AIIB); and the implications for the BRI of the emerging Asian security relationship composed of India, Vietnam, Japan, and the USA. We will consider one primary question on the nature and effects of deep interdependence and structural power, namely whether the BRI project will operate within the framework of a liberal order or whether expanding Chinese power will seek to displace part or all of this order?

2 Deep Interdependence and Structural Power

Over an 80-year period, the policies and actions of the USA have altered the nature of the global system. Through military, political, and economic policies and actions, the USA assumed responsibility for building and

enforcing system-minded rules, norms, regimes, and institutions framed around liberal conceptions of international relations (Ikenberry 2011). From preventing great power aggression against weaker states, to creating global economic and security institutions, to managing nuclear weapons and proliferation, to expanding freer trade and capital movement, to promoting an open global commons, to commitments to defend democratic states and allies, to managing global markets under stress, to accepting the former Soviet Union and Communist China into this liberal global system, the USA created dramatically new forms of global relationships. Most importantly, this process laid the basis for deep interdependence (Acharya 2014).

A global system of deep interdependence is composed of dense, tightly coupled, cumulative, and mutually reinforcing forms of exchange, interaction and norm-based relationships, creating a system distinctive from those existing prior to about 1950. The production of economic value and trade has expanded from a traditional exchange of physical goods across borders to a complex system of transactions involving: parts and components, points of assembly, and global knowledge flows; high volumes and various forms of capital flows, including foreign direct investment, portfolio investment, and debt (government and private); new private and public systems of infrastructure supporting exchange, such as logistics, port services, training for workers, educational systems, trade related finance, and bargains between firms and nations regarding the terms of production; increasingly distributed knowledge flows generated directly and indirectly by this system; negotiated and emergent rules, norms, regimes, and institutions among states and firms governing these transactions; and relationships of structural power among states and firms. Contemporary trade involves continuous multidirectional and networked flows of things, people, training, investment, and information that formerly took place within national factories and offices and now take place in globalized systems. Paralleling, sustaining, and reinforcing this economic system are security regimes, institutions, and norms framed around the preservation of peace.

The current system of deep and complex interdependence affects the incentives and choices of states by creating a shadow of the adaptive future that is difficult to imagine in positive terms outside this system. The very capacity for economic growth now involves intense and

voluminous interaction between national capabilities and global systems, with virtually no nation able to achieve sustainable growth without continuing access to this global system. The new forms of production, with open trade borders, and the diffusion of knowledge and innovation, have lowered the barriers to entry for poor states, thereby leading to unprecedented growth for many states, and mutual gains for much of the world. Expectations for future growth define the context for political choice, and elites almost everywhere understand this can only come from sustaining and advancing the existing global order.

Complex and deep interdependence increases substantially the size of gains and the way they are achieved, and the way gains and costs are distributed. Gains are largely mutual (but not equal) and require access to resources distributed across many states—that is, fostering growth, technology, and security require continuous access to the global system. Moreover, in the area of economic production and trade, it has become very difficult for one state to impose costs on other states that do not also fall on the imposing state, as we see from efforts by the USA to impose trade sanctions on China (Roach 2017). In periods of systemic crisis, the losses are widely shared and difficult to avoid. The confluence of the mutuality of interdependence in achieving gains and experiencing costs generates strong incentives for cooperation in managing the system of relationships among states (Milner 2014). Cooperation is essential for achieving gains and avoiding shared losses. This pressure for cooperation also arises from the seeming fragility of the system, as it is frequently subjected to systemic crises arising from global financial flows, requiring exceptional efforts by powerful states to restore stability.

Deep interdependence creates an increasing demand for, and is sustained by, the creation of and benefits from rules, norms, regimes, and institutions, for these provide the standards that facilitate interaction across great distances and many nations. As the volume of interactions rises, and interdependence deepens and becomes more complex, the greater is the demand for standards. It is great powers that both supply these standards and gain additional benefits from being the supplier. Structural power involves the ability to define the behavior patterns, rules, regimes, norms, and institutions for a system through the control

and creation of resources that facilitate the operation of the system (Mastanduno 2009; Nye 2011, 2017). Thus, structural power arises from the capacity for creating the rules, norms, regimes, and institutions that facilitate deep and complex interdependence. The value of this capacity in managing global systems and facilitating tightly coupled interactions rises disproportionately in relation to the volume and the connectedness of these interactions.[2] Examples of structural power include: the role of the US dollar as a key currency; the massive and relatively open US domestic market; and the innovative capabilities embedded in US higher education, firms, and research institutions.

A strategic environment of deep interdependence shifts the calculus and exercise of power from an emphasis on the threat and use of military force to the creation and manipulation of structural power (Kirshner 2007). This means that in a world of deep interdependence the capacity for shaping systems rises in relative importance to the power to hurt. Structuring the choices of others in the relationship to achieve the gains of the global systems is much more valuable, less costly, and more reliable than waging war for achieving great power aims. Military coercion is typically counterproductive, as disruptions in systems of deep interdependence produce widespread, significant and unintended negative consequences. A strategy of creating structural power, by which other actors must adjust their behavior to your preferences in order to achieve the gains from interdependence, is much the preferred approach. Deep interdependence does not eliminate conflict but changes the way nations attempt to "win" a conflict. We have an economic peace, in which great powers operating through global production, knowledge, investment, and trading networks do not go to war with each other, but are able to build influence over, and even direct, outcomes (Brooks 2007).

The strategic environment of deep and complex interdependence creates incentives for China to pursue its foreign policy goals through strategies framed around building structural power through enhancing economic growth for many states. Equally significant, this strategic environment affects the incentives of the USA in its acquiescence to this strategy. China's efforts will also be constrained by the multiple norms associated with this global order. This can most easily be seen in terms of

the norms now expected of the provider of such an order: gains for participant states must be clear and proportional; a fair system of governance rules, norms, and institutions must be the basis for choices; forthright Chinese policies must be developed for managing and resolving internal and inter-state conflicts within the region; and China cannot act in a unilateral and coercive fashion, such as in adjacent maritime areas.

3 Analyzing China's BRI in a World of Deep and Complex Interdependence

3.1 Chinese Objectives

The BRI is a massive project involving the funding and construction of a system of roads, railways, oil and natural gas pipelines, fiber-optic and communication systems, ports, and airports, with the model for this effort being the massive infrastructure efforts made by China as a key feature of its own rapid development strategy. This will create new forms of connectedness across much of Central Asia and on to Europe and will lead to greater interdependence and enhanced growth for states in these areas. Further, success will greatly enhance the stature of the Chinese economic model on a global scale and add to its soft power. Perhaps of equal significance, the BRI can contribute to recasting the infrastructure model by regionalizing China's surplus of capital and excess capacity in the heavy industries that produce this infrastructure (Knowledge@Wharton 2017; Dollar 2015).

China's efforts with the BRI reflect and operate within the liberal world order created by the USA. Indeed, in many ways the BRI project is an affirmation and clear indication of expected continuation of this world by China, perhaps even as it hopes to shift the global system more to its liking. China's ability to develop large-scale geoeconomic systems of economic interdependence and growth, and thereby develop important forms of structural power, reflects its integral understanding of the nature of the global strategic environment, defined by deep and complex interdependence. Certainly, for the foreseeable future China prominently defines the BRI as "win-win," specifically through the creation of an

economic system that will deliver mutual gains for all participants. Indeed, China has pledged in the "three nos" to avoid interference in the internal affairs of other nations, not to expand its sphere of influence, and not to seek hegemony or dominance.

There are derivative goals for the BRI that are surely of great importance to the Chinese, even if these are less visible. Domestically, the BRI is designed to reignite Chinese economic growth, especially in construction-related heavy industries with considerable overcapacity. In regional and global terms, the BRI is also part of an equally important effort to develop alternative and countervailing institutions and systems that create structural power linked to Chinese resources and capabilities (Heilmann et al. 2014). Structural power flows from resources and capabilities that create forms of public goods for all or parts of a system. A successful Chinese effort with the BRI will create a variety of new and important public goods-like resources that many, if not all, actors in the region must take into consideration in making choices. Systems of new and improved connectedness, and other forms of commerce-enabling infrastructure, will have large effects on the choices of states and firms, almost certainly attracting additional investment and commercial activity. Already, nations and firms are lining up hoping to be the recipients of BRI projects, and firms around the world are configuring their products and capabilities to win construction contracts. Such are the effects of structural power.

China's behavior in several contexts, but especially in the development of the BRI, strongly suggest its leadership understands the nature and value of structural power in a global system of deep interdependence and seeks to borrow many of the arrangements established by the USA in promoting structural power. This can be seen through its efforts in supplying capital, defining and implementing a system designed to provide mutual growth, and potentially providing the rules, norms, and institutions to facilitate the operation and management of such a system. Global and regional actors will need to take the BRI project into account because the system yields gains and benefits these actors will be drawn to. Of course, such systems of structural power will also serve to promote China's position, not only in the Asian region but also in much of the world, in opposition to American hegemony rooted in US structural power. Should

the BRI system achieve even some degree of success, China's regional and global position will be vastly enhanced (Wong 2016). Most broadly, the BRI will increase the gravitational pull on states and firms to participate as success breeds additional opportunities, even for many states and firms clearly involved in the US global order. Such is the nature and power of a liberal and open world that China can operate such an effort to build structural power and attract a very broad set of states to this effort. Even nations as closely connected to the USA as Israel and possibly Japan are likely to be moved to reap the gains of participation in the BRI (Shen 2016).

4 The USA and the Marshall Plan

The Marshall Plan is the closest analog to the BRI in scale, scope, and purpose, and offers important points of comparison relating to the creation of a globally dominant position through the construction of interdependence. The Marshall Plan combined strategic purpose with mutual gain, thereby leading to acceptance of the norms of a liberal world and to the creation of a system of deep and complex interdependence between the USA and much of Europe.

The Marshall Plan was a collection of grants to European states over a period of four years, typically tied to certain conditions, but broadly designed to create the basis for European economic recovery from World War II and to foster greater levels of European integration. It was premised on the expectation that European prosperity would solidify the relationship of the USA and Europe as military and political allies. The USA also used the Marshall Plan to reinforce US values in a war-torn Europe. Specifically, this included American-style capitalism, democracy, a broad commitment to a widely shared economic growth, and belief in the value of economic integration (Hogan 1987). The USA had many significant advantages in the Marshall Plan that China will not have in its BRI effort: substantially shared cultural and political values; recent and significant cooperation in fighting World War II; a budding security alliance relationship in opposition to Soviet threats to Europe; and a Europe, though then devastated by war, which had been rich and prosperous for

many years and could be quickly reconstructed. The outcome was the creation of a growing and much more secure Europe, ultimately enhanced considerably through political and economic unification. From the outset, the Marshall Plan was an intertwined effort linking security and prosperity. Its success led to the rebuilding and economic integration of Europe, to an enduring security alliance between Europe and the USA, and to the amassing of enormous structural power by the USA built on a transatlantic community. Perhaps more than any other US action, the Marshall Plan established the liberal ideal and reality of an open and positive sum world and led to an "empire by invitation" (Lundestad 2005).

Though many Chinese may reject the comparison, the Marshall Plan was an integral part of the construction by the USA of a liberal global order, premised on mutual gains from investment, trade, and common security concerns with Europeans. At the same time, in geostrategic terms the BRI dwarfs the Marshall Plan, as it stretches on land all the way from China to Northern Europe and by sea from China to Africa and into Southern Europe. The Chinese were both surprised and pleased at the large number and diversity of the states that signed up for membership in the AIIB. It suggests there is a wellspring of structural power to be created and tapped by China, especially if it is able to conform to the global norms of such a system.

5 Managing the BRI in an Environment of Deep Interdependence

There is manifold evidence the Chinese government understands the nature of deep interdependence and structural power as key elements of its strategic environment. This includes: progressively linking its economy to the global economy and achieving rapid economic growth; joining essentially all of the major global institutions; building institutions and regimes to provide rules for regional interactions; providing a stabilizing support to the global economy in the wake of the 2008 global financial crisis; and the very effort to construct the BRI. At the same time, constructing structural power in such an environment places very

large demands on the intellectual, human resource, and managerial capabilities of a state. Can China manage a giant multilateral project like the BRI and achieve a successful outcome? In a world of complex and deep interdependence, what does success look like and how can this be accomplished? There are special extenuating circumstances and challenges associated with building an international and multilateral system of structural power, largely from the ground up, and which extends well beyond any previous Chinese effort. These include:

- Making choices that consistently generate mutual gains of the type and variety preferred by other states.
- Making lending choices that reflect genuine economic value, even in the face of considerable pressure from Beijing to show progress.
- Incorporating a genuine multilateralism in the conception and operation of the BRI.
- Sharing governance across a wide diversity of states and viewpoints through the creation of multiple forums and institutions for dialog, policymaking, and implementation.
- Providing the assistance and nuanced advice to help weakly institutionalized states in the BRI make the reforms needed to cope with the process of large-scale projects and payments.
- Offering transparency for the definition and financing of projects sufficient to satisfy and attract private financing.
- Providing the bulk of financing for such a mammoth effort, even as China's debt to GDP approaches 300%.
- The Maritime Road cuts across the Indian Ocean, which India sees as a strategic asset. Can China possibly manage the security implications of such a situation, even as it is engaged in a long-standing, low-scale conflict along its border with India?

The Chinese governmental, financial, and business capabilities, which are formidable, will be severely tested in the implementation of the BRI. As of mid-2017, no Chinese agency has been placed in charge of the BRI, perhaps because of internal struggles within the Chinese government.[3] The BRI engages the interests of a number of governmental and quasi-governmental entities, such as state-owned enterprises. These

struggles will continue and present significant challenges in finding ongoing resolutions to sustain implementation. This also includes the ability of the officials at the AIIB to develop a staff based on merit and not on political considerations, make sound loans linked to sound projects, and then manage the likely issues associated with any default (Greenwood 2016; Reuters 2017). At a broader level, can China manage the wide array of political, economic, and cultural interests and preferences distributed across the vast expanse of this effort? For example, the perception/reality of differential gains among BRI participants presents large issues of trust for the Chinese (Hong 2016).

The BRI will create new security issues and opportunities to such an extent that many nations, including those in Europe, must take this into consideration in formulating policy. Relying on China to resolve security problems is almost certainly a necessary complement to the economic emphasis on infrastructure and growth. One of the most difficult of these efforts could be Chinese leadership to provide cooperation and security among affected states in the EU. This is one of the weakest elements of Chinese capabilities. China's position as an incomplete global power is most evident in the lack of any experience in creating and providing genuine security for other states. This will be a major hurdle for the Chinese (Ghiasy and Zhou 2017).

Although the commitment to a liberal order may be strong, there are several reasons to question the Chinese capacity for achieving this large and complex project, not least because many participant nations will present significant capability deficits and will not be able to contribute adequately to this process. Much doubt comes from Chinese experiences with similar efforts in Africa and Asia. There have been significant examples of poor choices for projects, coupled with loan defaults, and even in successful cases Chinese management has generated considerable hostility due to the inability to organize sufficient mutual gains. There has been large environmental damage, imported Chinese workers taking jobs that should go to locals, and too little cultural sensitivity (Larmer 2017). The very limited size of the actual financing and implementation of projects through 2017 suggests a "go-slow" process resulting from the multiple uncertainties associated with resolving these problems.

6 The Asian Infrastructure Investment Bank

Separate from but concomitant with the establishment of the BRI is the creation of the AIIB, which is designed to aggregate and allocate capital for infrastructure projects across Asia. The AIIB will provide funding to support infrastructure investment across Asia, primarily in the form of loans but including taking equity positions. The financing of the BRI depends overwhelmingly on China and will come from some combination of the AIIB, the New Development Bank, China's Export and Import Bank, China Development Bank, a special Silk Road Fund, and Chinese policy and commercial banks. The AIIB is composed of 80 member states, including many Western states closely associated with the USA. This consortium of states has agreed to pledge $100 billion for bank capital.

The financing arrangements of the AIIB parallel those of other multilateral development banks, in that it will borrow in global markets against the collateral of member states for the funds required to make loans. Operationally, this not only requires a positive spread between its borrowing costs and returns, but also deeply embeds the AIIB in the global financial system. This can result in a process that reinforces existing global rules. For example, the capacity for the AIIB to borrow funds in global markets will be based on an assessment of its creditworthiness as defined by global standards established in private markets. Ironically, participation of the USA and Japan in the AIIB—currently far from certain—would improve its capacity to borrow. Chinese engagement with Europe will also need to conform to European standards and this too can reinforce the importance of liberal order (Ikenberry and Lim 2017). In addition, the AIIB plans contain important institutional innovations that expand the role of developing nations in lending practices (Chin 2016).

Will China's efforts to create new regional and global institutions, such as the AIIB, lead it to ignore, challenge, or embrace the existing rules and norms of the global liberal system (Ikenberry and Lim 2017; Johnston 2007)? The answer probably involves all of the above. Chinese support of multilateralism, at least in the AIIB, is reflected not only in its size—80 nations, 20 of which are Western—but also in China's acceptance of a

range of global values in its loans, such as transparency and social and environmental standards (Shepard 2017). Early evidence suggests, not surprisingly, that AIIB loans do reflect transparency and social and environmental interests but will not require borrowers to privatize or deregulate state-owned firms.[4] The Chinese government remains committed to a form of state capitalism and will not conform to the private enterprise norms of the West (Qing 2015). The bank will modify some of the conditionality rules of other development banks and embrace both commercial and poverty reduction criteria for lending. Operating details regarding environmental and social sustainability criteria remain to be established (Chin 2016).

We should remember that in the arena of finance there is a large and active global network of institutions—part of the system of deep interdependence—able to evaluate and monitor the operation of the AIIB, thereby creating strong incentives to conform to global standards. Moreover, the size of the mutual gains involved in the BRI and the AIIB generates strong incentives to participate. Although in mid-2017 Japan was not a member of the AIIB, the Japanese-led Asian Development Bank has pledged to cooperate and not compete with the AIIB, and the Japanese Prime Minister has begun to talk of joining the BRI. The shift of position by Japan is a dramatic one and, along with the engagement of many wealthy Western nations, reflects the value and significance of structural power in a global order of deep interdependence (Pollmann 2017). The astonishingly inept and counterproductive decisions of the Obama Administration in its unsuccessful effort to undermine the AIIB and persuade countries to avoid joining has been exceeded by the Trump Administration's decision to withdraw from the Trans-Pacific Partnership and undercut trade agreements around the world. These actions have harmed the USA's global position and are likely to have opened the door to additions to China's structural power (Etzioni 2016). Although observers may be critical of some of the governance provisions of the AIIB, and especially the absence of preferences for private enterprise, these are not essential elements of a win-win liberal system (Ong 2017). Most evidence thus far is that China will continue to base much of the AIIB on existing global norms, regimes, and institutions.

7 Soft Balancing Against China: USA, Japan, India, and Vietnam

One of the least clear features of the Chinese BRI project is the impact of the complexities of the political relationship between China and other regional powers in Asia. Over the past decade or so, first in limited form but recently with greater clarity, several states have developed a set of related but lightly integrated bilateral relationships that stand against Chinese actions and power. In some sense, the seeming alignment of actions and purposes suggests a more multilateral dynamic at work (Hughes 2016). The existence and deepening of the relationships among this group of states, developed primarily because of Chinese maritime assertiveness in the South China Sea, produces a variety of political contradictions with the BRI project. At the same time, the actions of the USA, Japan, India, and Vietnam do not yet rise to the level of a coherent resistance to Chinese policies and actions.

The orchestration of this arrangement of soft balancing comes from the USA, and more recently India, with a widening array of actions and emerging relationships with Japan and Vietnam directed somewhat clearly against China. In summary form, the actions include: multiple meetings of heads of government, with frequent announcements of new initiatives for cooperation, including resolution of existing conflicts; agreements on military cooperation, including military exercises; ending arms embargoes, initiating sales of weaponry and support systems; integration of military information systems; major defense partnership status; formal strategic dialogue; alignment of positions on international law; maritime security and consultation and coordination on security issues; commercial and military credits; large-scale investments; and encouragement and support for a Vietnamese leadership role in resolving South China Sea issues. The most important frontline state in the South China Sea is Vietnam and the combination of relationships established with Vietnam has strengthened its strategy toward China on this issue, including expanding capabilities and assertiveness in pressing its case with China (Thayer 2017). The end result of these efforts is unclear but can only relate to increasing the pressure on China for a positive resolution of the maritime conflicts in the East and South China Seas.

The political and strategic environment for the Marshall Plan included a common adversary, whereas for the BRI the expanding arrangement of resistance to Chinese expansion represents a serious liability for China. Broadly, the political climate for cooperation relating to the BRI is damaged by the continuing and somewhat escalating context of conflict over maritime issues. The pattern of Chinese assertiveness followed by periods of "cooling down," in combination with its rejection of the ruling by the Permanent Court of Arbitration arbitral tribunal, suggests a continuing period of enhanced association of the USA, India, Japan, and Vietnam, and a periodic series of low-level Chinese provocations. The contradictions between China's BRI strategy and its South China Sea strategy are very significant and could certainly produce important problems for the credibility of China's expanding commitments in the BRI. In particular, this issue seriously undermines the conclusion that China will abide by global norms of strategic behavior. Should China reverse its current resistance to an ASEAN-negotiated Code of Conduct for the South China Sea and move toward an accommodative resolution of this issue, much of this uncertainty could be allayed.

8 Conclusions

Success for China's BRI strategy may well contribute to important shifts in global power relations but it is not likely to undermine global stability. Even as this project builds structural power apart from the USA, the overall effect is to reinforce a liberal global system. There is considerable irony in the US response to the BRI and the AIIB, when the nation benefiting the most from structural power adopts a fumbling and inept response to Chinese efforts at the same strategy. The USA needs to realize the best long-term outcome will be gains from a reaffirmation of the liberal order.

At the same time, it is far from clear that China can manage such a large and difficult task, so the USA may need to do nothing to get what it wants. But a Chinese failure may be the event that triggers a rejection of this order, which would be the most destabilizing outcome. The liberal global order requires large and sophisticated efforts by leading nations to

reconcile conflicts and accommodate differing interests. The effort to build such systems will severely test China's conceptual, human resource, and diplomatic skills. Even so, success in creating structural power often leads to circumstances that produce additional but new forms of structural power. Much like the Marshall Plan did for the USA, the BRI could well become a platform for expanding and deepening China's role on a global scale. This outcome depends primarily on China's ability to leverage the existing global system to its own ends.

The strength of the global system of deep and complex interdependence extends beyond the USA, even as it sustains US power. Though China has considerable capabilities and will continue to grow, the combination of economic, political, military, and structural power of the USA remains unmatched. The USA can even withdraw from some of its responsibilities, yet the incentives of deep interdependence will continue to move states toward cooperation, building structural power, and avoiding war among great powers (Nye 2017; Ikenberry 2014). The initial evidence on the AIIB strongly suggests China will continue to feel an incentive to conform to the norms, rules, and regimes of the US-created liberal order and this will increase the chances of the success of the BRI and its affiliated institutions. By contrast, the issue of the maritime position of China, and the soft balancing by the USA, India, Japan, and Vietnam generates considerable doubt about China's reliability as a state capable of creating relationships of mutual gain in an environment of deep interdependence. If the contradictions between China's position on maritime relations and the global liberal order cannot be reconciled they will continue to afflict China's effort to establish structural power. Operating as a nineteenth-century great power on the one hand and as a twenty-first-century great power on the other is not a strategy for consistent success.

Notes

1. The nomenclature of this project has been somewhat variable. The widely used One Belt One Road (OBOR) is a shortened version of the official, The Silk Road Economic Belt and the 21st-Century Maritime Silk Road. Our choice is Belt and Road Initiative (BRI). See http://languagelog.ldc.upenn.edu/nll/?p=32746. Even this may change.

2. This is a form of network effects.
3. Zhang Gaoli, vice premier and member of the Politburo Standing Committee, has been named titular head of the BRI, but the bureaucratic structure of this arrangement is unclear.
4. For details on AIIB projects and lending, see https://www.aiib.org/en/projects/approved/

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4

One Belt, One Road, One World: Where is US Business Connectivity?

Xiaohua Yang, Donald J. Lewis, Stephen Roddy, and Diana Moise

1 Introduction

China, as the world's second largest economy and largest exporter, has continuously sent shock waves around the globe. One of the biggest has been the launch of the One Belt, One Road (OBOR) or Belt and Road Initiative (BRI, 一带一路倡议). On March 28, 2015, China's top economic planning agency, the National Development and Reform Commission, released a new action plan outlining key details of President

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Xi Jinping's OBOR initiative, which was announced in late 2013. The BRI aims to link China to Europe, the Middle East, and Africa, via routes that could cover 55% of the world's GNP, 70% of the global population, and 75% of its known energy reserves. The BRI is buttressed by the $40 billion Silk Road Infrastructure Fund, the Asian Infrastructure Investment Bank (AIIB), with registered capital of $100 billion, and the BRICS New Development Bank, with eventual capital of $100 billion. The BRI has rightly been called "the most significant and far-reaching initiative that China has ever put forward" (Dzodin 2016).

While the rise of China is the most important business phenomenon of the twenty-first century (Davies and Raskovic 2017), the BRI is one of the most ambitious human projects experienced by the world, which aims to integrate geographically contiguous countries in Eurasia into an economically cohesive region via the land-based Silk Road Economic Belt and the oceangoing Maritime Silk Road (MSR). At $1.4 trillion and still growing, China's stated financial commitment to these projects is eleven times the size of the Marshall Plan, restated in current dollars; it is the largest and potentially the most transformative engineering effort in human history (Freeman 2017). Projects will be land bound from Kunming to Singapore and, separately, to Kolkata; Kashi [Kashgar] to Gwadar (which also is a key port), and separately to both Tashkent and Tehran; Xi'an to Istanbul and then to Moscow, Rotterdam, and Lisbon.

While the USA may appear not to be on the geographic pathway of the BRI (however, see Fig. 4.1 for a different perspective on the connectedness of all the planet's land masses), does that mean that the USA should remain aloof? The US government has been sending unclear signals in the last few years and US commentators only began to warm toward the BRI when the Trump Administration sent the Pottinger-led delegation to the BRI Summit in May, and the Administration announced support for US companies to participate in the BRI on June 22, 2017. This study intends to address the questions: What makes US businesses connect to China's twenty-first-century monumental BRI project? What are the gains, costs, and risks of such connectivity to the USA and US firms?

Fig. 4.1 How are the land masses connected on the planet? Source: Map of Proposed World Landbridge, reprinted with permission of EIR News Service, Inc., all rights reserved

International business theories suggest that multinationals from advanced countries expand overseas to exploit their firm-specific advantages (e.g., Dunning 1977; Rugman and Verbeke 2001). We suggest that the US firms' connection with the BRI is inevitable given the superior technological advantages and other core capabilities these firms have across a wide range of economic sectors, including information communications technology (ICT), energy industries (including clean energy), infrastructure and construction, engineering, logistics, e-commerce, legal and accounting services, finance (including fintech), and environmentally friendly industries and sustainable development (including green and circular economy sectors). Given the massive economic integration initiatives currently underway and encompassing all of the countries associated with the BRI, US businesses are likely to find location advantages in BRI countries. Gains seem obvious, but not without costs and risks in the current geopolitical environment, which are elaborated on in the next section.

2 BRI in History: US Involvement Along the Silk Road

In contrast to the 300-plus year history of American engagement in maritime trade in East and Southeast Asia, US actors have been largely absent from the land-based trading routes connecting China to Central Asia. One of the few exceptions was Owen Lattimore (1900–1989), who worked as a trader in Inner and Outer Mongolia in the 1920s. Lattimore's familiarity with the region raised its American profile during his tenure as editor of the Beiping (Beijing)-based periodical *Pacific Affairs* in the 1930s–1940s, but this never translated into more lasting business opportunities. Significant US business involvement in Inner Asia had to wait until the 1990s, when opportunities for investment were facilitated by the emergence of independent states in Central Asia, the decline of Russia's influence there and in Mongolia, and China's economic opening.

Among modern nation-states, Russia has the strongest historical foundations for Inner Asian continental trade with China. Commercial ties between the two nations may have been relatively small in scale before the reign of Catherine the Great (r. 1762–1796), but they assumed increasing significance as an outlet for Chinese luxury goods about the same time as tea, silk, and other export items began to flow to Europe and the USA through the maritime trade routes. Instead of traversing the ancient Silk Road routes through Xinjiang and Samarkand, however, the principal artery of Russian land-based trade ran from near Beijing through Inner and Outer Mongolia, into Siberia, and across the vast Russian steppes to Moscow and St. Petersburg. Similar to the Canton-based *Cohong* (guild) merchants, the Horhot-based Shanxi merchant firm Dashengkui grew immensely wealthy from the trade with Russia and Eastern Europe, to the extent that by 1893 its capitalization was equivalent to 70–100% of the total land-tax revenues of the entire Qing Empire (Qiao 2017: 31).

Although this trade lagged during much of the twentieth century, these historical foundations, coupled with the geographical proximity of Russia and China, potentially hampered the USA from assuming a major

role in Inner Asian trade. Successive American administrations have tried to overcome this disadvantage, in part through sponsoring initiatives such as the American University of Central Asia in Bishkek (Kyrgyzstan). Nonetheless, USA-based expertise on contemporary Central Asia remains limited, and military meddling in and around Afghanistan has compounded these difficulties. Moreover, instead of seeking peaceful, constructive engagement, the USA has perversely imposed sanctions on two of the most important links in the BRI network, namely Iran and Russia. This clumsy approach continues to hinder the collaboration across multiple political borders that will be essential if US businesses are to be successful there in the medium to long term.

In short, while US connectivity to the historical Silk Road is almost non-existent, given the country's short history, with the advent of the Cyber/Digital Silk Road its connectivity to the current BRI may present a totally different picture, given that the USA is a global epicenter for advanced technology, energy production, financial institutions, industry rules and standards, and the pervasive presence and utilization of US technology around the globe.

3 US Connectivity with the BRI in the Digital Age

According to the World Economic Forum, human society has now embarked on the Fourth Industrial Revolution, which builds upon the Digital Revolution, and is characterized by a new wave of technologies that have the potential to fuse and transform the physical, digital, and biological worlds we currently inhabit (Schwab 2016). The Fourth Industrial Revolution is marked by emerging technology breakthroughs in several fields, including robotics, artificial intelligence (AI), nanotechnology, quantum computing, biotechnology, Internet of Things (IoT), 3D printing, and autonomous vehicles (Schwab 2016). In stark contrast to earlier revolutions, from which it was largely absent to its immense detriment, China is likely to be at the very heart of such future epochal disruptive technological developments. The challenges of logistics, transport, time, distance, and

speed that propelled the Second Industrial Revolution remarkably are reappearing in the Fourth with the advent of the BRI. The BRI provides renewed opportunities for quantum leaps in innovation in such fields, while promising new, as yet unimagined, modalities for how we manage space-time and optimize multifarious cross-border data flows.

A major defining feature of the Fourth Industrial Revolution and, coincidentally, the BRI, is connectivity. Connectivity is ushering in a new era of deepening globalization and transforming how international business is conducted. Connectivity may well be the most dynamic force of the twenty-first century (Khanna 2016: 7–11). Governments and businesses are currently investing trillions of dollars per year in transportation, energy, and ICT infrastructure to stimulate and integrate the global economy (Khanna 2016: 11). Connectivity may, over time, render nation-states obsolete as it focuses on "hub" and "node" cities, and disregards or erodes the importance of national borders (Khanna 2016: 279–99). Connectivity is achieved by both physical and digital means. At the heart of the BRI is connectivity—as evidenced by the BRI transit corridors and their underlying physical and digital infrastructures. One of the five BRI pillars is "Facilities Connectivity" (Lewis and Moise 2017: 20).

Complementing closely the Cyber/Digital Silk Road, China is also developing the more traditional MSR. On June 20, 2017, President Xi Jinping announced China's vision for maritime cooperation, setting forth for the first time the details of the BRI by sea. In a world in which 90% of all trade is carried by sea, the modern MSR is bound to have a strong impact. With an emphasis on sustainable development, the MSR focuses on marine resource utilization, industry cooperation (in industrial parks for maritime sectors, and economic and trade cooperation zones), maritime connectivity (by building shipping service networks and shipping centers), transport (by facilitating mutual recognition of customs regulations, or mutual assistance in law enforcement), and information connectivity (by building information networks and exchanges, and ensuring security and coverage).

The MSR vision unveiled the geographic scope of this monumental oceanic undertaking, which consists of three "blue economic passages": (1) the China–Indian Ocean–Africa–Mediterranean Sea Blue Economic Passage, which connects the China–Pakistan Economic Corridor (CPEC) and the Bangladesh–China–India–Myanmar Economic Corridor; (2) the China–Oceania–South Pacific Blue Economic Passage, starting from

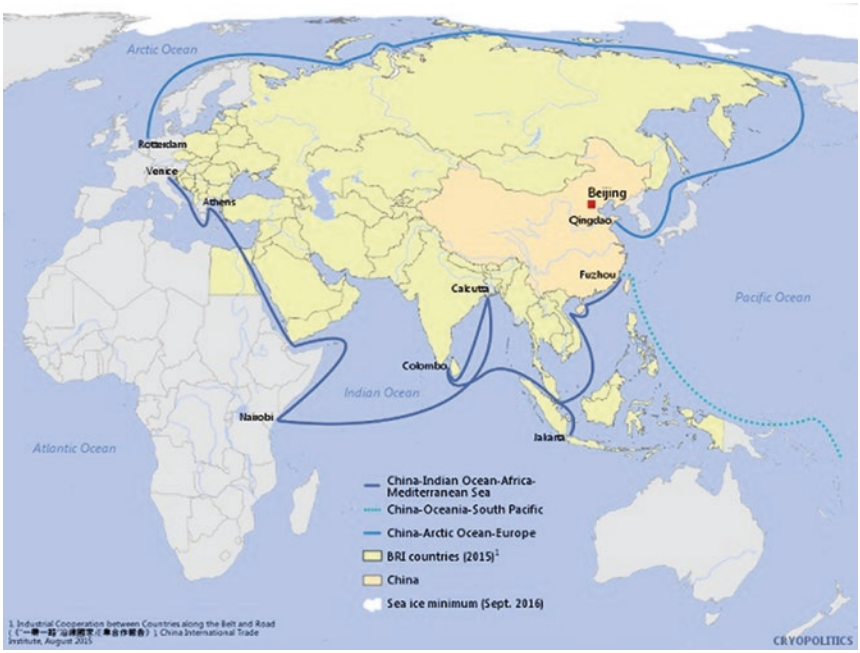

Fig. 4.2 Tentative map of BRI corridors. Source: https://www.maritime-executive.com/editorials/china-plans-arctic-belt-and-road-initiatives#gs.tBiWSPA

the South China Sea and continuing into the Pacific Ocean; and (3) a passage reaching Europe through the Arctic Ocean, whose more concrete details have not yet been disclosed (Fig. 4.2).

The blue economic passages follow the pattern of the already familiar economic corridors developed as part of the land route. The concept of economic corridors distinguishes itself from other initiatives through the network effects of combined bilateral and multilateral agreements. These agreements are concluded in various forms, ranging from Memoranda of Understanding to Free Trade Areas. Furthermore, they facilitate supply chains along areas with deep historical connections, in a unique combination of public and private intervention (Lewis and Moise 2017: 19).

USA–China relations are already characterized by a deep, profound connectivity, and concomitant economic interdependence. As of 2016, the USA and China are each other's largest trading partners. The majority

of US international trade is carried by sea, more precisely 53% of imports, and 38% of exports, with China being its top maritime trading partner. Each country is heavily invested in the other's economy and together constitute the world's numbers one and two foreign direct investment (FDI) destinations. The US, and especially the State of California, is a major recipient of Chinese outbound FDI (Hanemann et al. 2017: 32–33). A de facto comprehensive strategic partnership exists between the two countries, which has been described as G-2. However, the fact remains that the USA is not considered a BRI country, although the Trump Administration has expressed its support for the participation of American business in BRI projects and has just endorsed the development of the CPEC. Remarkably, the BRI generously comprehends the concept of "open inclusiveness"—that is, any country is free to participate in the BRI—including the USA. As the MSR is looking to build more ports and associated free trade zones, access will improve maritime transport worldwide. The Chinese initiative is a game-changer as the adjoining developments are open to any interested party, this in a context in which the standard practice is for a private company to open a port or operate a terminal exclusively (Shepard 2017).

As the Cyber Silk Road is still at an incipient stage of development, many of its elements are only now being identified and mapped by China and other BRI countries. Nevertheless, the maritime developments feed into its evolution. This presents an unparalleled opportunity for US companies in the ICT and Internet sectors to gain first-mover advantage in the construction and operation of this newest Silk Road. It also clearly plays to US competitive ownership advantages, not only for the IT giants of Silicon Valley, Silicon Alley, and Redmond, but also for a wide range of tech-savvy SMEs and start-ups, which collectively possess many ownership advantages. They will not be able to leverage their ownership advantages unless they participate in BRI e-commerce activities and evolving regional supply chains to leverage the location advantages (Lewis and Rogowsky 2015).

There are also large issues that will need to be addressed and resolved if the Cyber Silk Road is to operate smoothly, seamlessly, and safely. "Rules of the (Cyber Silk) Road" will need to be co-created, not just by governments, but inclusive of all relevant stakeholders, especially those

whose business is the Internet (Lewis and Rogowsky 2015). These "Rules" include, among others, interoperability, Internet governance, jurisdiction, conflict of laws, mutual legal assistance, trade facilitation, electronic contracts and documents, intellectual property rules, privacy, the protection of personal data, cross-border dispute resolution, and the convergence/integration of trade facilitation and e-commerce (Lewis and Rogowsky 2015). On the maritime side, China and the ASEAN States have agreed on a code of conduct in light of the notorious PCA arbitration with the Philippines regarding the South China Sea (Parameswaran 2017).

Chinese and US business leaders, government officials, engineers, scientists, academics, lawyers, and judges, in cooperation with BRI participants, should convene to discuss how best to structure a collaborative dialogue to address these "Rules of the Road" and formulate appropriate Cyber Silk Roadmaps. Institutional support is likely to enable such a collaboration (North 1990). Important vehicles to launch a comprehensive program include: the newly reorganized bilateral USA–China Comprehensive Economic Dialogue and Law Enforcement and Cyber Strategic Dialogue; subnational USA–Chinese state–provincial cooperation as well as USA–China sister cities associations; and the prescient Stanford–Berkeley–MIT Cyber Initiative, inaugurated by former President Obama in January 2015 in California.

On the maritime side, the AIIB is making cross-country connectivity through maritime routes a priority, particularly in South Asia, South East Asia and the Middle East. It is noteworthy that China has announced a $57 billion investment plan for the Gwadar port and free zone, an essential trade hub for the CPEC. The United Nations has acknowledged the importance of these developments as the Security Council recently recognized the BRI, and CPEC in particular, in a resolution issued on March 17, 2017 (S/RES/2344 2017: para. 35). This shows the international consensus toward recognizing the BRI.

Received multinational enterprise (MNE) theories suggest that firms seek out ownership and location advantages and they tend to leverage such advantages to expand their international business (Barney 1991; Dunning 1988). Ownership advantages refer to the possession and leveraging of certain valuable, rare, unique, hard to imitate, and organi-

zationally embedded intangible assets (i.e., proprietary technology and knowledge), strategic assets (i.e., competences and capabilities), and a firm's multinationality, that is, a platform from which the firm's assets can be further exploited internationally (Barney 1995).

Location advantages come from unique features, such as easy supply of natural and labor resources and government incentive policies. Thus, by possessing and leveraging these advantages, a MNE is likely to engage in cross-border, value-creating activities through their coordinated system or network (Cantwell et al. 2010; Dunning 2009). In the digital age, firms that possess proprietary technologies are more likely to be in a strategic position to leverage location advantages in foreign markets.

US big businesses have been quick to recognize the lucrative potential of the Cyber/Digital Silk Road. Many leading American ICT multinationals, such as Microsoft, IBM, Apple, Qualcomm, Intel, Cisco, and Oracle, have been enmeshed in the Chinese digital economy for decades. Their established China platforms now allow for relatively easy ingress to the BRI. Of course, such MNEs are already operating independently in many of the BRI countries to leverage location advantages. The Asia-Pacific Gateway (APG) is a clear example of digital connectivity by sea in which American big business has been involved. The APG is a submarine fiber-optic cable connecting China, Hong Kong, Japan, South Korea, Malaysia, Taiwan, Thailand, Vietnam, and Singapore. Companies that are part of the consortium include market leaders from all states, including the US Facebook, who invested an undisclosed value in 2012. APG represents an opportunity for cooperation, as the Japanese company NTT will manage junctions in Osaka and Tokyo to a cable connecting to Grover Beach, California, and Harbor Pointe, Washington, known as PC-1 (Fulton 2016). Although PC-1 and other previous attempts, such as the Asia America Gateway cable, are in service, another subsea cable is being built. (Fulton 2016) The Southern Cross Cable Network will travel from California to Sydney, also connecting to Japan. Facebook, Microsoft, and Google have all been consistently investing in similar initiatives. It seems that the APG bridges a gap, facilitating a long-sought connection. As American businesses have clearly expressed an interest, it is only a matter of time until the efforts yield results.

Microsoft is particularly well positioned to participate in the BRI via its ubiquitous Windows operating system and suites of business software products. To underscore its commitment to the Cyber/Digital Silk Road, in 2016 Microsoft jointly launched, with the Dunhuang Research Academy, "Xiaoice": an online chatbot imparting cultural information to Internet users about the Buddhist Mogao Grottoes along the ancient Silk Road, demonstrating how, in the age of the mobile Internet, AI can facilitate the understanding of different BRI cultures (Liu et al. 2017). Global market leaders Amazon and Microsoft, via Amazon Web Services (AWS) and Azure, respectively, are also posed to extend their cloud computing technologies to BRI countries, following the path of Alibaba's Aliyun. IBM has likewise entered the fray, having partnered in March 2017 with a division of the Wanda Group to provide IBM cloud computing services, such as Watson, blockchain, and the IoT, to Chinese companies via Wanda's data centers (Darrow 2017). Amazon, despite its limited success to date in penetrating the Chinese domestic market, appears to be gearing up for a major role in BRI e-commerce, taking on the heavyweight Alibaba—initially in the India and Southeast Asian markets (Koyanagi 2017). Fintech, in which China now leads the world (Mittal and Lloyd 2016: 6), is also attracting the interest of US financial institutions, including Experian and Silicon Valley Bank. In 2016 Silicon Valley's PayPal teamed up with China's UnionPay to facilitate cross-border e-commerce payments. As a result, foreign retailers in BRI countries, particularly those in Europe, now accept e-payments from UnionPay credit and debit cards via PayPal's Braintree m-commerce platform (Soper 2016).

4 Gains, Costs, and Risks of US Business Connectivity with the BRI: Resource-Based and Institutional Views

While the international business scholarly contribution to the BRI discussion remains very limited, with a few exceptions (e.g., Tung 2016), commentary and debate over policy have shed some light on the key issues surrounding US connectivity to the BRI, particularly on the gains,

costs, and risks of US involvement. First of all, the imperative of US connectivity to the BRI is not so much rooted in historical connections as it is to pragmatism, and the competitive firm-specific advantages of US firms to participate in BRI countries and international cooperation—in fact, nothing less than the future global competitiveness of US firms is at stake. A resource-based view (RBV) suggests that firms participate in international markets when they own valuable, non-substitutable, and difficult to imitate resources and capabilities (Barney 1991), such as upward technological capabilities. RBV informs us that firms are driven to expand overseas when they see the potential in foreign markets by leveraging their firm-specific advantages (Barney 1996, 2001). Using RBV's basic theoretical logic, we posit that tremendous firm-specific ownership advantages enable US firms to more effectively extend, transfer, and leverage their firm-specific capabilities to connect with BRI countries and their markets. Connecting and operating directly in the BRI also allows US firms to utilize the many beneficial programs brought about under the BRI umbrella structure by leveraging location advantages.

It is an accepted fact (at least for now) that US firms possess the most advanced technologies and other know-how. Possession of such ownership advantages places US firms in a competitive position to exploit location advantages offered by BRI programs. Despite the fact that the US government has not exerted an active role in the BRI, US firms' ownership advantages may lend themselves to effectively connect to BRI countries that are likely to need technologies from US high-tech firms.

As China continues its development of the BRI, ensuring that China remains integrated in the global economic ecosystem is of paramount importance to all parties. After all, "American business is China business and China business is American business (你中有我,我中有你)" (remarks by Yang 2015). Isolation will only drive China to develop its own rules and standards, which will be difficult to overcome once established. American businesses need to actively participate in the BRI to help shape its direction. Otherwise, they risk falling by the wayside (Bohman et al. 2017). Institutional views inform us that government can enable or constrain a firm's business activities (North 1990). The uncertainty in current USA–China relations poses costs and risks to the

involvement of US firms in BRI projects. Without the US government fully engaging in the BRI program, US firms may be at a disadvantage in bidding for projects and operating in a BRI environment. For instance, the fact that the USA is not an AIIB member country may hamper US firms from getting funding from this bank for their BRI projects or even bidding them. Other avenues for funding may raise costs or post other risks.

Second, the re-emergence of both China and the BRI as a whole may require a major shift from the mentality of American global dominance and habits engrained after decades of nearly unrivaled American global competitiveness, to that of co-existence, cooperation, and engagement. Participation of American businesses is a most effective means to help shape the BRI development process into a transparent, fair, and collective decision-making process to ensure its continued transformation into a "peaceful economic project," benefiting all participating countries (Bohman et al. 2017).

As Matt Pottinger pointed out, US firms may find good opportunities in BRI projects, especially in the areas of infrastructure, financing, the environment, and even energy. Given that the United States is a leading power in energy and financial services, US firms' competitive advantages in such BRI projects would land them winning bids if the US government becomes a facilitator like other foreign governments (Chen 2017).

With China's goal of achieving $2.5 trillion in trade with Silk Road countries by 2025, the Chinese government is encouraging mergers, acquisitions, and greenfield investments in BRI countries. The current surge of Chinese merger and acquisition activity in the EU reflects this objective, as does a desire to upgrade Chinese technology. China's continuing urbanization and investment in fiber-optic cable could provide new market opportunities for Silicon Valley high-tech firms that possess firm-specific advantages.

In fact, gains from participating in the BRI go beyond US firms. US domestic infrastructure projects can be improved by embracing Chinese firms and capital, provided they follow US domestic investment and environmental rules. By joining in BRI projects, the United States would actually be in a better position to monitor China's practices and voice concerns where needed, all of which would only make the initiative more

effective and transparent in the long run, bringing the BRI more in line with US interests.

The USA can gain a voice in the BRI by having US firms be conduits for the USA–China Comprehensive Economic Dialogue—in which to discuss a joint economic development agenda and come up with a role for the United States to play to its strengths. American defense contractors, for example, could provide physical security and cybersecurity services to BRI projects, and the US military could help secure some of the more volatile regions, where Washington already has military assets, such as the Horn of Africa. That would spare China the need to increase its overseas military presence and bolster the legitimacy of the US forces working in those areas. By embracing the BRI, the United States could ensure that American firms and investors are not excluded from the opportunities offered by what might become the biggest economic development project in human history. Washington's engagement could also encourage some of the European, Japanese, and South Korean investors who have been reluctant to fund Chinese-led infrastructure projects to change their tune—which would have a broadly positive impact on global growth and, by extension, on the US economy. And by becoming a more active participant in the BRI's various related institutions, the United States would be in a better position to ensure that China's projects adhere to the rules of the game. The involvement of formal institutions is an effective conduit to unleash business opportunities for firms (Yang and Stoltenberg 2008).

In light of the burgeoning development of the Cyber/Digital Silk Road and evident rising US commercial engagement, the time would seem ripe for the formulation of a USA–China Connectivity Platform, which would publicize IT business opportunities and challenges inherent in the Cyber/Digital Silk Road, while also bringing together American and Chinese stakeholders at both national and subnational levels. Important participants and beneficiaries of this proposed Connectivity Platform should include SMEs and tech start-ups. This medium would also provide a forum for airing the multitude of technical, legal, and business issues that will arise from the construction of this hugely promising, but also profoundly disruptive, Silk Road. Such a vibrant bilateral platform would present opportunities for deep collaboration—not only with

Chinese, but also other BRI, partners—and offers the prospect of future fusion with similar BRI initiatives now under construction along the emerging Cyber/Digital Silk Road.

5 Conclusions

As much as the BRI may have geopolitical overtones, getting US firms to the bidding side and bringing them to the negotiating table may not only bring windfall gains for US firms, but also serve as an important step to keep a US voice heard in BRI circles. With the USA's prominent position on critical technologies and its strong economic foundation, BRI countries and projects need US business connectivity and need to follow established, though evolving, common standards. US interests can be served better if it can leverage the BRI to American advantage and if both sides work to facilitate international business transactions and cooperation. Ultimately, China and the USA have to ask each other if they are willing to share the common destiny of humanity. Are they willing to prosper together? Are they willing to embrace each other? What should they do to maximize the gains for their firms and their economy, while minimizing the costs and risks for themselves?

This chapter contributes to the scant, but growing, literature on the BRI by contextualizing US connectivity from resource-based and institution-based views. We are keenly aware that our study is limited by availability of empirical data and we are struggling with defining the phenomenon in the wilderness of the BRI; nonetheless, based on anecdotal evidence we are able to explore trends in US connectivity to the BRI, especially the Cyber Silk Road, and offer a number of implications for future research in this area. As the BRI is such a broad and unwieldy emerging field for international business scholars, future research needs to define the magnitude of the BRI's impact on firm behavior and define specific contexts in studies, given the vast variations between the more than 60 BRI countries. For studies on bilateral business relationships, such as this one, researchers could focus on the collaborative behavior of US firms and how networks with Chinese firms investing in the USA facilitate US firms' ability to gain bids for BRI projects, as well as how the

government policy shifts affect business decisions. Specifically, we should ask the following questions: What are the factors that can increase the likelihood of US firms participating in BRI projects? What role do cultural and institutional distances play in encouraging (or discouraging) US firms from participating in BRI projects? How does the US government's policy shift affect the collaborative behavior of US firms in BRI projects? How does partnering with Chinese firms investing in the USA facilitate or enable US firms to gain bids for BRI projects? How do USA–China business partnership outcomes vary across the Land, Maritime, and Cyber Silk Roads?

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Part II

Regional and Geopolitical Perspectives

5

Free Trade Agreements as BRI's Stepping-Stone to Multilateralism: Is the Sino–Swiss FTA the Gold Standard?

Tomas Casas i Klett and Omar Ramon Serrano Oswald

1 Introduction: A Dynamic Framework for BRI Initiatives

The rapid evolution of the Belt and Road Initiative (BRI) has helped clarify its objectives and main drivers. Significant changes to the BRI have occurred since September 7, 2013, when President Xi Jinping made his "Promote People-to-People Friendship and Create a Better Future" speech at Kazakhstan's Nazarbayev University, which was followed by a subsequent visit and a similar announcement in Indonesia.[1] Pundits then went on to interpret China's initiative and some concluded that "OBOR

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is still a conception which lacks tangible strategy" (Shen 2016). Recently, the active process aimed at increasing the strategic coherence of the Silk Road Economic Belt and the twenty-first-century Maritime Silk Road initiatives has borne fruit. The initiative's English branding reflects this process. Initially terms around the Silk Road notion were emphasized, as in New Silk Road; then came the literal translation of 一带一路 (*yidai yilu*), One Belt, One Road, with its OBOR acronym. In early 2016 the term Belt and Road, with the acronym BnR, was favored. At present, the English branding seems settled, with the all-important qualifier "initiative" a part of the official BRI term.

Conceptually, the BRI centered around the idea of physical connectivity (Aris 2016), bringing together the vast swaths of Eurasia via investments in rail, roads, ports, or energy pipelines. As a result, it was also assumed that the main beneficiaries of the BRI would be state-owned enterprises (SOEs) tasked with building these connections (see e.g., Liu et al. 2017). Chinese financial resources would be channeled to these infrastructure projects mainly through the Silk Road Fund, policy banks (particularly the China Development Bank and to a lesser extent China Exim Bank) and China's big four state-owned banks. The focus was on ad hoc agreements. An important shift in emphasis has since taken place.

There has been a willingness to include private actors, in both the funding and implementation of initiative projects. The drive to build an institutional infrastructure will potentially have a large long-term impact. These objectives were clarified by the launch of the *Vision and Actions on Jointly Building the Silk Road Economic Belt and 21st Century Maritime Silk Road* (Vision and Actions 2015) by the Ministry of Foreign Affairs, the Ministry of Commerce, and the National Development and Reform Commission in March 2015. This policy document outlined that the initiative will follow market rules and international norms, giving the market a decisive role in resource allocation, with a key role for firms, while governments are to perform their "due functions." The latter indicates that states are expected to keep an oversight role.

We see this already happening in the growing (if still relatively small) multilateral development banks (MDBs) and their approach to funding the BRI. MDBs have established norms and practices on wide-ranging issues, including environmental and social impact criteria. Prominent

among them are the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank. Through co-financing projects along the BRI the AIIB has partnered with Western-led MDBs, such as the European Bank for Reconstruction and Development (EBRD), the Asian Development Bank (ADB), and the World Bank (WB). As of January 2017, two-thirds of its projects were being conducted with other MDBs (Caixin 2017).

This increasingly means the adoption of norms and rules that support trade and investment, and in so doing underpinning the provision of global public goods and welfare benefits. One of the key objectives of the BRI—as stated by the Leading Group for the BRI (the steering committee reporting directly to China's State Council) is to build a platform for unimpeded trade, increased trade, and investment. According to its latest report (BRI Leading Group 2017), alongside the building of infrastructure the BRI aims to build a network of multilateral and bilateral free trade agreements (FTAs) to support a rule-based open trade environment. The BRI blueprint document Vision and Actions (2015) emphasizes customs cooperation (e.g., information exchange, mutual recognition of regulations, assistance in law enforcement), bilateral and multilateral cooperation on inspection and quarantine, certification and accreditation, standard measurement, statistical information, and ensuring that the WTO Trade Facilitation Agreement takes effect and is implemented.

Economists prefer multilateral mechanisms as the ideal form of international cooperation, given that they yield the largest potential gains. This ideal has encountered the realities of international politics in the last decade, as opposing interest groups and narratives have gone against trade and, more broadly, globalization. Since the WTO's Doha Development Round breakdown in 2008 (over a developing versus developed nation split, pitting China, India or Brazil against the USA and the EU), the multilateral road has been tortuous. That includes the collapse of next-generation trade agreements led by developed nations, most notably the Transatlantic Trade and Investment Partnership and the Trans-Pacific Partnership (TPP). The latter American-led initiative left China out, prompting a response. It is noteworthy that China's own trade multilateralism is not prospering as expected. Even though agreements such as

the China–ASEAN Free Trade Area have been upgraded, multilateral agreements and especially the Regional Comprehensive Economic Partnership (RCEP) face important challenges. Despite the best efforts of China and other countries, RCEP's lack of ambition in services liberalization motivated India to block progress during a pre-ministerial meeting in Jakarta in July 2017. The reasons for this can be seen in the statements by a Ministry of Commerce and Industry official who argued that India was "under no pressure to quickly conclude the deal. We will negotiate what is important for us and on our terms." (Mint 2017). India would like to improve trade in services, labor mobility (under the General Agreement on Trade in Services, mode 4 provisions), and have easier visa regimes in RCEP countries. Beyond RCEP, progress on other multilateral agreements remains stalled. For example, China prefers trade integration to take place under the Shanghai Cooperation Organization, while Russia favors the framework of the Eurasian Economic Union (*The Diplomat* 2016).

Bilateral FTAs may thus be a pragmatic alternative; the road of least resistance to advancing trade and investment agendas in a world where multilateralism has stalled. This does not imply giving up on multilateral approaches—quite the opposite, one might conceive a strategic retreat that will afford new options designed to increase the likelihood of multilateral arrangements down the road. A dense network of bilateral FTAs could be consolidated and upgraded into a multilateral arrangement. Thus, there is a possibility that Chinese FTAs could constitute the foundation of a Eurasian multilateral trade system anchored by China's gravitational pull and vast open market. This system could be the BRI's most enduring legacy. Such a scenario raises research questions related to the architecture and performance of the system, its delivery of public goods such as trade investment, and its developmental process. Will a BRI multilateral trade system led by China be based on a distinct and innovative set of PRC-centric norms and institutions? More to the point, to what degree would such a system be the result of institutional outsourcing of the upward kind, that is, through the appropriation and incorporation of advanced economy institutions into the BRI? The AIIB is already an example of this (Callaghan and Hubbard 2016) with an institutional design similar to that of existing MDBs, and rules and guidelines (e.g.,

social and environmental criteria) following closely those of similar MDBs (e.g., WB, ADB, EBRD). As mentioned, the majority of current AIIB projects are co-led and co-financed with these institutions.

A fundamental proposition of this chapter is that China's FTAs are part of a long-term multilateral approach with the potential to be included in the institutional infrastructure of the BRI. Figure 5.1 proposes a structured flow approach for BRI initiatives. FTAs, as the framework depicts, are a type of public goods initiative distinct from connectivity or project approaches with their resource provision orientation. Of course, both public goods and project initiatives are related, as research on the trade creation effect of China's outward foreign direct investment (OFDI) (Lu et al. 2018) shows.

The BRI Initiatives Dynamic Evaluation Framework emphasizes the reality that any BRI initiative, whether institutional building or resource provision, will be subject to decision and evaluation mechanisms that transcend China proper. This is more significant than appears at first sight. While the conceptualization of Chinese policies in the face of Western modernization in the nineteenth century was the impact-response framework proposed by Fairbank (1954), this "reactive" framework was replaced by Cohen's model articulated in *Discovering History in China: American Historical Writing on the Recent Chinese Past* (1984). The working assumption has been for three decades that Chinese action is

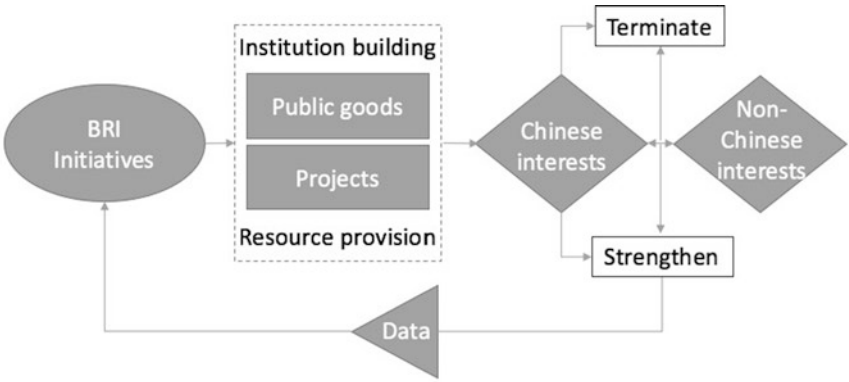

Fig. 5.1 BRI Initiatives Dynamic Evaluation Framework

always the result of complex domestic political conditions and interests—never a reaction or adaptation to foreign forces. This time, and for the BRI to succeed, China's leadership will make decisions in response and *reaction* to foreign interests as much as domestic ones. The focus on *initiative* in the BRI's name is explained as causing less apprehension among Asian neighbors than the grand-sounding OBOR term (after all, the BRI lives with many other initiatives in the region). A $20 billion, Yangon–Mandalay high-speed rail line in Myanmar, interests Chinese manufacturing and financial coalitions, but might face opposing forces in the partner country, as was the case when this deal lapsed (*Financial Times* 2017a). It is the joint interaction and decision-making of Chinese and foreign interests that will determine the fate of the BRI and its projects. For China, this is a novel model of international engagement (Blanchard and Flint 2017).

2 Application: China FTA and Evaluation Frameworks

Can the BRI be conceived of as an institutional innovation challenge run as a portfolio of experiments? If so, the experiments with the biggest bang are likely to be FTAs.

Switzerland, with a GDP of $680 billion, is China's first test with a relatively large advanced Western economy outside its Pacific neighborhood. Switzerland is a serial and serious FTA nation with three-fourths of Swiss exports to countries with whom it has an FTA. The figure for China is about one- third, which is more than halved if one takes out the Hong Kong Closer Economic and Partnership Arrangement, since Hong Kong represents about 14% of China's exports. The PRC does not have any FTAs with its top trading partners (USA, EU, and Japan), its most significant FTAs are with South Korea, ASEAN, and Singapore. The Sino–Swiss FTA can be seen as a committed experiment on both sides, negotiations started in 2006 and went into effect in July 2014, having already generated initial data and insight. What is also interesting is that the Sino–Swiss FTA does not follow the mainstream patterns of China's other FTAs.

Traditionally, the Chinese government has given precedence to political goals as important, "economic considerations are not predominant factors influencing China's FTA negotiations" (Zeng 2016). The same author finds that while China's preference for signing FTAs is with countries having "shared foreign policy goals or diplomatic agendas" FTAs are still signed "with countries on which it depends heavily for imports" (ibid.). China has no import dependence on Switzerland and the rationale for an FTA with Switzerland is certainly not political, even though diplomatic relations have been excellent since the founding of the PRC.[2] We take the position that the motivation on both sides is institutional and norm-building, and to demonstrate to global audiences that very motivation.

The advanced economies of Eurasia, foremost the EU bloc, will assess the BRI's institutional capabilities in the long term as the key signal to take the initiative seriously. To succeed, the economic powerhouse at the terminus of the New Silk Road must not reject or view the BRI as institutional outsourcing of the downward kind. For instance, the European Commission's investigation of the $2.89 billion Chinese Rail Project between Belgrade and Budapest over violation of EU laws on public procurement is a case in point of what can go wrong (*Financial Times* 2017b) as the BRI meets the institutions of advanced economies (even as the project itself makes a valuable contribution to European integration). In this vein, China's FTA overtures to the EU, did not see Brussels (nor Berlin) acquiesce. The EU and Switzerland are fully aware that the Sino–Swiss FTA is an institutional stepping-stone for China to engage with the EU. Framed in the BRI context, the Sino–Swiss FTA might represent an inflection point, with economics trumping politics. In this scenario, and if China intends the BRI to be comprehensively Eurasian rather than a developing world initiative, the building of a quality institutional infrastructure (Fig. 5.1) will be central.

2.1 China's Trade and Supporting Instructions

FTAs are institutional arrangements that may or may not work. Legge's (2018) meta-analysis, pointing at Kepaptsoglou et al. (2010), finds FTAs

have mixed effects, in some cases creating trade. Likewise, Kohl (2014) concludes that some Economic Integration Agreements promote trade by, at most, 50%, while others have no discernible impact, and only about one-quarter of agreements yield more trade. More positively, evidence has been provided of FTAs where bilateral trade volumes increased 100% after a decade (Baier and Bergstrand 2007, 2009). Getting FTAs right is hence critical. An additional challenge for a China-centric BRI is the gravity model, which was originally developed by Tinbergen (1962) and is employed to estimate the impact of FTAs on trade volumes (cf. Head and Mayer 2014). This model leverages the physical gravity metaphor for FTAs, in which trade effects are larger the larger the size of the economy, and geographical proximity is a key determinant for trade and FTA success. Two elements of the gravity equation are critical challenges for China: most BRI countries have economies much smaller than China; and the BRI happens to sprawl long-distance across the world's largest landmass.

While the BRI and, more specifically, FTAs have a mandate to increase trade, trade's significance to the Chinese economy is decreasing. At its height in 2006 trade represented 60% of GDP for China, while today it is down by over a third to slightly over 35%; for Switzerland the figure is above 100%, and trade has increased in significance. This begs the question as a challenge to the BRI's goals, and in light of global trade retrenchment: Is the PRC closing or opening up to global trade *relative* to other states? To shed some light on the matter, we consider two sets of evidence; one from Pakistan, which is China's closest ally; and the other from the EU, which along with the USA is China's top trading partner.

To Pakistan, the PRC is an "iron brother" and an "all-weather friend," as well as its largest trading partner. Yet, recently Pakistan's exports to China fell from $2.69 billion in 2013–2014 to $1.9 billion in 2015–2016, and a further 30% in the first half of 2016–2017; as did FDI (Dawn 2017; *Times of India* 2017a). Media speculated as to the reasons: "We don't need what Pakistan produces: China envoy" (*Times of India* 2017a), while tongue-in-cheek headlines point at the nature of India's rival trade with China, "Pak's kick-ass idea: Export donkeys to China" (*Times of India* 2017b). More pointedly, in Pakistan there is a sobering concern of the "hugely negative impact (FTA phase I) has had on domestic indus-

tries" (*Business Recorder* 2017). Moreover, the Pakistan Business Council (PBC), a business policy advocacy forum, notes that "the FTA with China is poorly negotiated which has resulted in ruining the domestic industry and dangerously widening the trade deficit of about $6 billion only through Pak-China trade" (ibid.). Product categories where Pakistan enjoys a competitive advantage and high export potential, such as jewelry, sugar or rice, face tariffs of 20% or higher. At the same time, Pakistan's all-important cotton exports, which increased by 252% to China over the last decade, would have further benefited from tariff eliminations, leading the PBC to state: "just this product could significantly boost Pakistan's exports to China" (ibid.). Despite exceptional political relations and the acknowledgment of the China–Pakistan Economic Corridor having large potential benefits for "massive developments in manufacturing, employment, infrastructure, energy and logistics" (ibid.), there is apprehension in Pakistan. Hence, a BRI cornerstone country now eschews the deepening of bilateral trade relations not bringing to a closure phase II of the FTA, under negotiation since July 2013.

Concerns in the developed world are not too different. Ahead of the Belt and Road Forum—held in May 2017 with attendance by 29 heads of state—Jörg Wuttke, President of the EU Chamber of Commerce in China, published a much-commented on *Financial Times* (2017c) article, "Xi Jinping's Silk Road is under threat from one-way traffic: Trade must flow both ways to make the route economically and politically viable." His argument is that trade flows are unbalanced, with China exporting to the EU double as much as it imports. In conjunction with trade, the article addressed investment: "In 2016 China invested four times more in Europe than EU companies invested in China." Not that Europeans do not have an investing appetite; their €8 billon investments in China pale when compared with their €200 billion investments in the USA (ibid.).

No amount of friction, apprehensiveness of partners, the gravity equation, or the *a priori* uncertainties about FTA effectiveness, will deter China's open trade BRI agenda. Several more FTAs are already under negotiation: The China–Maldives; China–Gulf Cooperation Council; China–Israel; China–Sri-Lanka; China–Norway; and the already mentioned China–Pakistan FTA, phase II. Feasibility studies are underway

for China–Nepal, China–Bangladesh, and China–Moldova agreements. Negotiations on a Trade and Economic Agreement between China and the Eurasian Economic Union have also recently been concluded (MOFCOM 2017). Beijing is thus determined to sign deeper trade agreements with complex partners (Eckhardt and Serrano 2014). This is another departure from earlier practices where China signed FTAs with small economies aimed at building trust vis-à-vis its neighbors (such as the agreements with Macao, Hong Kong, and ASEAN member states) or with distant and relatively small developing economies (Chile, Peru, or Costa Rica). The recent decision to sign deep FTAs with developed countries ups the ante, and points to a novel strategic approach. While Switzerland marks the most salient example, this applies to the FTAs with New Zealand or Iceland, or more recently with Australia and South Korea (both signed in 2014, entered into force in 2015). More substantial and multilateral approaches were the start of negotiations on a proposed China–South Korea–Japan preferential trade agreement in 2012 (even though it stalled while TPP was on the books). China now has a few FTAs that are among the deepest in the world. This direction may reflect political economy interests from Chinese firms and/or the aim to lock-in liberalization reforms at home. However, in light of the BRI, it also might reflect genuine and general Chinese enlightened self-interest aimed at institution and rule-building, not unlike America's post-World War II efforts. As we propose in this chapter, the FTAs have the potential to underpin a BRI open trade agenda. A central aspect of FTAs is their dynamic (enhancement), a matter to which we turn in the following sub-section.

2.2 FTA Evaluation Framework

FTA revision and upgrade processes are as important as the FTA itself. These processes must be agreed either in the FTA document itself or in a follow-up bilateral agreement by both states. In the case of the Sino–Swiss FTA, the revision and upgrade process has been set at two-year intervals, as per the joint study process deriving from the Memorandum of Understanding between the Swiss State Secretariat for Economic

Affairs (SECO) and the Chinese Ministry of Commerce (MOFCOM), agreed during President Xi Jinping's visit to Switzerland in January 2016. The revision and upgrade process should be guided by an ex post FTA performance evaluation, based on research and accepted methodologies. Chinese and partner country data and academic teams jointly participate and complement each other. On the Chinese side, the MOFCOM leads the conception of the FTA, while the Ministry of Foreign Affairs leads negotiations. The ministerial-level General Administration of Customs is a key stakeholder, as it implements the FTA and collects customs duties. For FTAs with BRI countries, the Leading Group for the BRI could have a coordination role in future. It is interesting to note that Switzerland, with its institution-building approach around FTAs, has a political process that requires ex post evaluation of FTAs. Thus the Swiss Parliament (*Parl. Verwaltungskontrolle*) has passed judgement on SECO for not monitoring the impact of FTAs extensively (Parliamentary Report 2016).[3] The FTA Dynamic Evaluation Framework (Fig. 5.2), considers joint FTA evaluations, relevant in the context of the Sino–Swiss FTA.

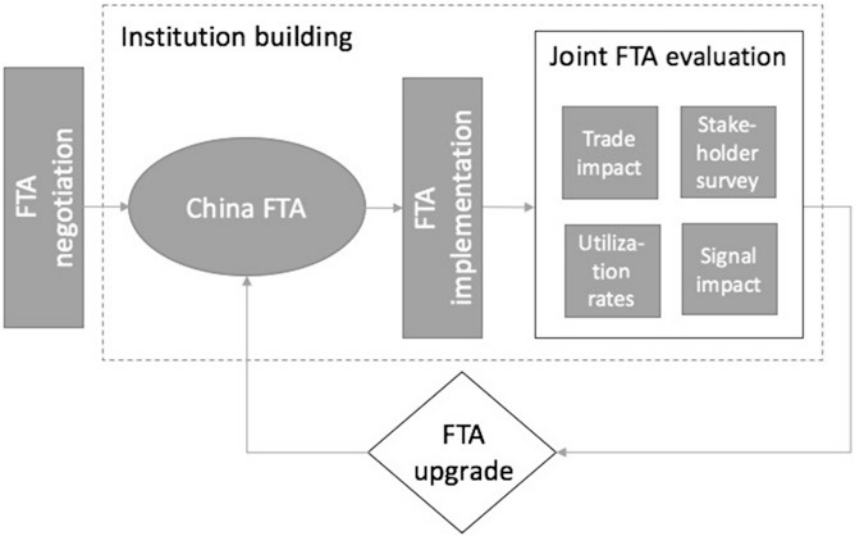

Fig. 5.2 FTA Dynamic Evaluation Framework

The key feature of the FTA Dynamic Evaluation Framework in Fig. 5.2 is its iterative nature, which makes the FTA instrument a living organism in the service of its stakeholders. The key element in the loop is the FTA upgrade. We introduce the key elements of the ex post joint FTA evaluation process, that determines FTA effectiveness and informs FTA upgrade negotiations.

1. Trade impact analysis: Trade impact is assessed based on an econometric methodology of import and export data provided by the custom administration of the respective countries. Following the standard approach, the standard gravity model (Tinbergen 1962), with the most recent advancements in the literature (including the work of Santos Silva and Tenreyro 2006), is used along with the Pseudo-Poisson-Maximum-Likelihood estimator to consider zero trade flows as well as heteroskedasticity in the data (Legge 2018). Generally speaking, trade was responsible for one-quarter of Swiss GDP growth (SECO 2016) between 1995 and 2015. On average, Swiss exports to a country rise by 40% within four years of the implementation of an FTA (ibid.). What was the impact of the Sino–Swiss FTA? During the first three years Swiss exports to China grew significantly, or about 35%, five times higher than aggregate Swiss exports. On the other hand, total Swiss imports from China were stable, showing no growth. Does this mean that Switzerland benefits more than China from the bilateral FTA? A trade impact analysis would answer this question.
2. Business agents survey: The trade impact analysis answers the "what" question. Surveys of firms operating at the grass-root level, the potential beneficiaries of the FTA, hone in on the "why." An FTA might not work because of a variety of reasons, such as: infrastructure bottlenecks; low trade volumes with FTA partner countries; lack of knowledge or experience; complicated procedures for obtaining the required certificate of origin; rules of origin compliance costs; and more (Ziltener 2017). The perennial non-tariff measures (NTM) or barriers are critical, "all non-price and non-quantity restrictions on trade in goods, services and investment, at federal and state level." These can be estimated by special gravity equations as much as by surveying businesses and sector experts, the final assessment being a multipronged

approach (Berden et al. 2009). Surveying FTA stakeholders or experts provides answers about why trade data is the way it is, and it is customary that FTA stakeholder surveys are carried out. It has been noted that research that relies exclusively on company surveys with voluntary participation may suffer from a sample selection bias toward higher utilization rates. It is thus important that the overall survey design complements other parts of the assessment, such as utilization rates.

3. Utilization rates: An FTA utilization rate measures the degree to which the FTA is successfully used to reach duty free exporting, that is, a utilization rate of 60% means that 60% of all exports (according to value) in that year were successfully making use of the FTA and effectively benefited from duty exemptions. The FTA savings potential for business due to reduced duties levied is an initial step (Ziltener 2014), followed up by the full methodology once data under the reduced duties regime becomes available (ibid. 2017). The General Utilization Rate is the value ratio of goods being traded benefiting from reduced or eliminated tariffs under a specific FTA relative to total trade (imports or exports). The Adjusted Utilization Rate (AUR) is defined as the value ratio of goods being traded relative to total trade (imports or exports) eligible for tariff exemption under the specific FTA. The AUR reflects the true extent of an FTA's utilization. A study by the University of International Business and Economics, Nanjing University, and the University of St. Gallen plans to provide the first AUR on both sides of the Sino–Swiss FTA. In the background looms the observation that there is "huge variation in effective utilization over time and between the different FTAs" (Ziltener 2016). This dynamism calls for longitudinal research designs.
4. Signal impact: The power of signaling has been recognized in economics since Akerlof pointed out "the interaction of quality differences and uncertainty may explain important institutions" (1970: 488). While Akerlof did not have FTAs in mind, they are an institution that sends out a wide range of signals. FTAs might help reduce NTMs by sending signals to domestic interests. The Swiss government emphasizes that FTAs provide legal security and avoid discrimination, especially vis-à-vis other countries with FTAs (SECO 2016). On their analysis of effects of the BRI on 48 countries, Lu et al. (2018) point

out, as a starting point, the increases in total OFDI. Egger and Wamser (2011) found that foreign direct investment and other cross-border economic activities went up with partners with which Switzerland has formal agreements for closer economic integration and cooperation. For signals to work, there first needs to exist an awareness of the signal (measurable in FTA surveys). It appears that Chinese firms involved in international trade are less aware of the FTA than their Swiss counterparts. On the other hand, larger SOEs seem to take signals seriously and have responded by making important investments in Switzerland, such as the $43 billion acquisition of Syngenta by ChemChina, announced in February 2016.

3 Conclusion: Sino–Swiss FTA Evaluation and General Findings (A Putative Gold Standard?)

The Sino–Swiss FTA in the BRI context might suggest a long-term strategy of upgrading bilateral relationships into a comprehensive system that relies on institutional outsourcing of the upward kind from nations with deep institution-building experience. That approach might lead to a multilateral system that is as state of the art as the constraints of a developing country (e.g., infant industries) allow. To conclude, the authors suggest a three-fold proposition:

1. China's FTAs promote both trade and non-trade public welfare
2. In the BRI context, bilateralism is a stepping-stone for multilateral development
3. A performance orientation is the basis to sustain bilateral FTAs as well as BRI multilateralism.

The Sino–Swiss FTA might be considered a benchmark; as such, is it a gold standard in the context of the BRI? During the first Sino–Swiss FTA enhancement meeting in May 2017, the academic advisor on the Swiss government side had written at one point in his presentation: "Include many trading partners in FTA! The benefits of FTA increase, the more

FTA are signed: Trade diversion is less likely and existing trade diversion is reversed."[4] This is an apt call for multilateralism disguised as bilateralism. A network of deep bilateral FTAs, based on consistent principles across the BRI, with China countering the gravity equation by encouraging access to its market, will make Chinese FTAs a much sought after instrument. The BRI will give China the narrative and coordinating capabilities to collapse bilateral FTAs into a multilateral arrangement to further maximize welfare benefits. That arrangement with China as the common denominator would have the peculiarity that it will include both developing and developed nations across the BRI. An important caveat follows since China, as the BRI common denominator, does not presuppose a hub model; the day Switzerland increases its trade with Kazakhstan because of the BRI, it will have been a success. In this sense the Sino–Swiss FTA is relevant for developed and less-developed nations alike.

Since the inception of the PRC in 1949, China never had an active global vision beyond the Maoist Five Principles of Peaceful Coexistence dating to 1954.[5] While not entirely irrelevant today, the principles, with their non-interventionist, quasi isolationist bent that eschew active global participation, would not serve the PRC's twenty-first-century interests. Indeed, this is reflected in David Shambaugh's assessment of China as a partial power, made before the BRI was launched. As a great economic, export, financial, geopolitical, and technological power, China increasingly perceives as in its own interests, its investment in a multilateral order. One with an increasing focus on the institutional public goods side of the equation proposed in the BRI Initiatives Dynamic Framework (Fig. 5.1). One can expect China to strategically promote FTAs, since they open doors for the BRI. The BRI's multilateral potential will be the more likely, the more successful experiences like the benchmark Sino–Swiss FTA turn out to be.

Notes

1. Ministry of Foreign Affairs of the People's Republic of China. Accessed August 16, 2017. http://www.fmprc.gov.cn/mfa_eng/topics_665678/xjpfwzysiesgjtfhshzzfh_665686/t1076334.shtml

2. Sino–Swiss relations have a long history, dating back to the establishment of diplomatic relations on 17 January 1950. Switzerland was one of the first Western countries to recognize the PRC. The Schindler Group (a Swiss multinational producing escalators and elevators) was the first firm to establish an industrial joint venture in China in 1980, heeding Deng Xiaoping's call for reform and opening. Apart from the FTA, which entered into force in 2014, a currency swap agreement was signed that same year, cementing the close economic relationship.
3. "The Swiss federal government does not follow any systematic monitoring of the real implications of its free trade agreements (FTA). It has been found that only customs duty-income reductions and country of origin specifications have been systematically controlled. Other customs aspects evaluated by the PVK (Parliamentary Commission) have been found to be failing in fulfilling its aims […]. Additionally, the aspect of FTA utilization (rates) is not systematically evaluated. The procedures and competences in the implementation and future development of FTAs also show deficiencies" (author's translation of the Parliamentary Report from German).
4. Moser, Peter. 2017. Presentation at the "Enhancement of the Switzerland–China Free Trade Agreement" first meeting May 18, 2017, Bern, Switzerland.
5. The principles are: mutual respect for sovereignty and territorial integrity; mutual non-aggression; non-interference in each other's internal affairs; equality and mutual benefit; and peaceful coexistence.

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6

Belt, Road, and Circle: The Arctic and Northern Europe in China's Belt and Road Initiative

Camilla T. N. Sørensen

1 Introduction

Initially, Northern Europe did not figure high in the Belt and Road Initiative (BRI). However, in the months following the Belt and Road Summit in Beijing in May 2017, Chinese leaders, in a bid to advance maritime cooperation under the BRI, presented plans for three blue economic passages on which China is ready to engage in "all-dimensional and broad-scoped maritime cooperation" (NDRC and SOA 2017). One of these blue economic passages is to connect China with Europe through the Arctic Ocean. There has previously been debate among Chinese scholars and experts on whether the Arctic sea lanes would be included and some even proposed expanding the previously used title "One Belt, One Road" to "One Belt, One Road, One Circle" (Huang 2017). With

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the addition of the three blue economic passages, Beijing has officially included the Arctic sea lanes, bringing the BRI to Northern Europe.

The five Nordic countries of Denmark, Norway, Sweden, Finland, and Iceland, are all small states in terms of the size of their population, economy, and military, and they therefore share a strong interest in preserving a rule-based international order, where their rights and interests are protected through strong institutions, which, ideally, are based on the liberal principles and values that underpin Nordic political systems and societies. Standing up for liberal principles and values, however, has become more challenging, which, not least, has to do with the growing importance for the Nordic countries of promoting positive and strong relationships with China (e.g., Sørensen 2016a). Because their national economies are relatively small, open economies, with limited national markets, the Nordic countries rely heavily on international trade. The fact that China, in terms of both bilateral trade and investments, plays an increasingly important role for the Nordic countries therefore goes a long way in explaining why the Nordic countries in recent years have worked hard to strengthen their relationships with China (e.g., Sverdrup-Thygeson and Hellström 2016).

Even though the Nordic countries share a range of common traits based upon geography, history and cultural affinities, they are also different in important aspects, including in national political, economic, and industrial composition, foreign and security policy outlook, and international institutional affiliations and commitments. In complex ways, this plays into how the Nordic countries assess the emerging opportunities as well as the growing challenges in their relationships with China and helps explain why the Nordic countries engage China mostly bilaterally and not from a strong joint Nordic platform.

In recent years, the Nordic countries have all signed up as members of the Chinese-led Asian Infrastructure Investment Bank (AIIB) and expressed a positive interest in the BRI, mostly seeing economic and commercial opportunities, with Nordic companies bidding on and participating in various infrastructure projects in third countries. As the Arctic sea lanes are now officially included, the potential of the BRI to directly affect Nordic economies and societies, and to connect Northern

Europe with China, is more apparent, which is likely to result in the Nordic countries further strengthening their focus and efforts.

This chapter analyzes and compares the Nordic countries' perspectives on and engagement in the BRI. It shows first how China is using the BRI to further intensify and strengthen its Arctic diplomacy and to strengthen relations with the Nordic countries in the Arctic. Second, the chapter highlights how the Nordic countries, despite similar positive perspectives on and attitudes toward the BRI, engage differently, particularly when it comes to the Arctic due to geography and certain domestic circumstances and considerations. Third, the chapter identifies the main difficulties for the Nordic countries joining forces in relation to China and, specifically, the BRI.

The structure is as follows. The chapter first examines how the BRI has come to include the Arctic sea lanes and briefly discusses Chinese interests in the Arctic and how these have evolved. Second, the chapter conducts a brief comparative analysis of the five Nordic countries' relations with China and uses this as the context for analyzing their perspective on and engagement in the BRI. The chapter concludes with a discussion of why the Nordic countries are not cooperating to a higher degree, despite growing Chinese efforts in recent years to introduce a 5 + 1 framework or mechanism for China's relationships with the Nordic countries.

In terms of theory and analytical approach, the analysis draws on a realist foreign policy analysis specifically developed to analyze the foreign and security policies of small states (e.g., Wivel 2013). As they navigate in the changing international system, small states like the Nordic countries are not able to influence the structure of the international system themselves. Rather, they adapt and adjust in different ways to protect and promote their national interests. To analyze more specifically *how* and *why* small states like the Nordic countries adapt and adjust as they do, one needs to open the "black box." The Nordic countries confront similar, systemically derived, rooms for maneuver, and therefore the focus needs to turn to domestic circumstances and considerations in order to understand and explain the differences in their strategies and reactions to a stronger China and, more specifically, how they engage differently with the BRI.

2 Links Between China's Intensifying and More Confident Arctic Diplomacy and the BRI

Even though Arctic issues are not at the top of the Chinese foreign and security policy agenda, China has increased its focus on and its engagement in the Arctic in the 2010s and has increasingly expressed a wish to be involved in the development of Arctic affairs (Lanteigne 2014). Overall, China's Arctic policy consists of four driving factors (e.g., Zhang 2015). First, China aims to build a solid Chinese polar research capacity, which especially relates to how the melting ice and changing climate in the Arctic affect China. Second, China wishes to access the energy resources and minerals that the Arctic holds, thereby helping to secure and diversify China's energy supply. Chinese SOEs within the energy sector, especially the China National Offshore Oil Corporation and the China National Petroleum Corporation, are already active in Northern Canada, Northern Russia, and the Dreki region between Iceland and Norway. Third, China seeks to develop and ensure access to the Arctic sea lanes, which could give it alternatives to the longer and strategically vulnerable routes now in use, especially through the Malacca Strait. And fourth, China wants to be a player in the evolving Arctic governance regime.

Key to China's Arctic policy is to establish strong and comprehensive bilateral relationships with all the Arctic states and stakeholders and gradually to increase China's presence and influence in Arctic multilateral institutions. The challenge for Beijing is to become increasingly involved in Arctic affairs without generating fear and tension. That is, the scrutiny and anxiety directed toward Beijing's economic and resource diplomacy in the Arctic region have made the Chinese careful, due to concerns about a diplomatic backlash if Beijing is perceived as taking a too assertive approach. Therefore, so-called, science diplomacy has been China's primary approach, using their research activities and institutions to legitimize their overall growing presence and to strengthen their influence in the region. In recent years, Chinese research activities in the Arctic have been further strengthened by launching more expeditions

and intensifying efforts to build networks and cooperation. Beijing has had its own research station in the Arctic since 2004, the Yellow River Station on Svalbard in Norway, operated by the Chinese Arctic and Antarctic Administration (Zhang 2015). China wants to establish additional Chinese research stations in the Arctic, for instance, in Greenland, where a Memorandum of Understanding on closer Arctic research cooperation between Greenland and China was signed in May 2016, specifically mentioning the establishment of a Chinese research station in Greenland (Petersen 2016). The Chinese side points to the Aurora Observatory in the sparsely populated Icelandic region of Kárhóll, funded by the Polar Research Institute China, as a potential model to be replicated in Greenland (Raspotnik 2016). At the October 2017 Arctic Circle meeting in Iceland, the Vice-Director Yong Yu of the Polar Research Institute China officially announced that the Chinese are negotiating with Greenland to set up a Chinese research station as fast as possible (Breum 2017). Greenland is a self-governing territory within the Kingdom of Denmark, and has, so-called, self-rule on a number of policy areas, with research being one. Therefore, it is the Greenlandic government in Nuuk—and not the Danish government in Copenhagen—that is negotiating with the Chinese. Foreign and security policy, however, lies in Copenhagen, and here the prospects of stronger economic and political relations between Greenland and China, and a significant Chinese presence in Greenland are causing growing concern (Sørensen 2017). Not least because Denmark's strongest ally, the USA, since the early 1950s has kept a military presence in Greenland. As will be elaborated on further, the complex—and continuously changing—constitutional set-up between Nuuk and Copenhagen plays an important role in explaining the hesitant attitude in Copenhagen toward including Arctic issues, including the Arctic sea lanes, in Denmark's otherwise strong relationship with China.

Aside from the proactive science diplomacy, China has generally kept a low profile in the Arctic including in the main governance institution, the Arctic Council, where China has had observer status since 2013. However, this is also changing as a more confident Chinese approach to the Arctic is emerging (e.g., Lanteigne 2015). This is where the recent addition to the BRI and hence the official Chinese linking of the BRI and

China's Arctic interests and ambitions is to be seen. Chinese scholars and experts were previously rather dismissive when asked about the potential role and inclusion of Arctic sea lanes in the BRI, often arguing that the BRI first had to prove that it could work and bring benefits to the involved countries, especially in Asia. It seems, however, that there has been a shift to a more confident and risk-taking approach by Beijing, where the BRI is seen as a way to further intensify and strengthen China's Arctic diplomacy and strengthen relations with the Nordic countries in the Arctic. The BRI hence gives China an extra card to play in its efforts to strengthen its role and influence in the Arctic—an additional framework, besides the science diplomacy one, within which to have Arctic countries think about Chinese interests and investments in the region. The speech to the opening session of the October 2017 Arctic Circle from the Deputy Administrator of China's State Oceanic Administration, Lin Shanqing, hence was titled "The Arctic in the Belt and Road Initiative" (Arctic Circle 2017: 5).

China brings the BRI to the Arctic to further legitimize and promote its growing interests and presence in the region. Within the framework of the BRI, China seeks to establish strong and comprehensive relationships with all the Arctic states and stakeholders through investments and economic deals. Concrete Chinese interests in the energy resources and minerals in the Arctic and in the Arctic sea lanes are, of course, important drivers, as mentioned. It is clear that any future larger-scale exploitation of energy resources and minerals in the Arctic will require significant infrastructural development, which is also the case for any commercial use of the Arctic sea lanes.

Chinese commercial vessels have already tested the Northeast Passage along Russia's northern coast line, and in 2016 the Chinese state-owned shipping company COSCO said it plans to launch regular services through the Arctic to Europe by way of the Northeast Passage (*The Guardian* 2016). When the Chinese icebreaker Xuelong made its first ever trip through the Northwest Passage in August 2017, it was probably also to test the feasibility of moving commercial vessels through as the Xuelong did not confine itself to specific locations for research purposes but circulated around the Arctic (Fife and Chase 2017). Furthermore, China's Maritime Safety Administration has released guidelines in recent years to

promote and help Chinese ships navigate Arctic waters. At the release of the most recent guidelines in April 2016, senior official Wu Yuxiao, who was involved in drafting the guidelines, stated, "Many countries have noticed the financial and strategic value of Arctic Ocean passages. China has also paid much attention" (Peng 2016). For China, the routes through the Arctic are approximately 30% shorter than through the Strait of Malacca and the Suez Canal, but are not necessarily quicker or cheaper. The Chinese, however, want to be ready to exploit new opportunities and are therefore testing the routes and are busy designing and building new ships that are better suited (Gang 2012: 361; Lanteigne 2014). The Arctic is still a highly challenging environment to build infrastructure and develop a comprehensive logistical system. However, the recent inclusion of the Arctic sea lanes in the BRI is likely to provide an extra push to Chinese companies and other Chinese stakeholders to get involved in the Arctic and provide them with improved opportunities for financial support, which might also result in them being more willing to take greater risks. This further increases the potential for combining Chinese capital and equipment with Nordic expertise and planning capabilities, and underlines once more the potential direct influence of China—and specifically Chinese investments in the framework of the BRI—on the trade routes between East Asia and Europe (e.g., ISDP 2016: 30).

Regarding the development in recent years of China's relations with the Nordic countries in the Arctic, China has sought to establish stronger relations with all five countries, especially within research and science. One example is the China Nordic Arctic Research Center, established in 2013 as a platform for academic cooperation on Arctic issues between Chinese and Nordic research institutes and led by the Polar Research Institute China (Lanteigne and Su 2015: 18). However, China has so far prioritized relations with Iceland, indicated by the number of high-level Chinese delegations going to Iceland in recent years, and by the conclusion of a free trade agreement with Iceland in 2013, which was the first Chinese free trade agreement with a European country. An important part of China's Arctic diplomacy also takes place within the Arctic Circle meetings established and driven in cooperation with Iceland (Lanteigne 2016). Chinese Arctic scholars also often point to Norway as one of the more important countries for China in the Arctic. Norway has a big

Arctic territory, including Svalbard, with the Chinese research station mentioned above, energy resources and minerals, a proven ability to use the Arctic sea lanes with direct access to the Northeast Passage, and a high level of relevant technological know-how. When China and Norway resumed normal diplomatic relations in December 2016—following six years without as a result of the awarding of the 2010 Nobel Peace Prize to the Chinese political activist Liu Xiaobo—the strong potential for cooperation on polar issues was mentioned in a four-point joint statement (China-Norway Joint Statement 2016; Sverdrup-Thygeson 2016). Finland also seems to be growing in importance in China's Arctic diplomacy. On his way to a summit with US President Trump in early April 2017, Chinese President Xi Jinping made a stopover in Finland for a three-day state visit. His Arctic intent became clear when Xi Jinping, after the meeting with the Finnish President Sauli Niinisto, stated that China and Finland will "seize the opportunity of Finland's rotating chairmanship of the Arctic Council to enhance cooperation in Arctic affairs" (Forsell 2017). On top of holding the chairmanship of the Arctic Council, Finland is also especially attractive to China due to its strong competences within communication and cable technology and icebreaker capabilities—China's second icebreaker is currently being built with Finnish technology.

Generally, the Nordic countries have been positive and supportive of China's role and interests in the Arctic and were helpful in persuading an initially hesitant Russia, Canada, and USA to approve China's and other Asian countries' admission to the Arctic Council as observer states (ISDP 2016: 30). Following China's intensifying and more confident Arctic diplomacy, and the linking of the Arctic to the BRI, the Nordic countries have shown different levels of attention and enthusiasm, with Finland, Iceland, and Norway being most eager. For example, the Finnish ICT company CINIA joined hands with the Chinese ICT company Huawei in 2016 to develop "The Digital Silk Road," connecting Europe to China via Finland and Russia (CINIA 2016). This indicates how—despite a general wait and see approach—there are more thoughts and efforts in the Nordic countries about how to develop cooperation with China on Arctic affairs under the framework of the BRI.

3 Nordic Countries' Perspective on and Engagement in the BRI

The four Nordic countries—Sweden, Denmark, Finland, and Norway—were among the first Western countries to recognize and establish formal diplomatic ties with the PRC in the 1950s. Iceland also reacted quickly in the early 1970s, when there were signs of improved relations between China and the USA, and the PRC had replaced the ROC (Taiwan) at the UN, and Iceland established formal diplomatic ties with the PRC in 1971. That the Nordic countries were early in recognizing the PRC holds important symbolic value, from both a Chinese and a Nordic perspective, reflecting historical friendships between China and the Nordic countries and is therefore always stressed in official documents and statements (Hellström 2014: 11).

Bilateral relations between China and each of the Nordic countries have, in general, been stable, except for the six years (2010–2016) when Norway, due to the effects of the Liu Xiaobo Nobel Peace prize, did not have diplomatic relations with China (e.g., Sverdrup-Thygeson 2016). The Nordic countries' China-policies have over the last decade been characterized by an overall trade-off between, on the one hand, wanting to establish and maintain strong relations with an upcoming economic, political, and military great power, and, on the other hand, upholding a variety of liberal principles and values often centered on human rights (ISDP 2016: 10). Although concerns over liberal principles and values remain, China's transition and increasing international economic, political, and military power have led the Nordic governments to adopt more pragmatic approaches. Simplistically put, relations between the Nordic countries and China range from broadly pragmatic (Denmark, Iceland), through more mercantilist (Finland), to somewhat more normative, characterized by being more vocal in promoting human rights (Sweden, Norway) (ISDP 2016: 10). This is a rough categorization, which—as detailed below—is becoming even more blurred.

Among the Nordic countries, Denmark and Iceland maintain the most comprehensive relations with China. Denmark's 2008 Comprehensive Strategic Partnership agreement and Iceland's 2013 free

trade agreement have boosted these countries' overall relations with China, leading to an increase in bilateral visits, projects, and commerce (Sørensen 2016b; Lanteigne 2016; ISDP 2016: 10). Finland is catching up and is currently in the process of negotiating a practice-oriented "new type of relationship" with China (Kallio 2016; ISDP 2016: 10). Sweden has struggled to balance business interests with vocal political dynamics on humanitarian issues but is also increasingly pushing for stronger and more stable relations with China (Hellström 2016). Norway, since resuming diplomatic relations with China in December 2016, has made huge efforts to stabilize relations and catch up on economic and commercial issues especially, and Oslo is currently negotiating a free trade agreement with China (Sverdrup-Thygeson 2016: 45).

From a Nordic perspective, China represents an increasingly important bilateral trading partner and source of investment. Trade between the Nordic countries and China has grown consistently since China's accession to the WTO in 2001 (Larcon and Brunstad 2017: 68). In recent years, Chinese investments in the Nordic region have seen an upswing, with Chinese companies acquiring flagship Nordic brands, such as Volvo, opening R&D facilities, and entering Nordic high-tech industries, for instance, the takeover of the Norwegian offshore technology company Awilco in 2008 (ISDP 2016: 11). In addition, a growing influence on global economic institutional frameworks makes China a country that the Nordic countries, with their relatively small, open, and trade-oriented economies, have to engage with (ISDP 2016: 14).

As trade and investment are at the core of relations between the Nordic countries and China, the BRI adds a potential new dimension. However, the BRI has still not attracted much attention among Nordic media and governments and does not figure high in official open-sourced China-strategies (e.g., Forsby and Jiang 2016). None of the Nordic countries seem to have a clear position and coherent strategy in relation to the BRI. Awareness of the BRI among the general Nordic public is limited at best (van der Putten et al. 2016: 8). The little Nordic press coverage of the BRI has mostly been negative, focusing on concerns about—and signs of—Chinese geopolitical ambitions and the potential of the BRI to erode common EU trade and investment rules and standards, as well as the EU as a political unity. Reference here is especially to China's establishment

of relations with regional clusters within the EU, for instance, the 16 + 1 mechanism with the Central and Eastern European countries (e.g., Mouritzen 2017).

Where the Nordic countries have come closest to openly engaging the BRI is through their early support as founding members of the AIIB. The active role by the Nordic countries in the AIIB could be seen as an indirect way to shape BRI-related activities by working to ensure that Chinese AIIB and BRI-related activities and projects are up to international standards (e.g., Forsby and Jiang 2016). In line with this, Rappe and Weissmann (2016) also find that the Swedish response to the BRI so far has been cautious and is generally best characterized as a wait and see approach. That is, the BRI is still not seen as being hugely relevant to the overall aim of the Nordic governments to strengthen bilateral relations with China; with the important exceptions of Iceland and Finland, with their strong focus on identifying opportunities within the BRI framework—especially after the Arctic addition—for attracting Chinese investments, boosting local and regional economic development and developing trade-relevant infrastructure. For example, in early October 2017 the Finnish Transport and Communication Minister Anne Berner expressed a positive interest in a proposal from a group of Finnish business leaders for an "Arctic Corridor" railway, referring specifically to joint Chinese–Russian plans about an "Ice Silk Road" as providing momentum (Karijord 2017).

China has so far invested comparatively little in the promotion of the BRI in Northern Europe, compared to other parts of Europe, especially Central and Eastern Europe. Before the recent Arctic dimension of the BRI, the Baltic region, which is linked to the BRI in relation to both the maritime route and the Eurasian land bridge, was where the BRI could become relevant for the Nordic countries. Denmark, Finland and Sweden border the Baltic Sea, and generally the Nordic countries have close economic, political, and cultural links with the Baltic countries, with some Nordic companies operating in the region. However, the potential importance of the Baltic region for the BRI has not yet caused much attention and debate in the Nordic countries (e.g., Larcon and Barre 2017).

Looking beyond Nordic governments and media, there are international leading companies in the Nordic region, for instance, Danish

Maersk, Swedish ABB, Norway's Statoil, Finnish Nokia or Metso, where engagement with the BRI likely receives more attention. These companies could realistically bid on BRI projects, for instance, in Central Asia. In particular, the Maersk Line—the world's largest container shipping company—could benefit and work with Chinese counterparts on the BRI. This division of the Maersk Group, which also includes APM Terminals and is one of the world's largest port and terminal operators, has already signed a Memorandum of Understanding with Qingdao Port Group for joint investment in a new port terminal at Vado Ligure in Italy, scheduled to open in 2018 (Larcon and Brunstad 2017: 69). It seems, however, that there are still no strategies in place from these Nordic companies on how to engage with, and become more actively involved in, the BRI, or any systematic attempts from the Nordic governments to promote such engagement (e.g., Forsby and Jiang 2016). An additional challenge is that the Nordic industrial composition is generally not geared for larger-scale system-export, for instance, Denmark has an extensive small and medium enterprise sector without a strong tradition for companies working together in order to bid on BRI projects. Nordic companies might be invited by the Chinese to participate with specific knowledge and expertise on corporate social responsibility, environmental standards and norms, but if they are only brought in to certify what Chinese companies have already done, it might not benefit them as much.

4 Conclusion

Taking stock of how the BRI is playing out in the Nordic countries so far, the wait and see and pragmatic low-profile engagement characterizations best sum up how the Nordic governments have reacted. This is understandable, as the Nordic countries do not host major concrete BRI projects, nor have they received a lot of attention from China in relation to BRI projects. However, the recent addition of the Arctic to the BRI is likely to increase the focus on the BRI among the Nordic governments. All Nordic countries in their China-strategies and policies indicate that they seek to explore new ways to stimulate cooperation and exchanges with China, and therefore more and more direct attempts from the

Nordic governments to tap into the overall BRI and AIIB frameworks are likely. Chinese diplomats in the Nordic countries are also increasingly seeking to promote the BRI in diplomatic meetings (e.g., Rappe and Weissmann 2016: 61).

As indicated in the introduction, there have been intensified Chinese efforts in recent years to promote a 5 + 1 framework for China–Nordic relations, similar to Beijing's 16 + 1 mechanism with the Central and Eastern European countries (e.g., ISDP 2016: 14). There is precedent for such a 5 + 1 framework, for instance, in May 2016 all five Nordic prime ministers joined forces and conducted a Nordic state visit to the White House. Arguably, a similar Nordic platform for high-level contacts with China could elevate the Nordic region's profile in China, leading to greater political access and providing an additional platform for strengthening economic ties (e.g., Sverdrup-Thygeson and Hellström 2016: 7). In addition, if the Nordic countries had a strong joint platform they could more efficiently promote shared norms, values, and concerns, for instance, on common trade and investment rules and standards. Furthermore, they could better withstand Chinese disapproval and punishment if a Nordic country goes against Chinese "core interests," as in the case with Norway following the Liu Xiaobo Nobel Peace prize.

In many ways, the five Nordic countries already make up an extensive sub-regional grouping with similar languages, deeply intertwined histories, comparable levels of development, and shared socio-political norms and liberal principles and values. They often coordinate and act together in international settings having created a system of policy coordination through the Nordic Council and the Nordic Council of Ministers, which is an inter-governmental institutional mechanism for cooperation between Nordic governments with a secretariat in Copenhagen (Norden 2017). Regarding substantial policy coordination and cooperation between the Nordic countries on China there is still not much taking place besides the China–Nordic networks on research, education, and innovation, but efforts are underway. The Nordic Council of Ministers, in a February 2016 meeting, decided to explore opportunities for greater Nordic sub-regional cooperation with China. This was followed in late May 2017 by a meeting in Beijing between the Chinese Vice-Minister of

Foreign Affairs, Wang Chao, and the Nordic Council of Ministers, represented by Secretary General Dagfinn Høybräten (Sino-Nordic Joint Press Release 2017).

Going forward, however, diverging policy preferences and inter-Nordic competition make plans about a Nordic platform for high-level contacts with China hard to execute (e.g., ISDP 2016: 9). That is, the Nordic countries, due to somewhat overlapping economic and commercial interests, are also competitors and generally they seem to share a confidence that they can better engage and utilize national attractiveness and take care of national interests through bilateral relations with China (e.g., Sverdrup-Thygeson and Hellström 2016: 7–8). On top of that, there are different international institutional affiliations and commitments in the Nordic countries, which make a joint platform difficult. Iceland and Norway are not EU member states, and Finland and Sweden are not full NATO member states. The challenge is that member states of EU and/or NATO have already outsourced certain policy areas and decisions, and have certain EU and/or NATO obligations, which makes it more complicated to engage in new sub-regional settings. It is also likely to meet resistance within the EU system, where there are already concerns about Chinese "divide and conquer" tactics and the tendency to set up and engage with regional clusters within the EU (van der Putten et al. 2016: 10). In relation to the Arctic, all Nordic countries are members of the Arctic Council but are engaged to different extents, with Iceland, Finland, and Norway as the most active, having key economic interests in potential economic development in the Arctic. Sweden, on the other hand, is relatively detached, while Denmark, especially due to the complex constitutional set-up between Nuuk and Copenhagen, has a rather ambivalent view on the prospect of a stronger Chinese presence and influence in the Arctic. While Copenhagen acknowledges the potential benefits for Denmark in supporting a stronger Chinese role in the Arctic region and in actively engaging China on Arctic issues, there are growing concerns about whether Nuuk is capable of dealing with potential massive Chinese investments and what the implications could be for Greenlandic efforts to gain greater independence (e.g., FE 2016; Sørensen 2017). Consequently, the issue of China in the Arctic for Copenhagen relates

directly to the future of the Kingdom of Denmark (The Kingdom of Denmark, Greenland, and The Faroes).

To sum up, despite recent growing openness and efforts from the Nordic governments, there is still a long way to go before a Nordic platform for high-level contacts with China and, more specifically, any joint engagement from the Nordic countries in the BRI are to be expected. However, the structure of the international system has been changing ever more rapidly, with what looks like a declining and more retracted US international role under President Trump, further opening up opportunities for China to increase its international role and influence. As supporters of a US-led international order, such structural shifts challenge the foundation of the Nordic countries' foreign and security policies, forcing them to again adapt and adjust. To best protect and promote their national interests in a more unpredictable international order, where China undoubtedly will have growing influence on their economy, politics, and security, stronger incentives and pushes could materialize for establishing a strong Nordic institutional framework from within to deal with the emerging challenges and opportunities.

Besides secondary sources on the BRI and the China strategies of Nordic countries, this chapter draws on interviews with Nordic scholars and experts, government officials and representatives of Danish/Nordic business interests.

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7

China's Strategy Toward Central and Eastern Europe Within the Framework of 16 + 1 Group: The Case of Poland

Jędrzej Górski

1 Introduction

The idea of China's cooperation with the Central and Eastern European Countries (CEECs) within the framework of the 16 + 1 Group (G16 + 1) came forth during Polish President Komorowski's visit to Beijing in December 2011.[1] The meeting with China's President Hu Jintao produced a Sino–Polish declaration stating that the Chinese were interested in increasing imports of Polish goods, in supporting the participation of Chinese entrepreneurs in infrastructural projects, and in the privatization of remaining state-owned enterprises in Poland (Chinese Embassy 2011). The Chinese soon formalized the idea during Prime Minister Wen Jiabao's visit to Warsaw in April 2012 by releasing the "Twelve Measures for Promoting Friendly Cooperation with Central and Eastern European Countries" (FMPRC 2012). The annual summits of the G16 + 1 were subsequently held in Bucharest, Belgrade, Suzhou, and Riga. Meanwhile,

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the Czech Republic elevated its ties with China to a strategic partnership agreement in March 2016 (Tian 2016), and Sino–Polish relations were elevated to a comprehensive partnership agreement in June 2016. The purpose of this chapter is to look critically at the relations of China with Poland as the largest country of the G16 + 1 in terms of demography, territory, and economy.

This chapter starts by offering background information on the role of the G16 + 1 (Sect. 2.1) and the significance of Poland (Sect. 2.2) to the BRI. It then reviews the history of Sino–Polish relations, including the period before World War II (Sect. 3.1), socialist Poland (Sect. 3.2), and Sino–Polish relations after Poland's transformation to a market economy (Sect. 3.3). Next, this chapter discusses the agreement on the Sino–Polish comprehensive strategic partnership reached in June 2016 (Sect. 4), assesses these developments from the perspective of the geopolitical determinism of CEE and Poland (Sect. 5.1), looks at current Polish developmental strategy (Sect. 5.2), and the EU's stance on the BRI and G16 + 1 (Sect. 5.3).

2 16 + 1 Group

2.1 16 + 1 Group and BRI

The obvious role of the G16 + 1 is to pave the way for the development of one of the two components of the BRI, its land component referred to as the Silk Road Economic Belt (SREB) (Du 2016; Summers 2016; Uyanayev 2015). The adoption of the Twelve Measures preceded Xi Jinping's BRI-related visits to Kazakhstan and Indonesia in 2013, which suggests that work on the SREB/BRI must have been well on track, contrary to the common view that the previous administration under Hu Jintao analyzed the prospects for the BRI but did not take any specific action (Ferdinand 2016). The Twelve Measures covered issues such as: an extension of a US$10 billion credit line by Chinese state-owned banks; the establishment of an investment fund aiming to raise at least US$500 million in the initial phase of operation; and local currency settlements/swaps. Under the Twelve Measures, China also committed to contributing RMB2 million annually to a CEE-focused research fund, to grant

5000 scholarships to CEEC citizens, and to open a G16 + 1 secretariat in Beijing.

The G16 + 1summits have produced so-called guidelines. The Bucharest Guidelines were mostly confined to listing planned symposia and workshops (China-CEEC 2013), whereas the Belgrade Guidelines covered more concrete plans, such as the construction of Serbo–Hungarian railway connections (FMPRC 2014). Meanwhile, the BRI's general agenda, released in March 2015, indirectly referred to the CEE region by defining the SREB's geographical focus as "bringing together China, Central Asia, Russia, and Europe (the Baltic); linking China with the Persian Gulf" on the one hand, and "jointly building a new Eurasian Land Bridge, and developing China–Mongolia–Russia, China–Central Asia–West Asia, and China–Indochina Peninsula economic corridors" on the other (NDRC et al. 2015). Subsequently, the Suzhou Guidelines listed further SREB-related developments, such as the conclusion of the framework agreement on customs clearance facilitation between China, Hungary, Serbia, and Macedonia in December 2015, or the participation of the CEECs' financial institutions in the first phase of the RMB Cross-border Inter-bank Payment System (FMPRC 2015).

2.2 Poland's Role in the BRI

A quick look at various maps depicting BRI routes reveals the importance of Poland's participation in this project (Górski 2016). The geography dictates that Poland is the most convenient hub for connecting SREB's railways from post-Soviet countries with planned railways from the Balkans and the Greek port of Piraeus. The projection of Germany as such a hub seems to be inaccurate seeing that the Budapest–Belgrade railway clearly leads further up north. The Czech Republic could be seen as an alternative railway hub but it is not as convenient as Poland's Łódź in terms of logistics efficiency. In this context, Xi's visit to Prague in March 2016, three months ahead of analogous visit to Warsaw, could be seen as a call to the Polish government for more action related to the BRI in the light of some idleness on the Polish side. Nonetheless, Poland has already turned into the EU's most important BRI-related transit country

thanks to private business-to-business initiatives. Rail freight transport between Chongqing and Duisburg reportedly commenced operations in 2011 (Summers 2016; Uyanayev 2015). Regular freight connections between Chengdu and Łódź were launched in March 2013 (Skorupska and Szczudlik-Tatar 2014), between Zhengzhou and Hamburg in mid-2013, and between Yiwu and Madrid in December 2014 (Uyanayev 2015); all having to pass through Poland. Compared with sea shipping, the transportation time was cut by half from about 30 to 15 days and many additional rail freight lines have since been opened.

3 History of Sino–Polish Relations

3.1 Pre-World War II

Contemporary Sino–Polish relations must be looked at bearing in mind the pretty complex relations that have existed between various forms of Polish and Chinese statehood for the last 120 years, because both bordered the Russian Empire and subsequently the Soviet Union. Ethnic Poles played a key role in the development of the Chinese Eastern Railway, based on the concession granted by Qing China to the Russian Empire in 1896 (Chia-pin 1930; Moustafine 2013). After a few decades of turmoil, the railway was handed back by the Soviet Union in 1952 (Urbansky 2012). During that period Poles were a huge proportion of the Russian citizens who settled in Harbin, the railway's headquarters, which had a huge impact on Sino–Polish relations, especially in the interwar period.

The newly independent Second Republic of Poland (2RP), established in November 1918, was recognized by China's Beiyang Government in March 1920 (PAIiIZ n.d.) and made efforts to maintain relations with the diminishing Polish diaspora in Manchuria (Kim 2010; Neja 2002). The Beiyang Government and the 2RP concluded a mostly commercial treaty in May 1929, which never entered into force because of the Beiyang Government's demise. The agreement renegotiated by the 2RP in the following year with the Nanjing Government covered numerous issues, such as diplomatic and consular relations, trade in goods, intellectual

property, establishment of subsidiary companies, sea trade, and the status of Polish schools and churches in Manchuria (Górski 2017).

Acting in the best interests of the remaining diaspora, the 2RP was soon forced to be among the first states to recognize Manchukuo, established in March 1932 (Winiarz 2011).[2] In turn, the Soviet Union was forced to sell its stake in the railway to the Japanese in 1935 (IPR 1934; Moustafine 2013). The Soviets indirectly supported the Chinese in the Sino–Japanese war from 1937 but did not militarily engage against Japan until 1945 (Fisher 1949; Jinghe 2007), which allowed the Russians and Poles remaining in Manchukuo to live there through the war, despite the fact that the 2RP government in exile in London withdrew their recognition of Manchukuo in 1941 (Neja 2002; Winiarz 2011).

3.2 Socialist Poland

In the aftermath of World War II, Sino–Polish relations depended on Sino–Soviet relations and on the Soviet Union's policies toward its Western allies. In July 1946, Western powers and the Republic of China withdrew recognition of the 2RP's government exiled in London and recognized the new provisional government established in 1945 in Warsaw (Cienciala 1985; Thackrah 1976). In October 1949, a fully Soviet-aligned Poland (known as Peoples' Republic of Poland or PRL after 1952) recognized the Peoples' Republic of China (PRC) (PAIiIZ n.d.). The Polish consulate in Harbin was reopened in March 1949, allowing the repatriation of almost 1000 Poles in July, while the remaining 450 persons in Manchuria left throughout the 1950s (Neja 2002).

The PRL and China established a framework of economic exchange in January 1951 by setting up a clearing mechanism, at exchange rates set by the Soviet Central Bank, and by agreeing on lists of products to be exported by each country. Both countries concluded similar agreements year on year following this template (Górski 2017). January 1951 also marked the establishment of the Polish–Chinese Shipping Joint Stock Company (CHIPOLBROK), which was the first foreign joint venture in China and that still exists (CHIPOLBROK n.d.; Górski 2017). Sino–Polish trade flourished during the 1950s, with the PRL mostly exporting

industrial plant equipment, heavy machinery, transportation equipment, and steel, and with China mostly exporting agricultural products, such as canned fruits, tea, soya beans, iron ore, and silk cloth (Jan 1961).

This Sino–Polish economic cooperation soon turned into a complex geopolitical game. The PRC helped the PRL largely liberate itself from Soviet influence by refusing to back a potential Soviet intervention in Poland in October 1956 in the wake of June riots in Poznań following the Khrushchev Thaw (Gruson 1956; Jan 1961; Kemp-Welch 2006; Persak 2006; Torańska 1987). All Soviet advisors were then recalled from Warsaw and, only at Polish discretion, some Soviet troops remained in the PRL to guarantee its Western border (Persak 2006).

Despite some ideological rifts between Polish and Chinese leaders in the late 1950s (Jan 1961; Lüthi 2015) both countries continued with business as usual pretty much until the Reagan administration's economic sanctions, imposed on the PRL in December 1981. China yet again backed the PRL by supplying pork and extending interest-free commodity credit a number of times throughout the 1980s (Górski 2017).

Among many other Sino–Polish agreements concluded in the 1980s, agreements related to civil aviation and legal assistance still remain in force. The March 1986 agreement on civil aviation granted a most-favored-nation clause in terms of airport fees and technical services to one designated airline from each country, it also regulated issues such as aviation-specific tax exemptions. The June 1987 agreement on legal assistance covered issues such as national treatment of natural and legal persons in terms of court fees, simplified legalization of official documents, and the mutual recognition of court decisions and arbitration awards (Górski 2017).

3.3 From Transformation On

The shift of the PRL (relabeled in December 1989 as the Republic of Poland) toward a market economy was reflected in Sino–Polish relations with a set of agreements concluded in June 1988, which still remain in force. For example, the agreement on taxation capped at 10%, tax rates imposed on dividends, capital interest rates, and copyright royalties paid out to another country (7% in the case of industrial property royalties).

A bilateral investment treaty set up a state–state dispute settlement mechanism (Górski 2017).

A Sino–Polish free trade agreement (FTA) of December 1989 replaced a previous clearing system with payment settlements through floating currencies. However, that FTA did not provide for any tariff reductions other than by the most-favored-nations clause. Nor did the subsequent FTA of 1993, which remained in force until Poland's accession to the EU in May 2004. Among other developments, the new agreement on maritime trade of October 1996 recognized, for example, the use of a flag of convenience by parties' vessels and upheld the status of the CHIPOLBROK.

After accession to the EU, Poland largely lost its sovereignty related to trade policies, passing it to the European Commission, and only continued to conclude less significant agreements with China in fields other than trade-related concessions.

4 Toward the Sino–Polish Comprehensive Strategic Partnership of 2016

After the release of the Twelve Measures in April 2012, the actions of the Polish government did not speak louder than the words in subsequent Bucharest, Belgrade, Suzhou, and Riga guidelines. Polish efforts have focused on fairs, exhibitions, workshops, and so on, instead of specific infrastructural projects. Nonetheless, what positively differentiates Poland from other CEECs was its decision to join the Asian Infrastructure Investment Bank (AIIB). This was done despite the strong pressure the USA put on its allies not to do so, driven by the fear that the AIIB would undermine the existing system of development aid and financial stability dominated by the World Bank and the International Monetary Fund (Khor 2015; Steinbock 2015).

Subsequently, during the G16 + 1 summit in Suzhou, Poland along with the Czech Republic, Bulgaria, and Slovakia signed yet another memorandum on the development of the SREB in the CEEC (*China Daily* 2015), which led to Xi Jinping's visit to Warsaw in June 2016, and

brought about the comprehensive strategic partnership between Poland and China. The Chinese, in an op-ed for the leading Polish newspaper authored by Xi, virtually confirmed Poland's central role for the SREB, stating that:

- "Poland is at the heartland of Europe,"
- "It is also where the Amber Road and the Silk Road meet,"
- "Several China Railway Express trains to Europe pass through Poland or are bound for Poland." (Xi 2016)

The core document signed in Warsaw, that is, the Joint Declaration on the Establishment of the Comprehensive Strategic Partnership, also referred to the BRI and the SREB (Prezydent 2016), stating that:

> Both Parties will make joint efforts toward promoting bilateral cooperation within the framework of the Action plan for responsible development of Poland presented by Poland and the Silk Road Economic Belt as well as the twenty-first-century Maritime Silk Road initiative (Belt and Road Initiative) presented by China.

Poland and China simultaneously concluded a number of accompanying agreements. For example, the agreement on taxation in civil aviation clarified that air transportation services shall be mutually exempted from value-added tax. The agreement on academic recognition specified which degrees/certificates are allowed when applying to higher-degree academic programs in the other country. However, that agreement has not set up any general framework for the automatic recognition of diplomas/certificates or professional qualifications (Górski 2017).

5 Assessment

5.1 Poland, CEE, and Geopolitical Determinism

Recent developments in China's relations with Poland and the G16 + 1 must been seen entirely through the prism of the geopolitical consequences

of SREB's success, namely the reversal of the results of the Age of Discoveries (Mackinder 1904). Many Chinese scholars talk about the restoration of European civilization, should European actors explore all the opportunities deriving from an increased land trade with China, particularly across Russia and the Eurasian Economic Union (EEU) (Fasslabend 2015: 300; Ferdinand 2016: 955). They like to draw upon the Anglo-Saxon understanding of geopolitics shaped by Mackinder's (1904) notions of heartland and rimland, like Wang (2015) who repeated after Mackinder and Brzeziński that the economic and infrastructural reintegration of Eurasia would isolate the USA. These trends in Chinese geopolitical thoughts have been noticed in the Anglo-Saxon world, as in the memorable text in *The National Interest* from August 2015 titled "America's Worst Nightmare: Russia and China Are Getting Closer," which noticed that Russia and China indeed "seek to realize Mackinder's vision of a Eurasian heartland" (Burrows and Manning 2015).

Such a rebalancing of global powers would also have significant economic consequences for the CEECs, including Poland. Both BRI's manifesto from March 2015 (NDRC et al. 2015) and the bill on Poland's accession to the AIIB (Sejm 2016) referred to a better division of labor and distribution of industrial chains. It is well discerned in the literature concerning the BRI that one of its major internal objectives is to cure glaring underdevelopment in China's western provinces compared with the coastal ones (Ferdinand 2016). There are obvious analogies between China's western provinces and the underdevelopment of the CEECs compared with Western Europe. However, this has not yet been well explored in literature in the context of the BRI.

CEECs, including Poland, as the peripheral region of the Western hemisphere, fundamentally differ from, say, China's Xinjiang or Russia's Far Eastern District. The success of the SREB and the economic development of Xinjiang and Russia's Far East is in the best interests of Beijing and Moscow. However, Poland's economic integration with Eurasia, along with Poland moving up the chain of value, is not necessarily consistent with the interests of Western centers of power, for which the status quo in the CEE region has been convenient.

Specifically, there has existed a form of dual economy in Europe, split by the river of Elbe ever since the Age of Discovery, which particularly

benefited Prussia/Germany. As Hobsbawm (1954) summarized it, the seventeenth century called a halt to the French Levantine trade, as a result of which exports from the Baltic to Western Europe turned to raw material, while the Mediterranean soon became like the Baltic. The Elbe-delineated economic dualism has implied that Eastern European societies were trapped in manorialism and could not accumulate capital, unlike Western European societies (Karayalcin 2016). Perkins (1986) likened the estates held by the *Junckers* in the eastern part of Prussia that relied on serfdom (i.e., east of the Elbe) to the plantation economies in the Caribbean and the Americas that relied on black slavery, and also claimed that Western European capitalism benefited from the existence of both such backward social systems. Seventeenth-century Poland fell behind Asian countries in terms of GDP per capita and caught up with Asia in the nineteenth century, but has never caught up with Western Europe (Malinowski and van Zanden 2015; Malinowski 2016).

After the collapse of the Soviet bloc, the place of Poland and other CEECs in the chain of production has again resembled the economy of the Polish-Lithuanian Commonwealth or East Prussia since the seventeenth century. Gone are the 1950s to 1970s, when the PRL exported high-value and high-technology products to the members of the Council for Mutual Economic Assistance and other communist/socialist countries like China.[3] Since the enlargement of the EU to the CEECs in 2004, Poland has again become the granary of Europe. Exports—of foodstuffs, raw materials, intermediate products, and any products placed low in the chain of value—from the CEECs to the West have grown massively; while the CEECs, particularly the western regions of Poland, have seen numerous investments in assembly plants with no accompanying research and development infrastructure.

5.2 Polish Strategy

The attitudes of various Polish centers of powers toward the BRI and the SREB are not always consistent, despite the fact that since fall 2015, the president (Andrzej Duda), the largest parliamentary majority in Poland after 1989, and the government (led by Beata Szydło) all came from the

same political party (*Law and Justice* or *Prawo i Sprawiedliwość*). While President Duda enthusiastically discussed the prospects for the development of the SREB's hub in Poland (Xinhua 2015; Fu and Li 2016), Defense Minister Antoni Macierewicz, in November 2015, expressed the view that the BRI is part of a more complex agreement between Western Europe, Russia, and China, the premise of which is to eradicate US influences in the Eurasian space and to liquidate Poland as a sovereign subject (GoniecTV 2015). The press also widely reported that Polish Military Property (Agencja Mienia Wojskowego) had cancelled a planned auction for the sale of a 33-hectare plot in Łódź, on which Chinese investors planned to develop a railway freight terminal (*Newsweek Poland* 2017).

Despite such difficulties, the Polish administration did not completely relinquish the idea of actively supporting SREB-related projects. At the turn of 2016 and 2017 Polish policymakers, generally siding with the USA against Russia, feared for a possible new Russo–American realignment expected directly after Trump's victory. This could have resembled Obama's reset toward Russia announced in March 2009, however, this has been held back by the irreconcilable interests of Russia and the USA in Syria since 2012. Thus, on the one hand, on July 5–6, 2017, Warsaw hosted President Trump's visit, which was widely reported worldwide, the only substantial objective of which was to sell American liquefied natural gas (LNG) to Poland (Oxford Analytica 2017; White House 2017b). On the other hand, one week later, Warsaw quietly hosted a four-days-long working visit by the Chairman Zhang Dejiang of the Standing Committee of China's National People's Congress, who reaffirmed China's commitment to work with the Polish authorities on the BRI (Xi 2017).

As far as official documents are concerned, the Polish position on the BRI has been specified in the "Action plan for responsible development of Poland" (also known as the Morawiecki plan, after Poland's finance minister), which is mentioned in the text of the 2016 Strategic Partnership as Poland's leading developmental strategy (President 2016). The Morawiecki plan is underpinned by Keynesian economics. Many of its points can be seen as self-contradictory and some also seem to clash with the SREB. The document identifies risks for the Polish economy, such as: the middle-income trap; the lack of balance between foreign and domestic investment/capital; reliance on the production of low-value products

and cheap labor; and an aging society (Council of Ministers 2016). However, the Morawiecki plan fails to offer any actual solutions, but proposes interventionist/statist stimuli in fields such as: reindustrialization; development of innovative companies; financing of economic development; foreign expansion of Polish enterprises; and social and regional development. The plan only perfunctorily mentions the AIIB and remains quiet as to the BRI and the SREB. The general hesitancy about foreign investment as the leitmotif of this document does not bode well for effortless Chinese investment in Polish infrastructure.

5.3 SREB and the EU

Polish strategy toward the BRI and the SREB is conditional not only upon Russo–American geopolitical games but also upon Polish membership of the EU and German economic interests in the CEECs. Chinese policymakers, for the time being, seem to recognize the status quo of having to deal also with the EU with regard to the CEECs. Documents such as the Belgrade Guidelines (FMPRC 2014) or the Sino–Polish Strategic Comprehensive Partnership (President 2016) constantly refer to the EU–China 2020 Strategic Agenda for Cooperation signed in November 2013. Because of timing, the 2020 Agenda could not include BRI/SREB-specific provisions and only very generally refers to transport and infrastructure (EUEA 2013, point 4.2).

The EU took a pronounced stance on the G16 + 1 only after EU–China relations deteriorated over trade issues to the extent that the EU and China did not release a joint declaration after the Eighteenth EU–China Summit held in Beijing in July 2016. Among many other complaints directed toward Chinese partners and included in the communication released ahead of that summit, the European Commission seemed to be sending a warning to the CEECs against plotting with China behind the EU's back (European Commission 2013, point II).

There are other long-standing issues with Brussel's stance on future relations with China, apart from the inclination toward a suppression of Member States' bilateral or regional ties with China. One has been that the EU bloc has been incapable of formulating a coherent stance toward

Russia/EEU as an essential part of its policy toward China (Holslag 2011), despite the fact that Russia/EEU has so far proven indispensable for the SREB, proactively participating with the establishment of freight railway lines passing through its territory. Instead, the 2020 Agenda put an emphasis on EU–China cooperation with regard to connectivity and energy in Central Asia (EUEA 2013), hinting that, despite all the obstacles present in Central Asia and the Caucasus, the EU might be strongly advocating SREB's southern variant, bypassing Poland, in which case SREB's hub would be most likely to be situated further to the west, somewhere in Germany.

While Western European policymakers seem to live in denial of China's pretty straightforward strategy toward the G16 + 1 and Poland, the USA has come up with the Three Seas Initiative (also known as Trimarium) which not only competes with the G16 + 1 but also further undermines the EU's unity in terms of its stance on the BRI/SREB. The Trimarium platform, which was inaugurated under the Obama administration in August 2016 in Dubrovnik, overlaps with the G16 + 1 by covering those G16 + 1 members that are also EU Member States, plus Austria. On the surface, the Dubrovnik Statement (Predsjednica 2016) seemed to assure that the project was not aimed against the EU. Nonetheless, Trump's administration, which fully embraced the idea of Trimarium, further deepened the affront to the Western European countries during Trump's visit to Warsaw in July 2017, by making it serve as the second Trimarium summit, which Germany's Foreign Minister Sigmar Gabriel refused to attend.

President Trump pressurized Trimarium members to accelerate projects related to the imports of American LNG through terminals in Poland and Croatia, which could wreck Germany's ambitions to become a European hub for the sale of gas supplied through Nord Stream from Russia (Oxford Analytica 2017). On the whole, the emerging US strategy toward CEECs appears to be much more pragmatic than the EU's and Germany's. Washington's blueprint seems to be to proactively engage in the region and put forth projects that are complementary to China's infrastructural projects. Through such an enhanced presence in the region, Washington could keep Chinese infrastructural investment in check, or perhaps even secure the participation of American business in projects originally conceived in Beijing. What remains to be seen are the

means through which Brussels and Berlin will try to torpedo both Trimarium and the G16 + 1.

6 Conclusion

For centuries the CEECs, and particularly Poland, have been a playground for the world's major powers. The region has been essential to various forms of Prussian/German statehood as the hinterland for the German industrial powerhouse, while the existence of buffer states in the CEE region aligned with various forms of Russian statehood satisfied the Kremlin's fixation on expanding Russia's strategic depth. After the collapse of the Soviet bloc, control over the region has been crucial for Washington, compelled to somehow keep in check a unified Germany and to quell any attempts at a new Russo–German cooperation in any form. Now, the CEECs, with Poland geographically predestined to bridge the railways coming from Russia/EEU and the Balkans, is also indispensable for the BRI and the economic reintegration of Eurasia.

It suffices to look at the trade profile of the PRL and China between the 1950s and 1970s to understand where the G16 + 1 members could now stand in the chain of value and production, in the absence of collectivized and centrally planned economies, should the trade, regulatory, and political barriers be removed between the CEECs, China, and Russia/EEU. Nonetheless, prospects for the full exploitation of the BRI's dormant potential are uncertain. For the time being, virtually all the CEECs are still reliant on EU structural funds and are not yet ready for a major geopolitical shift, such as a break-up from Western Europe; and some, like Poland, still strongly prefer to keep the Trans-Pacific alliance in place, which severely hinders Chinese projects that also involve Russia/EEU.

Notes

1. Including: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Montenegro, Poland, Romania, Serbia, Slovakia, and Slovenia.

2. However, Winiarz (2011) does not offer details of this recognition whereas two Polish governmental agencies (PAIiIZ and PARP) claim that Poland recognized Manchukuo in October 1938. These discrepancies might lie in that some memoires specifically related to the Polish community in Harbin might refer to earlier and less formal consular arrangements between the 2RP and Manchukuo.
3. China withdrew from the Council for Mutual Economic Assistance after the Sino–Soviet split in 1961.

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8

The Impact of the Belt and Road Initiative on Central Asia: Building New Relations in a Reshaped Geopolitical Scenario

Fabio Indeo

1 The Belt and Road Initiative: Focus on Central Asia

The Belt and Road Initiative (BRI) represents a global geopolitical strategy backed by China to increase interconnectivity through the realization of an economic and trade corridor that crosses Eurasia to link China with Europe, the Middle East, and South Asia. Since 2013, when Chinese President Xi Jinping announced the former Silk Road Economic Belt project during a speech at the Nazarbayev University in Kazakhstan, China has invested billions of dollars to build new transport infrastructures—highways, railroads, dry ports, pipelines—or to upgrade existing

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ones on which to undertake this strategy (Huang 2016: 314–321). According to China's National Reform and Development Commission, since the launch of this global strategy China has invested over US$50 billion in countries along the Belt and Road and between 2014 and 2016 signed contracts for new construction projects worth US$304.9 billion (*China Daily* 2017). This massive financial engagement was confirmed in May 2017 during the Belt and Road Forum in Beijing, when Chinese President Xi Jinping pledged US$124 billion in a combination of aid, loans, and investments to the countries involved in the BRI.

Before the launch of the Asian Infrastructure Investment Bank (AIIB) in January 2016, bilateral loans—which are mainly granted by state-owned commercial banks, particularly China Exim Bank—and the Silk Road Fund (SRF, created in November 2014 with US$40 billion), were the main investment tools for realizing BRI-labeled projects. During the Belt and Road Forum in May 2017 the Chinese President decided to allocate US$14.7 billion more to the SRF and to make an additional US$79.4 billion of investments (International Crisis Group 2017: 4). However, the AIIB—with US$100 billion in nominal capital, which will be paid in gradually by members—is expected to be one of the main sources of finance for the BRI, both investing and attracting other financial support to develop transport, energy, and communication projects in the region. The AIIB has approved loans worth US$1.73 billion to support 13 projects in eight countries, including the former Soviet states of Azerbaijan and Tajikistan (Sands 2017; Hong 2017: 355).

From a Chinese perspective, BRI geopolitical projects aim to achieve two strategic goals: the implementation of an alternative continental route for trade and energy imports to reduce the dependence on maritime routes crossing Malacca and the South China Sea; and the enhancement of a security buffer zone between Xinjiang western province and Central Asia to preserve China's western provinces from instability and threats linked to Islamist terrorism (International Crisis Group 2017: 4–5). Central Asia has a strategic relevance to the BRI because this region is crossed by two of the six main BRI economic corridor projects (China–Central Asia–West Asia and the Eurasian land bridge) which will have an impact on their economic evolution and will influence the regional geopolitical scenario.

The China–Central Asia–West Asia corridor should connect the China–Kazakhstan railway to Uzbekistan, Turkmenistan, and Iran. This corridor is strategically relevant in geopolitical terms, mainly because it will bypass Russian territory and thereby downplay Russia's influence in Central Asia.

The new Eurasian land bridge economic corridor will involve Russia by linking China with Europe via Kazakhstan and Russia. There are other sub-corridors, or spurs, of the main projects that are particularly relevant:

- the Khorgos–Aktau railway, linking the Kazakh port in the Caspian Sea to the main BRI trade gateway of Khorgos;
- the China–Kyrgyzstan–Uzbekistan Railway, linking the western Xinjiang cities of Kashgar/Kashi, via the southern Kyrgyz city of Osh, to Andijan in eastern Uzbekistan;
- China–Central Asia gas pipeline, which at present is mainly fueled with Turkmen gas but, following the realization of Line D, will involve all five Central Asian countries as both suppliers and transit countries (Cooley 2016: 5).

The involvement of Central Asian countries in the BRI is evidently very profitable, by ensuring them economic and political benefits. In geopolitical terms, a growing Chinese presence in the region will allow Central Asian countries to undertake a multivector strategy in foreign policy, containing the traditional Russian influence, and balancing Moscow's pressures to join or further develop their economic integration project, the Eurasian Economic Union (EEU). The Chinese initiative is based on an inclusive dimension; all five Central Asian republics are involved in the BRI mainly because the support to this project does not include a rigid membership to a potential supranational organization, like the adhesion to the EEU (Bugajski and Assenova 2016). The convergence of massive investments to develop and upgrade national infrastructures will be highly profitable for Central Asian countries by promoting interconnectivity and improving regional trade cooperation through the creation of a trans-regional transport network, and by opening up new markets for these landlocked countries; furthermore, modernization of

the transport infrastructure will allow Central Asian states to set aside the networks of pipelines, roads, and railways inherited from the Soviet era, which were designed to serve the needs of the Russian hub of the Soviet economy (Indeo 2017: 39; Cooley 2016: 3).

China has become the main economic power in the region. Trade between China and the five Central Asian republics has risen from US$1.8 billion in 2000 to US$34 billion in 2015, while the five states' trade with Russia amounted to only US$23 billion (Peyrouse 2017: 98). Moreover, China is the most important creditor in the region; in addition to the financing of infrastructural projects, the energy sector in Turkmenistan and Kazakhstan has attracted huge investments from the Chinese government and banks, which granted US$8 billion to Turkmenistan and US$13 billion to Kazakhstan to develop oil and natural gas deposits and to realize east-oriented pipelines to ship hydrocarbons to China (Cooley 2016: 4). The economic downturn which has affected Russia—due to the collapse of oil prices and the effects of Western sanctions—has currently hampered Moscow in fulfilling its economic commitments to realize hydroelectric power plant projects in Kyrgyzstan and to provide a military aid package to Tajikistan, which has eroded its geopolitical influence in the post-Soviet space.

It is interesting to analyze how the BRI is influencing the foreign policy of Central Asian countries and relations between them and Russia. As a matter of fact, even if Beijing denies having political ambitions and highlights that BRI is only a global economic project, it is clear that Chinese involvement in the region will erode and marginalize Russia's presence. By enhancing a new framework of cooperation between China and Central Asian countries, there will be an impact in the domestic political field (Orozobekova 2016). In spite of the Chinese reiterating their adhesion to the principles of non-interference in the internal affairs of other states, the size of their investments and the realization of huge infrastructural projects will entail a growing influence of China on the foreign policy orientations and decisions adopted by Central Asian republics—especially since China has signed a strategic partnership agreement with all of them.

In this chapter, the analysis will be focused on the influence of the BRI in the foreign policy orientations of Uzbekistan, Kazakhstan, and

Tajikistan because its impact in these countries appears to be significant, and because of the different roles they have in the regional geopolitical chessboard: Kazakhstan is a founder member of the EEU; Tajikistan is evaluating its adhesion; while Uzbekistan has always refused to join the EEU, preferring to play a multivector strategy in foreign policy. Turkmenistan and Kyrgyzstan are also included in the BRI and benefit from this project: China realized strategic road connections in Kyrgyzstan—Osh–Sarytash–Irkeshtam and Bishkek–Naryn–Torugart; while Turkmenistan is one of the most important natural gas suppliers for Beijing, following the realization of the China–Central Asia gas pipeline. However, the impact of the Chinese initiative on their foreign policy is less compared to the other three Central Asian countries: Kyrgyzstan's adhesion to the EEU enhances its pro-Russian orientation in foreign policy; while the most visible impact of the BRI in Turkmenistan is almost exclusively limited to the energy sector, to implement the eastward gas pipeline from Turkmenistan to China.

2 Uzbekistan: BRI Projects and Regional Cooperation

Given its geographic centrality in the heart of Central Asia—sharing a border with the other four Central Asian republics and with Afghanistan—Uzbekistan is in a key strategic position in the BRI. Since independence, the main rationale of Uzbek foreign policy has been to balance interests between East and West, containing Russian, Chinese, and US influence. However, the new President Mirziyoyev has undertaken a proactive approach to foreign policy, based on a profitable multivector strategy to strengthen cooperation with both Russia and China, but mainly oriented to revamping regional cooperation, improving relations with other Central Asian republics (Rakhimov 2017). In this new paradigm, cooperation with China on the BRI project is a key component that is influencing Tashkent's strategic orientations, especially because China's political and economic system is perceived as a concrete and successful alternative to Western-style democracy or to overcome the Russian legacy; moreover, the Chinese approach of pursuing "the principles of non-interference in

the internal affairs of other states" makes China a model partner for Uzbekistan (Yu-Wen Chen and Günther 2016).

Before the launch of the Chinese initiative, Uzbekistan had progressively enhanced its relations and cooperation with China, which became an important trade and political partner. Under the former President Karimov, Uzbekistan and China signed a Declaration on Strategic Partnership in June 2012, upgrading their political and economic relations. During Xi Jinping's visit to Tashkent in September 2013, in addition to several agreements on economic cooperation, they also signed a Treaty on Friendship and Cooperation and a Joint Declaration "On Further Development and Deepening Bilateral Relations of Strategic Partnership." Following this agreement Uzbekistan and China are committed to strongly supporting each other's chosen path of development in respect of internal conditions and supporting each other's international cooperation initiatives. Moreover, these countries have engaged themselves to avoid joining alliances or military blocs that could damage the sovereignty, security, and territorial integrity of the other side (Tolipov 2013).

These principles are in line with the foreign policy doctrine of Uzbekistan, which is based on four pillars: non-intervention in the internal matters of foreign countries; non-alignment with any military organizations, including non-deployment of foreign military bases on the territory of Uzbekistan; non-membership in the Russian-led EEU; and improvement of relations with Uzbekistan's immediate neighbors, which will be implemented as a key priority matter (this last pillar was introduced by the new Uzbek President Mirziyoyev, reorienting Uzbek foreign policy toward Central Asia). From a Chinese BRI perspective, Uzbekistan is important not only as a transit country but also as security partner in order to maintain stability in Central Asia and cooperate in the fight against Islamic fundamentalism, even if Uzbekistan does not share a border with China (Hashimova 2016; Yu-Wen Chen and Günther 2016).

In May 2017, the Uzbek President visited China to sign a bilateral deal with President Xi Jinping and to attend an important conference on the BRI. During the bilateral summit, Uzbekistan and China signed nearly 100 deals, worth a total of US$20 billion, which legitimized China's role as the main trading partner of Uzbekistan; in 2016 bilateral

trade turnover hit US$4.2 billion and both countries aim to reach US$10 billion in the future (Hashimova 2016). Moreover, China is a key investor in Uzbekistan, helping the country in the process of modernization and in the economy's diversification. Following the last bilateral meeting in Beijing, a Chinese bank has pledged to entirely finance a US$1.2 billion project for the production of synthetic liquid fuel at Uzbekistan's largest gas refinery complex in Shurtan, while an additional US$3 billion will be invested in the modernization of around 300 water pumping stations and in the development of Uzbekistan's hydroelectricity sector. The realization of the Pap–Angren railway, which connects the Ferghana Valley (in eastern Uzbekistan) with other Uzbek regions, represents the most important project realized with the support of Chinese capital. This railway is a segment of a larger BRI project, which aims to realize a trans-regional railway connecting China's western city of Kashgar to Osh, in the Kyrgyz sector of the Ferghana Valley, and from there the railway will reach Uzbekistan, Turkmenistan, Iran, and Turkey. Chinese companies are also involved in the realization of a US$175 million motorway project, an automobile tunnel under the Kamchik Pass to run parallel to the railroad in the Ferghana Valley. In the energy sector, China has also financed and realized three pipelines to connect Uzbekistan to the main gas pipeline from Turkmenistan to China, also engaging itself to supply ten billion cubic meters of natural gas per year (*Eurasianet* 2017).

During the BRI summit, the Uzbek President stressed the strategic relevance of the planned China–Kyrgyzstan–Uzbekistan–Afghanistan railroad to connect the region with markets in the Persian Gulf and in South Asia. At present Uzbekistan is Afghanistan's only neighbor with a railway connection, the Termez–Hairaton–Mazar-i-Sharif railway. The improvement of bilateral relations between Uzbekistan and Kyrgyzstan clearly represents a necessary precondition for completing this strategic transportation project, Kyrgyz opposition has to be overcome to realize the domestic line of this trans-regional railway project. However, the visit of Uzbek Prime Minister Aripov to Kyrgyzstan in August 2017 could pave the way for a solution to the border problems and their definitive demarcation, also allowing some progress in the realization of a China–Kyrgyzstan–Uzbekistan railway (Pannier 2017b). In this new paradigm of renovated regional cooperation, the recent rapprochement with

Turkmenistan will produce significant geopolitical benefits, connecting Uzbekistan with the north–south railway from China through Turkmenistan, which will allow Tashkent to open trade corridors with the Caspian and Persian Gulf regions.

In spite of this privileged cooperation with China, Uzbekistan continues to successfully play a multivector policy, which also includes Russia. As a matter of fact, even if Mirziyoyev reiterated the traditional Uzbek approach to foreign policy by refusing to join the regional organization backed by Russia in the security field (the Collective Security Treaty Organization) and in the economic field (the EEU), he did renew economic cooperation with Russia by signing economic and cooperation deals for US$16 billion during a visit to Moscow in April and a military–technical cooperation agreement (Mashrab 2017). On the one hand, Russia is recognized as an important trade and political partner in the region, and Uzbekistan considers it profitable to cooperate with Moscow in bilateral terms. On the other hand, Uzbekistan can successfully play both the Chinese and Russian cards in the Central Asia geopolitical scenario, exploiting their competition to maximize benefits and strategic gains.

3 Kazakhstan: Central Asian Pivot of the Modern "Silk Road"

The political stability that has characterized the country after independence, the huge economic growth supported by oil exports, the strategic centrality of its geographic position as a kind of Euro–Asia bridge are the main reasons that have allowed Kazakhstan to undertake a multivector strategy in foreign policy. Even if Kazakhstan is one of the founder members of the EEU and a traditional partner of Russia, President Nazarbayev has enthusiastically supported the Belt and Road geopolitical initiative, within which Kazakhstan plays a strategic role as Central Asian pivot. Significantly, Chinese President Xi Jinping presented the former Silk Road Economic Belt initiative in Kazakhstan, at the Nazarbayev University in Almaty on September 7, 2013, confirming the special and

long-term relations between China and this Central Asian republic, which were recently upgraded through the Sino–Kazakh strategic partnership signed in 2005 (McDermott 2011).

Kazakhstan benefits from a significant role in the BRI initiative, as a strategic transit country crossed by most of the land corridors projected to reach Europe. As a matter of fact, Kazakhstan is crossed by the Eurasian land bridge corridor and the China–Central Asia–West Asia corridor, and is also fully involved in the Khorgos–Aktau railway corridor, aimed to link the Sino–Kazak border with the Kazakh seaport in the Caspian Sea (Indeo 2017: 40–41). Astana has already received over US$27 billion of China's BRI investment to realize these transport infrastructures and to develop some transport hubs along the Sino–Kazakh border; among them, Khorgos—opened in 2015—is the most relevant land bridge, which currently represents the main commercial and logistic hub in Eurasia under the BRI label (Ghiasy and Zhou 2017: 20). The strategic centrality of Khorgos to the BRI, which also hosts one of the ten Special Economic Zones created by Nazarbayev, is confirmed not only by the railway connecting the Sino–Kazak border with Aktau—one of the main oil-producing areas of the country, where Chinese companies invested several billion dollars to exploit the energy sector—but also because it is the main gateway of the BRI infrastructural and energy projects (Assar 2017). In May 2017, the Chinese COSCO Shipping Corporation and Jiangsu Lianyungang Port Co purchased a 49% stake in the Khorgos transport hub from the national railway company, further showing the relevance of this transport hub to the BRI project (*China Daily* 2017).

The deep cooperation with China in the BRI framework has gradually influenced the evolution of Kazakh foreign policy, which remains multivector—based on balancing the interests and goals of all external actors involved in the country—even if it is gradually coordinating and integrating with the Chinese initiative.

As a matter of fact, President Nazarbayev has highlighted the strategic complementarity between the BRI initiative and Kazakhstan's new economic policy, called the Bright Road, because both aim to create new transport infrastructures integrated with the big international railway and roads in order to consolidate the role of Kazakhstan as a political and

economic bridge between East and West. This cooperation is conceived as mutually beneficial for achieving a common prosperity, also allowing Kazakhstan to be connected with international markets and to develop diplomatic and commercial partnerships with other players (Putz 2015b; Kassenova 2017: 110–116). According to Kazakh officials, the integration of these projects will create a multiplying effect for the development of industries and unimpeded trade in the region, turning Kazakhstan into a major Eurasian transport and logistics hub (*Astana Times* 2016).

The mutual dimension of this strategic cooperation in foreign policy further emerges following the visit of President Xi Jinping to Astana in June 2017 (one month after the BRI summit in Beijing), when he signed US$8 billion business deals confirming the Chinese intention to work on aligning the BRI with Kazakhstan's *Nurly Zhol* (The Path to the Future) economic policy (International Crisis Group 2017). Furthermore, China–Kazakhstan economic cooperation is not limited to infrastructure projects. Since 2005, China and Kazakhstan have developed a profitable cooperation in the energy field, and the China National Petroleum Corporation (CNPC) has invested billions of dollars to exploit Kazakh oil fields. The Atyrau–Alashankou oil pipeline represents a tangible result of this cooperation, allowing both Astana and Beijing to enhance the diversification strategy of energy routes (CNPC 2017). In addition to the oil sector, China is also interested in completing the Beyneu–Bozoi–Shymkent gas pipeline, which will be connected to the China–Central Asia Gas Pipeline, at present fueled by Turkmen and Uzbek gas.

Chinese investments are crucial to support Kazakhstan's efforts to overcome the economic downturn mainly due to the scenario of low oil prices and worsened by membership of the EEU, where the Russian economy is severely affected by Western sanctions. Kazakhstan (and Kyrgyzstan) do not have significant economic benefits from their EEU adhesion, even if the abolition of customs barriers from the Kazakh–Kyrgyz border in August 2015 and from shared EEU borders is a concrete result of this regional cooperation. There are some economic distortions to address and hindrances to remove to implement economic cooperation within the EEU. One of the main problems is that the single external tariff adopted by EEU members is based on pre-existing higher Russian trade tariffs, and, consequently, for Kazakhstan and Kyrgyzstan

imports are more expensive (mainly for Kyrgyzstan this regime implies higher prices on Chinese imports and difficulties for wholesale and re-export trade). Moreover, the balance of trade is unfavorable to Kazakhstan. National exports within EEU space are declining as is bilateral trade with neighboring Kyrgyzstan (International Crisis Group 2016: 10–13; Pannier 2017a).

Even if Nazarbayev has strongly supported the idea of Eurasia for a long time, he fears the perceived neo-imperialist approach of Moscow in the region, which could affect and limit the profitable multivector strategy adopted in his foreign policy, as well as their national sovereignty. The Kazakh President has clearly stressed that the EEU will only have an economic dimension, refusing the idea of creating a supranational political institution. In fact, to preserve its sovereignty and political independence, Kazakhstan has threatened to leave the EEU (Satpayev 2015: 11–16).

4 Tajikistan: Between the BRI and the EEU

The impact of the BRI on Tajikistan's foreign policy is a good case study given the position of the country in the geopolitical regional scenario. Unlike Kazakhstan or Uzbekistan, Tajikistan is a poor country, without natural resources to exploit; and since its independence this Central Asian republic has been dependent on Russia in the economic, energy, and security fields. Tajikistan has become a member of the Collective Security Treaty Organization, and Moscow maintains its largest foreign military base in the country (the 201st Motorized Rifle Division). Tajikistan has not yet joined the EEU, which has opened a space for maneuver for China to extend its influence in the country through the BRI strategy.

Since 2014 Tajikistan has enthusiastically supported the BRI. The two sides have adopted a five-year development plan for a China–Tajikistan strategic partnership, with the ambition to expand bilateral cooperation in economy and trade, infrastructure construction, energy, and mining, and to create favorable conditions to attract more Chinese investment (*China Daily* 2014). It is evident that Chinese investments aim to realize internal rail and road routes—which could eventually form the basis of a

new trans-regional network—and to boost the national security system to better fight the terrorist threat coming from neighboring Afghanistan, which has gradually influenced Tajikistan's foreign policy. However, Tajikistan still appears too geopolitically weak to successfully play a multivector foreign policy while balancing Sino–Russian interests. China has invested approximately US$720 million in infrastructure improvements in Tajikistan, including the rebuilding, widening, and improvement of the road between Dushanbe and Khujand, and the opening of a new major highway from Dushanbe to Kulma, which has incentivized the rise of bilateral trade (Shahbazov 2017). The implementation of the Dushanbe–Kulyab–Khorog–Kulma–Karakorum highway will be the key project in the Sino–Tajik cooperation, because this route will run from Dushanbe to Xinjiang, crossing the border at the Kulma Pass, the only overland route between Tajikistan and China (Putz 2015a). Furthermore, the project to build the China–Kyrgyzstan–Tajikistan–Afghanistan–Iran railway will increase connectivity in the region, opening new trade routes toward the Persian Gulf and boosting the necessary cooperation between Tajikistan and Kyrgyzstan, which have had bad relations due to border disputes. In 2016, the AIIB approved a loan of US$27.5 million for the Dushanbe–Uzbekistan border road improvement project, for an upgrade of a key five-kilometer section of the motorway. This project is co-financed by the European Bank for Reconstruction and Development with US$62.5 million, in a total project cost of US$105.9 million (AIIB 2017). In this case, the precondition for implementing the project will be the improvement of bilateral cooperation with Uzbekistan, solving border problems, and other issues, which will also benefit China.

In addition to economic and trade issues, the growing military presence of China in Tajikistan as a potential security provider is raising discontent and concern in Moscow, which wants to maintain the Central Asian country under its sphere of influence. Following the withdrawal of NATO military forces from Afghanistan in 2014—although a new NATO-led mission is currently training and assisting Afghan security forces—Russia and the existing multilateral security organizations—CSTO and the Shanghai Cooperation Organization, which includes both China and Russia—appear unable to provide security in the region. Chinese concerns about stability in Tajikistan are strongly linked to the need to provide security for the trade and energy corridors included in

the BRI framework. China has to adopt concrete initiatives to contain and fight the serious threats represented by transnational terrorism and radical Islamist insurgency, which could propagate along the shared borders and seriously affect China's western region. The vulnerable and porous Tajik–Afghan border is the main source of concern, considering that it is regularly threatened and affected by Taliban attacks. Moreover, many ethnic Tajiks have fought in the Middle East under the banner of the Islamic State—from 400 to 2000, depending on the source—and they could represent a threat to Tajik and regional stability following their return after the defeat of the Islamic State in Syria and Iraq (Lemon 2015: 69–73). To address these threats, on August 4, 2016, China promoted a new regional forum in the security field, the Quadrilateral Cooperation and Coordination Mechanism, with Tajikistan, Afghanistan, and Pakistan, to develop closer military cooperation in a multilateral regional organization which excludes Russia. Furthermore, in September 2016, China signed an agreement with Tajikistan, pledging the construction of 11 outposts and a training center along the Afghan–Tajik border. In terms of military assistance, China has already spent US$15 million to construct apartments for military officers in Dushanbe, while in October 2016 China held its first-ever joint bilateral counterterrorism exercises in Gorno Badakhshan, the remote eastern end of Tajikistan that borders both Afghanistan and China (Shahbazov 2017).

The Dushanbe government is attracted by the Chinese perspective because Beijing is concretely investing in the country, effectively realizing the pledged projects, while Russia appears unable to fulfill its promises to invest in the country. In 2012, when Tajikistan allowed Russia to extend the lease of its military base in the country for another 30 years, Moscow pledged to grant US$200 million in military aid to Tajikistan, which became US$1.2 billion in 2015. After Chinese military maneuvers in Tajikistan, Russia has further renovated its promise to deliver military equipment to the country, also offering to expand its military presence by renting a new military base in Ayni. Nevertheless, these promises of financial and military aid have not entirely materialized (Kucera 2016; *Asia Plus* 2017).

In this Sino–Russian competition to extend influence in this Central Asian country, the turning point will be Tajikistan's decision about its membership of the EEU. For China, the adhesion of Tajikistan in the

Russia-led EEU would hamper its chances of directly shipping its economic goods to Central Asia. As a matter of fact, Tajikistan remains the only Central Asian country sharing a border with China that is not included in the Russian project of economic integration.

At present Tajikistan has not made a decision and is studying the experience of countries like Kyrgyzstan within the EEU, while the negative economic records of Russia and Kazakhstan may push Tajik President Rahmon to carefully rethink this important step in foreign policy (*Asia Plus* 2017; Salimov 2015). At the same time, Russia could play some strong cards to influence Tajik decisions, among them, Tajik migrant workers in Russia and the economic relevance of their remittances for the national budget, even though since 2014–2015 the number of Tajik worker migrants in Russia has been decreasing because of the economic downturn affecting the Russian economy. Nearly a million Tajik citizens live in Russia and their remittances cover around half the country's annual GDP. The adoption of restrictive immigration policies or the promise of better conditions could influence the approach of Tajik authorities, considering the destabilizing repercussions linked to the return of Tajik workers from Russia in a national context of unemployment, poverty, and lack of professional prospects (Indeo 2016: 9–10).

5 Conclusion

The BRI is an ambitious global economic project that will modify the current geopolitical landscape, not only in Central Asia but also in all the countries involved. For Central Asian countries, BRI in an attractive idea and its success will ensure economic benefits in terms of access to new markets, transit fees, and modern infrastructures. Nevertheless, the envisaged prosperity promoted by the BRI will not be homogeneous. Some countries will be able to exploit their position as strategic pawns in the Chinese initiative, while others could have more difficulty.

The Chinese initiative will allow Kazakhstan and Uzbekistan to further maintain their multivector strategy in foreign policy. In the case of Kazakhstan, the envisaged integration between BRI and *Nurly Zhol* appears limited to the economic dimension, while relations with Russia could potentially be managed in a wider framework based on potential

cooperation between the BRI and the EEU (or better, Russia). However, the potential merger of these two geopolitical strategies will mean China and Russia have to overcome mutual mistrust in some fields and work on a tailored cooperation.

Uzbekistan's ability to look for a balance between Russia and China is also confirmed by its new president. The combination of BRI investment and new regional foreign policy could produce significant results while legitimizing the country as a powerful actor in the regional chessboard.

China has become a reliable partner in foreign policy for Tajikistan and Kyrgyzstan, but they will not be able to resist the potential pressure of Russia, which disposes of several tools to reorient their political decision (migrant workers, energy dependence, trade, the use of Kant military airbase in Kyrgyzstan and other military facilities in Tajikistan).

For Turkmenistan, the gas pipeline oriented to China has represented a great success in foreign policy, breaking the traditional Russian monopoly on the control of Turkmen exports. However, Ashgabat is nearly totally dependent on this export route, highlighting an unbalanced dependence on China, which is conditioning the evolution of its foreign policy.

One of the main long-term problems for Sino–Central Asia cooperation within the BRI project will be the capacity of these countries to repay the huge loans granted by China. Kyrgyzstan and Tajikistan in particular could suffer from this situation, because they have no energy reserves, raw materials, or goods to sell in international markets. Another issue is that Central Asian public opinion is increasingly worried about China's growing activism. The threat of Beijing's hidden long-term intentions for territorial expansion and interference could push Central Asian countries to limit their cooperation with China.

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9

Live and Let Live: Africa's Response Options to China's BRI

Emmanuel Kodzi

1 Introduction

China's increasing role in African development is consistent with the goals of the Belt and Road Initiative (BRI). The 2015 Ministerial Meeting of the Forum on China–Africa Cooperation (FOCAC) ended with a declaration that China–Africa relations have been upgraded to "comprehensive strategic and cooperative partnership status." This is significant because China categorizes its relations with other nations in order of importance (strategic partner, cooperative partner, and friendly cooperative), based on depth of collaboration and other factors. The FOCAC declaration is an implicit acknowledgment of interdependence between the parties, and a signal of increasing Chinese investment in African countries for the foreseeable future. The proliferation of Chinese firms in Africa also appears to be driven by a shorter institutional distance between China and Africa, leading to more favorable risk assessments and easier

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adjustment of business practices to local conditions (Cuervo-Cazurra and Genc 2008; Luo et al. 2011; Wang et al. 2013). However, increasing the level of engagement is also associated with unintended effects, such as competitive pressures, power asymmetries, and diplomatic challenges. For host nation businesses, the combination of competitive pressures and the imbalance of power in China's favor raises the stakes for survival. Thus, with increasing Chinese engagement, it is important for local businesses in African countries to understand the real basis for competitive advantage in their local markets so that they will be adequately rewarded in the ensuing exchange. From a supply chain disruption perspective, it is conceivable that even for a country in a weaker position the survival of its industries may be highly beneficial to global economic exchanges.

China has itself prioritized the survival of various industries by providing support for businesses in both their domestic growth and international expansion. The Haier Group is one such business, which has played a significant role in transforming a fledgling home appliances industry, while benefitting from state support (Duysters et al. 2009). The Haier Group appears to have staged a robust response to the competition thrust upon it by the entrance of GE and Whirlpool into the Chinese market—and has more than survived. Du (2003), Child and Rodrigues (2005), and Duysters et al. (2009) have all examined Haier's competitive response in detail. Another example of industry sector response to competitive foreign direct investment (FDI) is Bajaj Auto in India. Bajaj focused on the competitive levers within its supply chain—distinctive local products, local connections, and local distribution networks—to continue earning substantial market rents when Honda entered the Indian motorcycle market (Dawar and Frost 1999). The response principles adopted by the Haier Group and Bajaj Auto may have applications in local African industry sectors, given that the operating context bore some similarities to the current African situation in terms of FDI flows and limited in-country capabilities. The nature of the response will depend on the intensity of the power dynamics and competitive pressures resulting from Chinese exchanges with various African countries. For example, Djibouti may have only been a "pit stop" on China's path to European markets, since the country previously had just "friendly negotiations" with China. However, Djibouti's increasing importance in providing global access for

Chinese-driven Ethiopian exports, and in enhancing security for the shipping lanes around the Horn of Africa, has changed the relationship significantly. Djibouti welcomed the opening of a Chinese-funded Silkroad International Bank in January 2017, and China's first foreign military base in July 2017. It appears that this country will have a key role in the unfolding of the BRI. More intense engagement with a strategic partner may warrant a comprehensive response, to ensure mutually beneficial exchanges. So, it is of interest for Djibouti to carve out local industry advantages in transportation and logistics, for example, as it provides benefits to the BRI. The broad question in this chapter is how countries that are integral to the BRI might recognize and harness the potential value they bring to these economic exchanges. Thus, we concur with previous literature that recommends searching for strategies by which Africa might utilize the developmental spin-offs that result from increased investment and trade (Cheru and Obi 2011). Given the importance of African countries to the BRI, based on the FOCAC declaration, this chapter examines applicable response strategies for African countries with increased FDI flows from China. It explores dimensions of industry-level response and the enabling mechanisms for the survival of specific sectors that experience disruption through Chinese investment. By adopting a pragmatic conceptualization of how African countries could *respond* to China's business engagement, this chapter contributes a critical dimension to the ongoing debate about how China's BRI might deliver tangible benefits to African countries. This response view will allow managers of impacted business clusters to proactively embrace options for meaningful exchange as essential participants rather than victims.

In the rest of the chapter we review China's engagement in Latin America and Southeast Asia to identify patterns of impact on local industries that might signal possible business impacts on African countries in the new BRI dispensation. We adopt the resource dependency theory (RDT) and the supply chain practice view as our framework for exploring impact and response. We selected Kenya for in-depth analysis, given its economic influence in the East African region, the importance of its Mombasa port as a gateway for trade, and evidence of multi-sectoral Chinese investment; and examined flows of product, information, and capital into and out of Kenya to understand the mutual dependencies

and power imbalance associated with the China–Kenya exchange. Then we conceptualize how specific industries and government sectors might respond to the competitive pressures accompanying Chinese business engagement. We summarize the discussion with theoretical generalizations of this response view for other African countries connected with the BRI.

2 Expected Impact of Chinese Engagement

Many developing countries seek FDI, along with the expectation of positive spillovers such as job creation, technology transfer, and productivity increases. Such positive effects are likely to be more substantial if the investors are technologically and institutionally close (Takii 2005; Luo et al. 2011); thus, investment from China is generally welcomed by developing countries. However, there is the need to establish value-adding linkages between incoming and local businesses for the expected FDI benefits to be realized. Kubny and Voss (2014) find that in Vietnam, Chinese firms source local inputs only to a limited degree, and that their arm's-length exchanges do not furnish the expected technology transfers. Similar to Vietnam, local sourcing in Africa is particularly low because Chinese businesses typically import their inputs for production and construction, and so have weak, if any, linkages with local firms (Corkin 2007; Amendolagine et al. 2013). Furthermore, Chinese construction businesses have been known to import low-skilled Chinese labor for several projects in Africa (Cheru and Obi 2011), which further obstructs linkages for local knowledge transfer. Sun and Lin (2017) refute the notion of poor linkages by pointing to a Chinese multinational partnering with the Kenyan Ministry of Education for skills training. However, they also refer to this multinational as "unique among Chinese companies in Africa in the extent to which it has invested in local skills development." The phenomenon of limited business linkages has also been observed in several Latin American countries. In that region, increased Chinese engagement has often led to the relocation of high-end manufacturing activity from some Latin American countries to China. This relocation means that actual Chinese investment in those countries has

mainly targeted specialization in primary products, which further limits the creation of local value-adding linkages (Jenkins 2010). Similarly, Flynn (2013) refers to how China's demand for primary products such as minerals and timber restricts specialization in many African countries to low value-added outputs—which constrains linkages. By nurturing backward and forward linkages, Chinese investors could generate opportunities for local businesses to be drawn into the global production system, and thereby deliver on the often-touted "win-win" exchanges (Irshad et al. 2015; Ferdinand 2016). Contrary to such disposition, infrastructure investments overseas are often viewed as opportunities to increase the demand for components supplied by businesses back in China (Swaine 2015; Chia and Sussangkarn 2006). Therefore, it is considered reasonable that incoming Chinese firms would source production inputs mainly from their parent companies or other Chinese firms rather than from local suppliers (Corkin and Burke 2006; van der Lugt et al. 2011). In fact, backward linkages in the host country may only serve to strengthen the foreign business position where there is the need to establish initial local connections or build legitimacy in an incremental expansion model (Johanson and Vahlne 2009), as may be the case in Sun and Lin (2017). Moreover, such linkages may be loose, and not aimed at developing the long-term relationships that enhance the productive capacities of local businesses. The weak linkages between Chinese investors and local suppliers do not appear to be driven by poor absorptive capacity in the local firms per se, but from the general unwillingness of the investor to recognize, engage, or develop local capabilities (Kubny and Voss 2014). Foreign–local partnerships that involve shared ownership of portions of the supply chain, may create better linkages. As Smarzynska Javorcik (2004) finds with Lithuanian firms, positive productivity spillovers derive more from projects with shared foreign–local ownership.

Another aspect of the potential for reaping positive FDI benefits is the type of goods involved in the exchange. Chinese businesses may tackle overcapacity by exporting capital goods (Rolland 2015), and this may be in the interests of importing nations—small-scale manufacturers gain increased access to machinery that supports the conversion of inputs into intermediate goods, for example. The opportunity for technology transfer and increased production capability is improved when FDI is

associated with the import of capital goods rather than consumer goods (UNCTAD 2012). On the whole, the value of capital goods imports into Africa from China exceeded the value of consumer goods between 2011 and 2015 (WITS 2013). However, concerns about import competition still remain. Kaplinsky and Messner (2008) capture this tension in terms of complementary and competitive impacts, for example, where the import of cheap consumer goods from China could improve the buying power of local customers but could also displace local producers. Elu and Price (2010) note that increased trade with China has the effect of lowering total factor productivity for sub-Saharan African manufacturing firms, directly through import competition, and indirectly through negative technology transfer. Reduced productivity in African countries hampers cost reduction efforts and further compounds the relative cost disadvantage (Adisu et al. 2010). Thus, even where benefits accrue from the exchange, the positive impact may be transient if African businesses do not build the productive capacity to be relevant in long-term exchanges. In a related context, Chia and Sussangkarn (2006) highlight the need for members of the Association of Southeast Asian Nations (ASEAN) to pursue integration in order to exploit scale economies and together become more competitive in their exchanges with China. The essential theme here is that competitiveness elevates the status of ASEAN countries in the relationship, by increasing mutual dependence with China. Similarly, rather than expect Chinese businesses to voluntarily create value-adding interactions with African businesses, Onjala (2010) challenges African countries to actively diversify the structure of their exports and produce higher volumes through taking advantage of the scale and scope of the Chinese economy.

3 Navigating Mutual Dependence and Power Imbalance

The idea of African businesses making adjustments to increase their standing in BRI exchanges may be conceptualized with the RDT—that organizations must restructure their dependency on the external environment in order to increase their chances of survival (Pfeffer and

Salancik 1978). Kaplinsky and Morris (2008) present an example of supply chain adjustment adopted by a South African producer of underwear that faced severe competitive challenges from Chinese imports. The company helped its retailers reduce inventory holdings and improve their responsiveness to customer demand—a clear example of relational performance in the supply chain (Carter et al. 2017; Cheung et al. 2011). This company had the capability to restructure its dependency on the external environment; and such traits make it an attractive target for partnerships. Partnering (including alliances, joint ventures, co-optation, interlocks, mergers, or vertical integration) is one way to create a long-term view of cooperative business exchanges and reduce uncertainties across the supply chain (Hillman et al. 2009). The opportunity for value-creating long-term partnerships will increase when the competitive levers across specific industries in Africa are identified and nurtured.

Casciaro and Piskorski (2005) view mutual dependence and power imbalance as two related aspects of the RDT notion of interdependence between two parties in an exchange. Pfeffer and Salancik (1978) focused on minimizing interdependence; however, there is value to collaboration and reciprocity especially between buyers and sellers (Ado and Su 2016). High levels of mutual dependence shift exchange relationships more toward symbiosis than competition. Thus, the competitive impacts of power imbalance may be reduced if mutual dependence is high. In the case of African countries, even though the balance of power is heavily in China's favor, the exercise of that power may be restrained if high levels of mutual dependence exist between Africa and China. Clearly, bilateral relations between African countries and China will yield more benefits if African businesses can supply substantial resources that are critical to the BRI. Such resources must be identified carefully, since in several industries (such as textiles) China has comparative advantage in the factors of production. Challenges in various industries, such as capacity limitations, make production sharing an attractive model for competitively scaling the output of national or regional supply chains. Koopman et al. (2010) view supply chains as systems of value-added sources and destinations within integrated production networks. The integration of production networks is at the core of production sharing and implies a reorganization of the production function. Reorganization might involve achieving a

balance between outsourcing peripheral productive functions across a regional network and controlling the centers of value creation (Neilson et al. 2014). The functions in the network need to be assigned collaboratively rather than just dictating the terms of engagement to supply chain partners. This collaborative approach to production sharing may be a useful framework to consider within industry sectors (Wang et al. 2013). In other words, with proactive collaboration in a specific industry, it may be possible to establish unique regional or country production advantages, relative to Chinese businesses, and thus create a basis for increased mutual dependence. Carter et al. (2017) describe the mutual dependence between Amazon and several businesses in terms of the benefits to smaller companies of being roped into Amazon's extensive delivery network, while Amazon reaps the benefits of better network utilization. This is a win-win in the supply chain. It is from this perspective, that the chapter explores the response of African businesses to increased Chinese engagement.

Industry-level coordination of production sharing does not preclude institutional oversight. On the contrary, the role of the state may be reframed as an agent of development, as China itself did. Even with a liberalized economy, China's policies were endogenously driven rather than being imposed externally, allowing them to have better control over the globalization of their economy (Jilberto and Hogenboom 2012). Similarly, the dispensation of zero-tariffs for Cambodian textile exports into the EU, allowed Cambodia to participate in the textile industry, even though neighboring Vietnam had a larger economy, a larger pool of cheaper labor, and industrial production advantages relative to Cambodia (Chen et al. 2011). Thus, Cheru and Obi's (2011) challenge to African leadership is pertinent: define thoughtful frameworks for bilateral, fair, and balanced cooperation. Could country-level negotiations in Africa create a fairer production climate and provide an incentive for industries to collaborate in a production-sharing framework that makes the most of the BRI dispensation? Would intraregional trade in a production-sharing framework redirect China's engagement with the continent, and result in local enterprise skills development and technology transfer? These questions align with the main objective of examining industry-level response strategies under the threat of foreign competition. The

next section comprises in-depth analyses of industrial flows in Kenya to examine mutual dependencies and power imbalances associated with the China–Kenya exchange, and to conceptualize how specific industry sectors might respond to the competitive pressures accompanying Chinese business engagement.

4 The Case of Kenya

In recognition of the significant country differences at the industry and institutional levels across Africa, we focus on the East African region as an area with historic and current connections to China. We selected Kenya for study, given its economic influence within the East African Community of nations (EAC), the importance of its Mombasa port as a gateway for trade, and evidence of multi-sectoral Chinese investment. For example, in 2014 Kenya signed a US$3.8 billion agreement for Chinese high-speed railway technology to connect Nairobi to Mombasa, the largest port in East Africa (Arase 2015). Kenya has the largest economy in the EAC and is among the top five African countries receiving imports from China. Kenya is also one of two African countries whose presidents were part of the May 2017 Belt and Road Forum for International Cooperation in Beijing; the forum involved cooperative consultation on the BRI for participating countries (*China Daily* 2017).

Kenya produces and exports substantial quantities of tea, flowers, and coffee, among other products. Participation in global production networks has often been construed to mean increasing industrial production for exports, suggesting it may be attractive to target China's markets with value-added products. This view is reasonable, given that China's growth strategy has pivoted to greater reliance on domestic consumption (Hawke 2016). However, existing capacity constraints limit the scaling of export-oriented production in Kenya. For example, Ikiara and Ndirangu (2003) point to a concentration of Kenya's industrial production in export processing zones (EPZs) as evidence of infrastructure inadequacies in the wider economy. Despite such limitations, export orientation will continue to be attractive because increased scale may translate into productivity, learning, and quality advantages. On the other hand, export

pricing may decrease the incentive for local production if the perceived local value is small, thereby weakening rather than supporting local industry amid foreign competition. Thus, response initiatives such as increasing the production of premium tea for local Kenyan consumption (Stevis 2017) may help not only to stabilize producer prices, but also to cement the comparative advantage that Kenya has in tea production. Similarly, local factories can be reorganized to reduce order minimums, and increase direct access for small-scale manufacturers. Such reorganization will reduce the direct cost of inputs for small-scale manufacturers (Coughlin and Ikiara 1988), and increase demand for the output of these factories, thereby providing an impetus for scaling up production, improving learning, and increasing competitiveness. Reorganization as a response will likewise benefit tanneries and the local leather industry in general amid growing demand for high quality leather, and the increased import of Chinese shoes into the EAC. Analogous applications may be made for sisal, pyrethrum, and even tire manufacturing; the recent capacity additions for automotive assembly in Kenya offer an opportunity for local tire manufacturers, but without significant reorganization tire imports from China will limit this potential.

Our goal in this analysis is not to conduct a comprehensive quantification of China's impact on Kenya, but to understand the nature of the impact on industry as a basis for exploring potential models for reorganization. In this regard, a survey of individual businesses is beyond the scope of this chapter. However, sans such a survey, evidence exists (as is true even in the USA) of local industries that have been impacted adversely by China's low-priced imports—including textiles in Zambia, shoes in Ethiopia, and garden furniture in Ghana (McGreal 2007). Our interest is in exploring options for African businesses in general, and Kenyan businesses in particular, to remain relevant in global production and trade networks. Thus, we examine how existing opportunities for reorganization and production sharing might be framed in support of a competitive industrial response. We examine product and trade flows within and across Kenya's borders, by assembling and triangulating limited available data from several sources, including the Kenya National Bureau of Statistics, the EAC data portal, the International Trade Center in Geneva, the United Nations Conference on Trade and Development,

the World Integrated Trade Solution of the World Bank, the Hong Kong Trade Development Council, and specialized sources like the East African Tea Trade Association. We also reference available data from the Kenya Association of Manufacturers (KAM) to glean more detailed industry information for a fuller conceptualization of our response framework.

Considering trade flows within East African countries, and between these countries and destinations outside the region, it is clear that trade within the EAC is almost the same in value as that between EAC and the rest of Africa (see Fig. 9.1). However, trade outside Africa is significantly higher, and it appears that total trade is more sensitive to the extra-African component. Herein lies the opportunity for diversifying the direction and structure of African exports and for achieving less volatility in demand, pricing, and production (Onjala 2010).

Kenya's contribution to EAC trade is significant, even though in recent years, Kenya appears to have contributed a smaller proportion to trade within the EAC (see Fig. 9.2). The decline in Kenya's contribution may

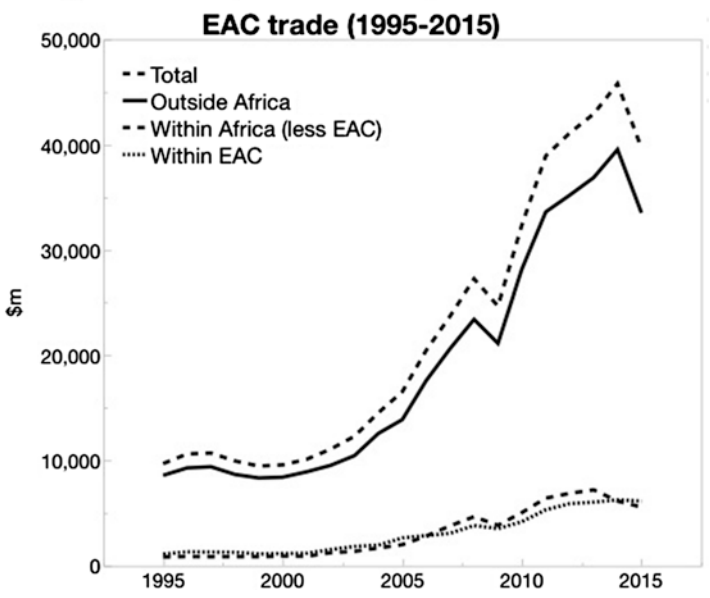

Fig. 9.1 Trade within and outside East African countries

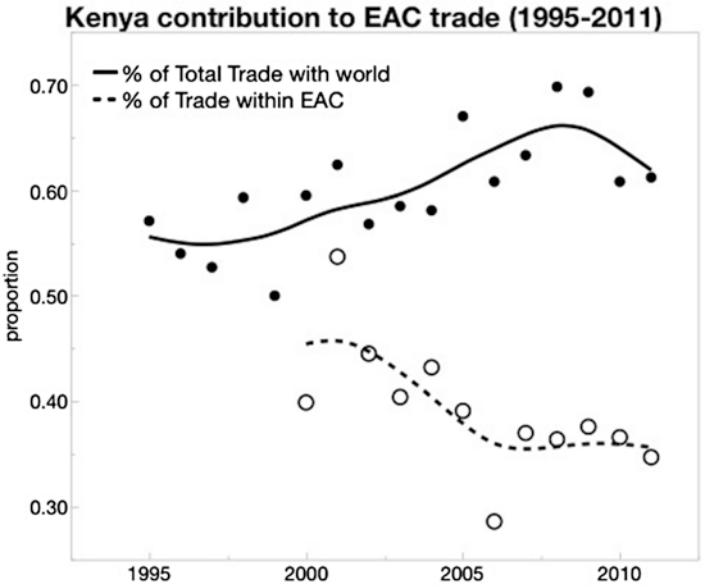

Fig. 9.2 Contribution of Kenya to EAC trade

not necessarily be as a result of decreased production per se, but perhaps of the strengthening of productive capacity in other EAC countries, or of the increase in imports arriving in other EAC countries. Net FDI flows as a percentage of GDP have been generally higher in Uganda and Tanzania, averaging 4.65% and 4.12% respectively, between 2005 and 2015 compared with Kenya at 2.15% over the same period (World Bank 2016).

Further insights emerge when Kenya's industrial production is superimposed on imports from China and total imports (see Fig. 9.3). Evidently, Kenya's production has been growing, even though at the rate has slowed. World Bank (2016) data corroborate this pattern but indicate that the value-added contribution of services has been growing significantly faster than that of manufacturing. The World Bank data also show that the contribution of manufacturing to GDP was about 11% on average from 2001 to 2014 (max. 12.8% in 2007, and min. 9.7% in 2001 and 2003). However, a regression line from 2006 (five years after the Doha Round of WTO negotiations) shows a strong negative association between Year-since-2001 and manufacturing contribution (slope

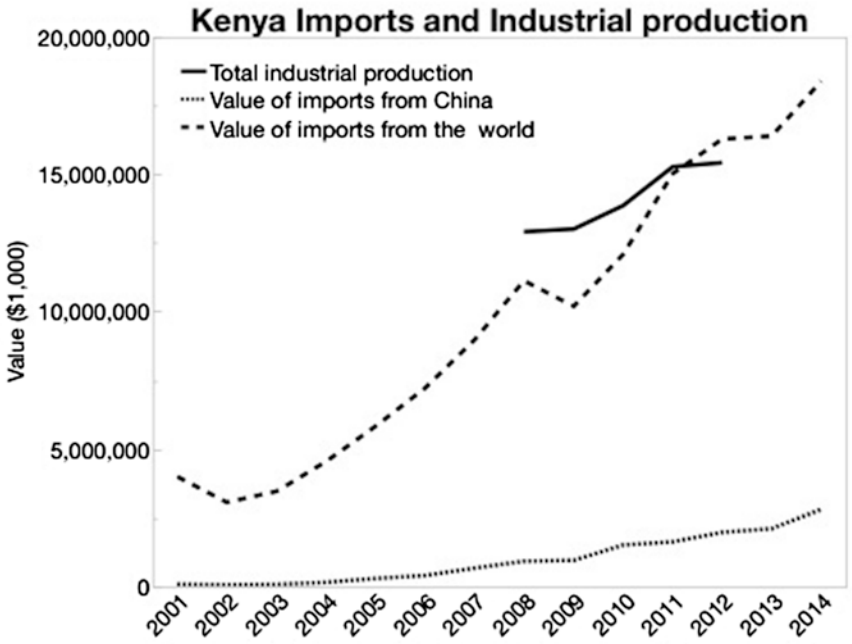

Fig. 9.3 Value of imports into Kenya and industrial production within Kenya

estimate −0.3405, *t* ratio −9.48). This is a cause for concern since total imports outstripped industrial production in 2011 (see Fig. 9.3). The import of Chinese tires, for example, may already be hampering local production. The free flow of goods and services within the EAC also creates a situation where tires imported from China into Tanzania may have a direct impact on the productive capacity of the larger automotive industry in Kenya. Overall, with growing Chinese imports, it remains to be seen to what extent Kenya's aggregate industrial activity will be affected.

As shown by the components of imports (see Fig. 9.4), the largest proportion of imports into Kenya comprises consumer goods, and these are not known to support local production capacity, as discussed. However, capital goods imports are also high, along with intermediate goods, suggesting that there is a sustained demand for inputs of industrial production. These flows may account for the fact that we do not currently observe drastic shifts in

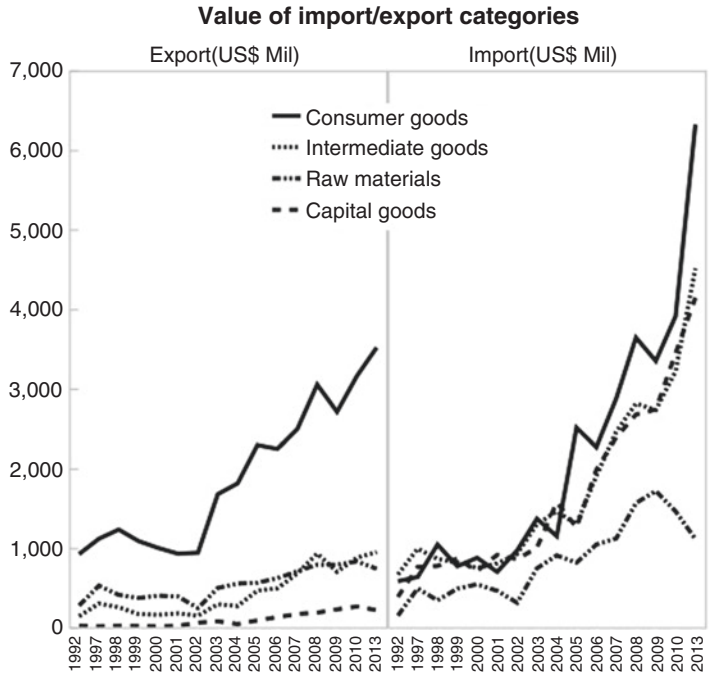

Fig. 9.4 Main categories of imports and exports in Kenya

Kenya's aggregate industrial activity. On the other hand, FDI inflows rose from US$21 million in 2005 to US$1.44 billion in 2015 (UNCTAD 2016), which may reflect China's involvement in large infrastructure projects (road and building construction) and in the financial and telecommunications sectors. Investments in these sectors may also compete directly or indirectly with industrial production (e.g., building materials) in Kenya, if no prior arrangements exist for sourcing supplies locally. Skillful negotiation and targeted incentives on the part of government may be a channel by which such large investments may enable industrial production. The affected sectors may complement such negotiation by reorganizing to leverage the associated efficiencies in transportation and financial services.

We also identify sectors that are major contributors to Kenya's industrial production (see Fig. 9.5). Understanding the nature of these contributing sectors may provide some insights into what competencies

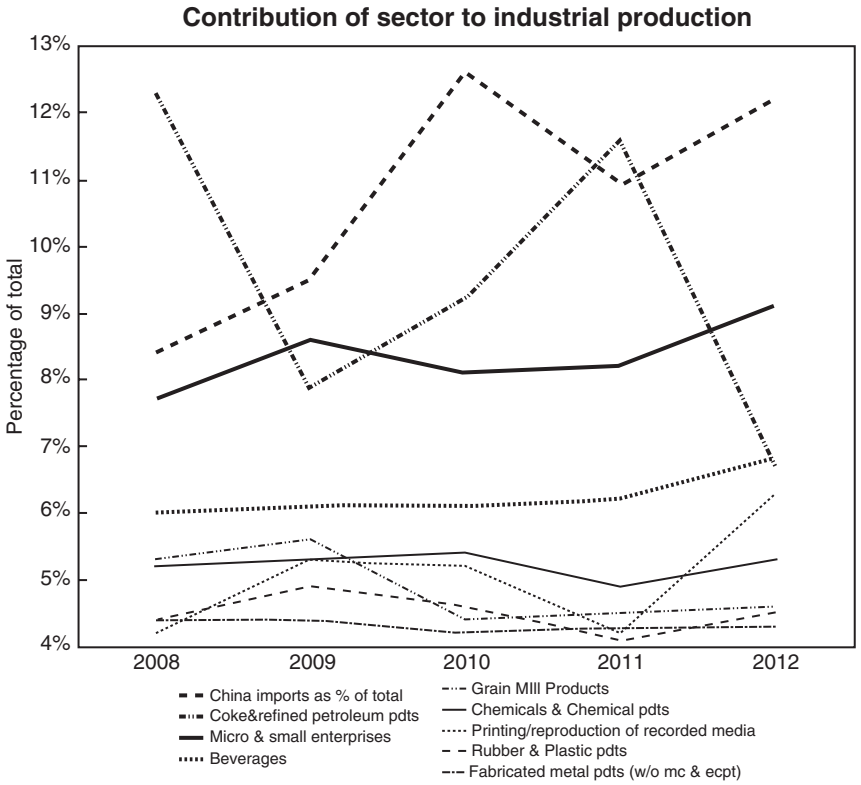

Fig. 9.5 Industrial production in Kenya

Kenya might leverage to sustain an advantage in certain industries. The graph shows only the top seven sectors, plus grain mill products. Grain mill products is the highest in the food category but its contribution has declined over time, which may be a function of droughts in Kenya and the inability to effectively source grain supplies from the sub-region.

The contribution of coke and refined petroleum products has been high but variable and may be reflecting petroleum price variation. However, the increased installed capacity of geothermal power plants may also be reducing the demand for petroleum products. The contribution of beverages has been growing only slightly over time. This stagnation may reflect the intense price competition in that industry between

East African Breweries Ltd. and South African Breweries. These beverage establishments have now negotiated an operating model based on coopetition, and the contribution of beverages may increase with time. The contribution of micro and small enterprises is high and significant, and presents an important opportunity for Kenya. When Africa is viewed as an aggregate market it is very attractive to foreign investors. The same is true of understanding the total productive power of micro and small enterprises in Kenya. We underline the importance of the aggregate of smaller enterprises by noting that the changing structure of tea production is a credible signal that smallholders cannot be ignored in the Kenyan economy (see Fig. 9.6).

Other industry contributors—such as fabricated metal, rubber and plastic products, and chemicals and chemical products—are also very significant when taken together (about 14% of production). It is reasonable to consider their joint contribution, given their impact on, for example, the automotive industry.

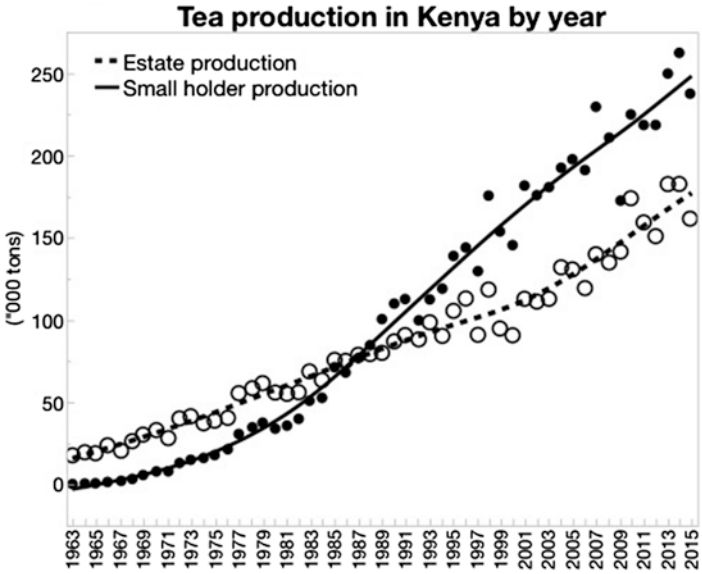

Fig. 9.6 Tea production with a focus on smallholders

Table 9.1 Industry sectors represented by the Kenya Association of manufacturers[a]

Sector	*N*	% of total
Food & beverages	146	24.13
Metal & allied	73	12.07
Chemical & allied	60	9.92
Plastics & rubber	58	9.59
Paper & board	56	9.26
Textiles & apparel	46	7.60
Motor vehicle assemblers & accessories	41	6.78
Energy, electrical & electronics	33	5.45
Building, mining & construction	31	5.12
Timber, wood & furniture	24	3.97
Pharmaceutical & medical equipment	19	3.14
Fresh produce	12	1.98
Leather & footwear	6	0.99

[a]102 companies listed in services and consultancy were excluded

We review the broad structure of industry sectors in the KAM (see Table 9.1).

It is of interest to examine each industry in turn but for brevity we focus only on the motor vehicle assemblers and accessories (MVAA). As expected, there are more companies operating in the associated sectors of metals, chemicals, plastics, and paper than in the MVAA sector. Of the 40 MVAA companies, 21 had websites listed, and 20 of those websites were functional. Based on a detailed analysis of information from their websites, we observe that the companies included: businesses that had started small and kept growing to the third generation; businesses that operated as subsidiaries of global companies; and businesses that were operating in the EAC market with plans to further expand into the larger COMESA region. There were businesses that reported adapting their operating model after WTO rules opened the Kenyan market to direct global competition. There were also businesses maintaining a hybrid of importing some standardized intermediate goods, and yet manufacturing their own customized versions of the end-product. These companies appeared to thematically cater to the harsh transportation specifications of Kenya and viewed that strategic targeting as an advantage. The product range was impressive, from vehicle seats and interiors, to filters (air, oil, fuel), to trailers, to complete vehicle design and manufacturing.

The MVAA industry sector uses inputs from several other sectors—including paper and board, plastics and rubber, chemicals and allied, and metals and allied—and if the linkages can be clearly identified, a system of value-addition will emerge. Considering the scope of production across these sectors, there is certainly room to leverage the scale and synergies of production sharing. Similar to the supply chain levers of distinctive local products, local connections, and local distribution networks that were in Bajaj Auto's favor (Dawar and Frost 1999), these Kenyan business networks have sometimes idiosyncratic local advantages. Thus, Kenyan businesses must be proactive about building resilient industry clusters to maintain a growth trajectory, given the substantial and growing impact of Chinese engagement. Using the case of Mauritius, Ancharaz (2009) emphasizes building resilience as a way of mitigating adverse effects of sudden pressure, such as Chinese dominance, and then striving to create a win-win exchange. In this case, win-win meant China had access to other world markets through Mauritius' free trade zones; and Mauritius built its manufacturing base by purposeful negotiation and institutional support. Mauritius had responded to the African Growth and Opportunity Act initiative and tariff preferences in the EU by setting up EPZs, which spurred industrial growth and provided the leverage for engaging China. In this way, Mauritius was better incorporated into global production networks. An opportunity exists to approach Chinese engagement as a potential path for participating in global value chains through technological upgrades and innovation. In the case of Kenya, China is deriving benefits from large-scale infrastructure projects, and Kenya can coordinate its industrial activity to create a more inclusive supplier base for Chinese-led projects. Such coordination is best managed by an agency reflecting a private-public partnership. For example, Enterprise Mauritius was a collaborative partnership between industry and government to help local enterprises develop competitive capacity and evolve into regional or global exporters. Such an agency in Kenya would share a vision of staged but connected production across industry sectors. This step would help operationalize the vision of production sharing and process innovation within industry sectors such as the MVAA. Thus, the needed adjustments may be supported institutionally by removing structural constraints to synergistic production across sectors. As noted earlier, incentives to reduce order minimums and improve access to inputs from

local factories will reduce raw material costs, increase the pace of local production, and provide better opportunities for scaling. If the fragmented production in these sectors is better coordinated, the resulting efficiencies will immediately free up capacity for increased output. Increased output means more learning, with the associated benefits of quality improvements, innovation, and market appeal. All these benefits will help to increase the level of mutual dependence between Kenya and China, as Chinese businesses seek investments in Kenya.

5 Summary and Conclusion

This chapter explored how African countries might respond to the competitive pressures associated with China's increased engagement with Africa in the BRI dispensation. The possibility that China's business activity can marginalize industrial production in Africa was of concern because industrial production has been a critical path of growth for many countries. Thus, despite the imbalance of economic power in China's favor, we examined the plausibility of creating win-win exchanges with African countries. Specifically, the chapter focused on industry-level adjustments by which African countries may increase the strategic value of their contribution in BRI exchanges. Despite having access to limited data on the subject, there was sufficient indication from literature about how economic exchanges might play out between China and Africa. We found that, based on the pattern of Chinese business activity in other regions, African countries cannot rely on China to create the industry linkages that facilitate technology and knowledge transfer unless it is in their clear interest to do so. However, African countries cannot afford to be ambivalent about the growing dominance of China in their markets. Rather, these countries could proactively change the power dynamics by increasing the level of mutual dependence between their industries and China's incoming businesses. African countries can promote mutual dependence through reorganizing industry supply chains based on country and regional priorities, and by creating integrated production networks as a means to increase the value their industries bring to the economic exchange. FDI can and should be harnessed for growth in sub-Saharan African countries, but it needs to be done strategically to

minimize the downsides and derive reasonable rents. By adopting a *response view*, this chapter contributes a critical dimension to the ongoing debate about how China's BRI might deliver tangible benefits to African countries.

The response of industry will be limited without institutional support. Therefore, we offer these perspectives on supply chain coordination and production sharing, not only for the consideration of existing businesses but in hopes that it will help frame the institutional support provided for business growth in key sectors. By establishing soundly negotiated investment partnerships with China, African countries may be able to stimulate local industrialization without having China pursue its usual business practices in Africa. The returns to a nation for developing an integrated production network, and building regional markets to increase demand, may outweigh the mere establishment of Chinese businesses in the country. Much like a capable stage in a supply chain that manages flows of product, information, and funds, a respected public–private partnership could be responsible for building trust among industry players, coordinating their roles in the network, and facilitating an equitable distribution of supply chain surplus, until a steady state of production is attained. At this point, the success of the first iteration would have some spillover effects, and feed subsequent refinements. This chapter points to some avenues for research on strengthening the developmental impacts of Chinese investments through responsible supply chain management and corporate engagement. Our hope is that conversations will continue around the relationship between globalization, country response, and sustainable economic development. This is important for strengthening the social contract in African countries.

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10

Small State, Smart Influence: China's Belt and Road Extended to New Zealand

Jake Lin

1 Introduction

The Belt and Road Initiative (BRI) has become the hallmark of Xi Jinping's prioritized economic and foreign policy, since the basic ideas were unveiled by Xi himself in late 2013 at a couple of international occasions. The Silk Road Economic Belt is designed to connect China westbound with Mongolia, central Asia, Russia, Iran, Turkey, the Balkans, Central and Eastern Europe, and ultimately Germany and the Netherlands. The Twenty-First-Century Maritime Silk Road aims to link China with Southeast Asia, Bangladesh, India, the Persian Gulf, and the Mediterranean, also ending up in Western Europe (Xinhua 2016). Altogether, the BRI has the ambition to integrate the world's largest yet most diverse landmass and maritime territory by building infrastructural, cultural, and people connectivity, and ultimately to form a "community of shared destiny" (National Development and Reform Commission 2015).

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Xi has since dedicated enormous amounts of political and media resources to promote the BRI as it is integral to his own series of theoretical innovations with Chinese characteristics, such as the "China Dream" and the "Great Rejuvenation." Responses to the BRI vary among the great powers and small states. New Zealand, as a small liberal state, plays a unique role in influencing China's free trade policy and the BRI. After a series of milestone events to accelerate China's integration into the world trade system, New Zealand became the first developed country to officially endorse the BRI. Whereas most larger powers reject it and small states in Asia passively jump on the bandwagon of China's "Project of the Century" (Xinhua 2017a), New Zealand takes a distinctive position by actively participating and shaping some important aspects of China's BRI.

This chapter seeks to examine the extent to which New Zealand as a small liberal state is able to exert a smart influence on the great powers such as China. It first presents a brief review of the varied responses to China's BRI from both great powers and small states, and how the literature theorizes the power of small states in international relations (IR). It then examines New Zealand's role in shaping China's free trade and BRI policies by using such influences as its dairy farming industry, relations building, agenda setting, and normative powers. The last section discusses the limits of New Zealand's deepening engagement with China's free trade and BRI policy, and its vulnerability as a small state. The concluding section argues that New Zealand, as an exemplar of a small liberal state, has the ability to shape and influence a great power's enormous foreign policy initiative, such as the BRI. Nonetheless, New Zealand should be cautious about its increasingly vulnerable position under the BRI, and the limits of free trade-focused bilateral relations with China.

2 Responses to the BRI: Contextualizing Power and Small States

Despite the buzz surrounding the "Project of the Century," responses to the BRI vary. Major great powers reject the BRI, overtly or covertly, including the USA, the EU, Japan, India, and Australia. The USA has paid minimal attention to the BRI as if any response would give oxygen

to the first ambitious international initiative from the Chinese. The EU has achieved no unanimous position. Australia has declined the BRI offer bluntly. Initially, Japan was highly skeptical about China's BRI, especially on the issues of finance and transparency, but it softened its position in mid-2017. By far the most vocal opponent of China's continent-spanning BRI is India, with territorial disputes being the primary hurdle.

In general, major powers' common concerns about the BRI are: economic concerns about debt and financial risk; strategic concerns about the political purpose of the infrastructure building; environmental concerns; and social concerns. These all relate to the gap between China's proclaimed intentions and the diverging interpretations by other international players. While the BRI on paper is aimed at economic development by enhancing connectivity, many interpret it as a "spatial fix" solution for overcapacity, debt, and labor unrest as necessary symptoms of capitalism (Summers 2016; Yu 2017a; Lin 2017). Financial observers see the BRI as a "fantastic way of getting someone to pay for your debt and use your surplus capacity" (Xie 2017). Strategically, the BRI is seen as an upgraded "Go West" policy (Wang 2014; Jin 2015), and a geopolitical counter-response to the US "Pivot to Asia," and the Trans-Pacific Partnership initiative that dominates in the Pacific (Johnson 2016; Rolland 2017).

In contrast, most small states cooperate with China's BRI. In fact, from the outset it was designed to target small developing states along the Belt and Road and to draw them into its orbit. By May 2017, 22 countries had signed the BRI Memorandum of Understanding (MoU), and 29 heads of state had attended the first BRI forum in Beijing. Most of the attendees were from developing small states in Asia, such as ASEAN and Central Asian countries. This was an early sign of small states being submissive toward the emerging regional great power that is China.

Among these varied responses to China's BRI, New Zealand's position is unique. It is not only less risk averse than its traditional liberal allies, but also has more policy independence and influence than its fellow small states. In its bilateral relations with China, New Zealand continues its traditional proactive pragmatism and has become the frontrunner for BRI cooperation in the region. During Premier Li Keqiang's visit in March 2017, New Zealand became the first developed country to sign a

cooperation agreement with China on the BRI. The MoU encompasses issues such as trade and policy cooperation, cultural exchanges (e.g., tourism and film production), and multilateral cooperation. The MoU allows both sides 18 months to work out a more detailed cooperation arrangement (MoU 2017).

How and why does a small liberal state like New Zealand act on China's BRI differently from other major allies and small developing countries? In IR, scholarship on the great powers dominates the field. Although the analysis of small states is largely underrepresented in the literature, it has been growing, especially regarding small liberal states' influence in world politics. The concept of a small state is not well defined in IR; small states are small because "small" is defined often by their weaknesses (Long 2016). Theorizing power and influence based on material resources, realists tend to see small states as "fragile creatures in the rough sea of international relations; internally well suited for democratic regimes but externally helpless and constantly threatened by extinction" (Goetschel 1998: 13). In global affairs, small states are generally regarded as having limited capacities to exercise influence. Classic realists refer to the Melian Dilemma as a timeless example of small states acquiescing to great powers with reactive attitudes. During the height of the Cold War, Baehr (1975) argued that a small state's foreign policy is conflict averse, focuses on soft power approaches, is restricted to geographically proximate regions, and emphasizes trade and diplomatic multilateralism. Nye and Keohane (1977) concur that small and peripheral liberal states are mostly subordinate players in the power hierarchy of the global nation-state systems, particularly when substantial changes happen in international politics. From a mostly structural perspective, contemporary IR literature sees small states as being system sensitive, with minimum agency, and as heavily influenced by the international system and its institutional setting (Ingebristen and Neumann 2006).

However, the study of small states' power and influence, especially small liberal states, continues to grow. That is because the conception of power and influence is becoming increasingly plural. Dahl defines power as "A can get B to do something that B would not otherwise do" (Dahl 1957: 202). Although this definition is often used as a basis by realists, many have expanded it to measure power by multiple dimensions, such

as: institutional or agenda-setting powers (Bachrach and Baratz 1962; Nye and Keohane 1977); normative power (Ropp and Sikkink 1999; Manners 2002); soft power (Nye 2004); and ideological or psychological powers (Lukes 1974). Many have used these diversified conceptions of power to show how small liberal states are able to exert power and influence in world politics, such as: Ghana and Oman playing a stronger role in regional affairs than their size would suggest (Hey 2003, Sherwood 2016); small European states taking fuller advantage from global trade (Katzenstein 1985; Alesina and Spolaore 2003); and better multilateral skills within institutions—such as, small states in the EU (Ingebristen 2004) and Singapore in ASEAN (Acharya 2008). Long (2016) theorizes small states' powers by looking at their particular intrinsic power (material and ideational resources with comparative advantages), derivative power (convincing larger states to take actions that boost their interests), and collective power (institutional, multilateral, and coalitional). Although it is a theoretically informative and useful concept, most of these elements of power are cross-dimensional and intertwined and defy a clear-cut framework.

When it comes to New Zealand, the debate continues as to what kind of power it does have and what foreign policy best suits it in relation to the great powers. Despite the lack of a clear definition, few would dispute that New Zealand is a small liberal state vis-à-vis China. If one follows the structural and material analysis, New Zealand's proactive response to an ambitious initiative by a rising power is natural and predictable, since smaller states have few choices but to cooperate. In other words, it is understandable that New Zealand cooperates with China in terms of an economic relationship, while standing alongside allies in the West politically or security-wise. For example, some see it as natural and yet risky that New Zealand pursues a subordinate "vassal state" economic policy towards China in exchange for a massive market for exporting its dairy products (Anderlini 2015). Describing New Zealand as being "a little bit naïve" in its relationship with China, David Shambaugh warns that healthy bilateral relations should be multifaceted, and that small states have a vulnerable position in front of the great powers (Young 2014).

However, New Zealand's small size and limited material resources do not mean it is always system conformist and with no significant influence. Focusing on New Zealand, Buchanan (2010) argues that a small liberal state can be "system-reformative" and "punch above its weight" in the international arena. Young (2017) demonstrates that ideational factors matter and are "key for achieving agency" in the case of New Zealand, where the country's identity as a "small trading nation" and "good international citizen" has contributed to its successful shift to Asia. Following this theoretical emphasis, this chapter examines New Zealand as an exemplar of a small liberal state in negotiating BRI cooperation, and its active influence on the world's second-largest economy, China.

Despite the multidimensional and fluid conception of power, it is possible to trace New Zealand's influence on bilateral trade relations with China. The following section discusses how New Zealand exerts a smart influence on China under the BRI, focusing on agenda setting and normative influences in its diplomacy with the Chinese government. Elements of power (particular intrinsic material and ideational resources) are discussed, including dairy farming products, liberal and free trade norms, long-term friendly relations with China, multilateralism, and institutional negotiation skills.

3 New Zealand's Power to Influence China's BRI

Long before the BRI cooperation, New Zealand had a track record of negotiating closer bilateral relations with China. This shows that New Zealand has considerable influence in accelerating the process of China's integration into the world economy and trade. After the political turmoil in 1989, China was eager to reform and become part of the international system dominated by traditional developed nations. The economic rise of China was in tandem with the decades-long process of being socialized into liberal international society (Johnston 2007). New Zealand played a particularly important role in this process, which is not easily replicated by other states. In 1997 New Zealand became the first Western country to conclude a bilateral agreement on China's accession to the World Trade

Organization (WTO), the first of a series of firsts in their bilateral relations. In 2001 New Zealand became the first developed country to recognize China as a market economy, and then entered into negotiations for a Free Trade Agreement (FTA) in 2004 and in 2008 was the first developed country to sign a comprehensive FTA with China.

Conversely, China offers a massive consumption market with a growing middle class that suits New Zealand's need to export dairy products as its main particular intrinsic material resource; New Zealand's big export businesses have benefited a great deal from a closer trade relationship with China. In 1972, when Sino–New Zealand relations were first established, New Zealand's exports to China were merely NZ$6 million, or 0.3% of New Zealand's total exports. Decades on, especially after the FTA deal, exports to China have grown exponentially and reached over NZ$20 billion in 2016, more than 20% of New Zealand's total exports. Milk powder, untreated logs, and meat (beef and lamb) are among the top export goods to China (Statistics New Zealand 2016).

Apart from historically socializing China into a global trade system based on Western liberal rules, New Zealand has recently exercised a tangible influence on China's grand foreign economic and trade policy, such as the Asia Infrastructure and Investment Bank (AIIB) and the BRI. At the negotiation stage of the AIIB, New Zealand had enough power to shape its institutional design. When the AIIB was unofficially suggested in 2009 at the Bo'ao Forum, the US media called it "a new Asian development bank to compete with Western dominated institutions" (Cha 2009). Most liberal states expressed a concern that the AIIB would become China's vehicle for its own strategic goals, as opposed to a Western multilateralism with transparency, good governance, and lending standards (Stone 2008; McKeown 2009). When the AIIB was launched in Beijing on October 24, 2014, delegates from 21 Asian countries attended, including India, Thailand, and Malaysia. However, major powers from the region were missing, such as Australia, Indonesia, South Korea, Japan, the EU, and the USA.

Contrary to the passive skepticism exhibited by most Western developed states, then Prime Minister John Key expressed New Zealand's interest in the AIIB during the Asia-Pacific Economic Cooperation meeting in November 2014, with governance as the prioritized agenda (Ifeng 2014):

> We could see the logic, and the need for it because it sits alongside the Asian Development Bank and others who operate in this space […] we wanted to make sure that there was good governance in place because there are New Zealand taxpayer dollars here that will be invested. (Edwards 2015)

Shortly after this, New Zealand became the twenty-fourth founding member of AIIB on January 5, 2015.

Former New Zealand Prime Minister Jenny Shipley also publicly supported the decision to join the AIIB and help to inject liberal norms into the institution. She spoke on the Bo'ao Forum in March 2015, "New Zealand can not only be part of the negotiations, but also exert positive influence on the bank's governance structure." And she confirmed that New Zealand provided staff with development banking expertise to AIIB's preparation team for its establishment in March 2015 (BBC 2015). Prime Minister Bill English reflected on his involvement in joining the AIIB as Minister of Finance:

> If we are open to opportunities, we can, for fleeting moments, exercise influence. When I was finance minister, John Key and I were making a decision to get involved very early in the AIIB. New Zealand put a proposition up that said, "we are interested in this but it needs to be a proper multilateral institution and not a Chinese Government SOE." Now the AIIB is regarded as a credible multilateral institution (English 2017).

New Zealand's early support of China's bold initiative to establish the AIIB has enabled it to exert a positive influence on China in two ways. First, by contributing to negotiations on the AIIB's establishment and turning it from a Chinese new development bank into a multilateral international organization with a clear organizational structure, openness and transparency, efficient governance, and a credible international leadership. Second, New Zealand's risk-taking pragmatism of reserving a place early on at the AIIB negotiation table arguably catalyzed the later wide support from developed countries who were skeptical at the beginning. A few months after New Zealand, great powers such as the UK and France, small liberal states, such as Denmark, Finland, and Iceland, all followed suit. The USA and Japan remained aloof.

New Zealand's successful involvement in the AIIB provided a confidence boost for both sides right before the ambitious BRI cooperation. After two years of promoting the initiative, Xi made a personal effort to get New Zealand involved in the BRI, as evidenced in his state visit to New Zealand in November 2014. Xi and Prime Minister John Key agreed that China and New Zealand would upgrade their bilateral relations to a "comprehensive strategic partnership." At the same time, China officially extended the BRI scope and called the South Pacific region "a natural extension of the Twenty-First-Century Maritime Silk Road," and welcomed New Zealand to participate, so as to promote China–New Zealand economic and trade cooperation for greater development (*China Daily* 2014). In other words, China added New Zealand to the BRI geographical routes and considered it a strategic location for access to the South Pacific.

In March 2017, one week after Australia formally rejected BRI cooperation, Premier Li and New Zealand Prime Minister Bill English, witnessed the signing of the MoU for BRI. This added to the already long list of groundbreaking firsts the two countries have scored in bilateral cooperation. "China and New Zealand will explore the possibilities of bilateral cooperation in various fields to promote interconnectivity between the two countries," Li said at a joint news conference with English. Soon after New Zealand signed the MoU of the BRI in March 2017, China officially extended the BRI to New Zealand and South Pacific, as elaborated by a document entitled "Vision for maritime Cooperation under the Belt and Road Initiative," jointly released on June 20, 2017 by the National Development and Reform Commission and the State Oceanic Administration, as an addition to the founding document of the BRI (Xinhua 2017b). The document unveils three "blue economic passages" along the extended Maritime Silk Road:

- the China–Indian Ocean–Africa–Mediterranean Sea blue economic passage;
- the China–Oceania–South Pacific blue economic passage; and
- the blue passage leading to Europe via the Arctic Ocean.

New Zealand and the South Pacific have become an important part of the China–Oceania–South Pacific blue economic passage. Under this "Blue Partnership" along the Maritime Silk Road, China proposed five cooperation priorities with slightly different focuses than for the five general BRI priorities. They are: green development, ocean-based prosperity, maritime security, innovative growth, and collaborative governance. Numerous smaller initiatives and projects are proposed under these five priorities for maritime cooperation. For green development, China aims to increase cooperation in areas such as ecological conservation, marine pollution, and climate change. Important projects involving the South Pacific were highlighted, such as Small Island States on Climate Change Issues, China–Small Island States Ocean-related Ministerial Round Table Meeting, and the Global Blue Economy Partnership Forum.

In this case, New Zealand demonstrated its influence by substantially altering China's already enormous BRI, and geographically extending it to the South Pacific. The influence is smart because of the mixed use of material resources, relationship building, agenda setting, negotiation, and normative power. New Zealand can potentially become a leader in facilitating cooperation in the region by seizing opportunities to participate in some of the areas where its traditional strengths are needed, such as providing technology and know-how on environmental protection, information infrastructure building, maritime law enforcement, and the building of multilateral mechanisms for cooperation. New Zealand can take a pioneering and active role in most of the projects involving the small island states in the South Pacific. While most of the liberal powers in the West hesitate, New Zealand has achieved a level of influence on the BRI that none of the Asian small states could have done.

4 Limits of Influence and Intrinsic Vulnerability of a Small State

Although New Zealand has had, by and large, successful bilateral relations with China, and at times has actively influenced China's foreign policy initiatives, there are limits and costs to this trade-based relationship. While China's "Reform and Open" transformation has had far-reaching consequences,

such as rising inequality and environmental degradation issues, New Zealand's overall free market strategy (one not just directed to China) has resulted in several economic and social problems during the last three decades. New Zealand's income inequality has been rising faster than in many other OECD countries since the 1990s. Housing affordability is plummeting, especially in the main cities. Child poverty and the gap between wealthy and poor is growing. Also gaining traction in public discussions are the environmental effects resulting from the exponential growth of dairy product export to China, which is New Zealand's largest market for dairy products. New Zealand's greenhouse gas emissions in 2015 were 24.1% higher than 1990 levels—a long way below what the country committed to in the Paris Agreement (Gudsell 2017). Highlighting the contribution of dairy farming to river pollution, one NGO warned in 2017 that more than 60% of monitored rivers are unsafe to swim in. These limits and costs of deepening free trade with China with a massive market exposes the vulnerable position of New Zealand as a small liberal state.

Many lessons can be learned from Beijing's handling of domestic connectivity projects, because the BRI is actually the continuation of China's provincial and sub-national ideas and practices. The first popular initiative to promote internal connectivity was the "Develop the West" campaign in 2000. Although the initial goal was to close development gaps between China's coastal east and inland west, inequality actually grew at its highest recorded rate over the following ten years. This economic inequality has been coupled with issues such as forced migration and environmental degradation. The campaign led to deteriorating ethnic relations in Xinjiang and Tibet. But Hong Kong is possibly one of the worst cases in Beijing's state-led connectivity and integration campaign. The campaign started with the good intention of helping boost economic growth after the SARS epidemic crisis in 2001 and strengthening Hong Kong people's diminishing loyalty and patriotism to the mainland. However, the ambitious campaign unintendedly caused growing grievances towards the central government through a political and identity conflict with the mainland, and the rise of an indigenous resistance movement (Ortmann 2015; Chan and So 2016).

Internationally, Beijing's economic connectivity projects often result in a series of broader issues. For example, Korea's Jeju Island has been turned

into "Chinatown" under the 2014 China–South Korea FTA. There is a growing resentment among the local islanders toward the influx of tourists and investors. Other international connectivity projects in Asia and Africa have had varied outcomes but generate common concerns: lack of transparency around projects, environmental issues, and undue political influence on local governance (Eisemann et al. 2015; Zhao 2014). In Australia there have been episodes of undue Chinese political influence reported in Australian universities, and a port lease in Darwin to a Chinese company with military ties (Greene 2017; Nicholson 2015).

So far, New Zealand has been lucky, with no major political tensions coming to the fore in its deepening relations with China. However, New Zealand's growing economic relations with China are not immune to conflicts of interest. There is an increasing political debate within New Zealand about how to manage the potential negative impact on society of incoming Chinese investment, with land purchases, for instance, being a sensitive issue. When China's Vice President Li Yuanchao met New Zealand's then opposition leader Andrew Little in 2015, he talked about why the Chinese have a strong emotional attachment to land ownership and are interested in purchasing land in New Zealand (*Chinese Herald* 2015). In 2015 the New Zealand parliament rejected a NZ$88 million bid from Pure 100 Farm Ltd.—a subsidiary of Chinese-owned Shanghai Pengxin, on the basis that the benefits to New Zealand were not "substantial and identifiable" (Piddock et al. 2015).

For New Zealand, one of the important justifications for negotiating an FTA with China is to use a normative influence to bring China into the liberal institutions. On the eve of the signing of the FTA with China in 2008, then Prime Minister Helen Clark argued that the more the emerging superpower could be engaged with and drawn into an international rules-based environment the better for everyone (Oliver 2008). Annette King, then Acting Minister of Trade, responded to the concerns raised by a number of submissions on Chinese human rights and said, "experience shows that engagement with countries speeds up the process of reform and change, but that isolation slows down that process. New Zealand's closer relationship with China will make a small but positive indirect contribution to China's reform in that area" (New Zealand Parliament 2008).

However, almost a decade on, China has not become politically more open and liberal, despite its deeper integration into the world economy. New Zealand increasingly faces the hard choice between trade benefit and living up to the goal of liberalizing China. Partly because of being afraid to damage a relatively stable trade relationship with China, New Zealand has often not stood up to defend its own core values, such as the rule of law, a free press, rights to political participation, and the right to peacefully criticize authorities. For example, Bill English had a last-minute cancellation of a meeting with two Hong Kong democracy leaders in October 2016. New Zealand did not join 11 embassies in Beijing to criticize China's crackdown on human rights lawyers in March 2017. Nor did New Zealand support the UN's March 2016 joint statement about China's human rights situation—a statement endorsed by New Zealand's traditional allies such as Australia, Japan, the UK, and the USA. If instances like this are repeated too often, New Zealand may risk either offending China or being "normalized" by its traditional allies as a country drifting away from the liberal world.

5 Conclusion

In light of the above analysis, New Zealand is an exemplar in the sense of showing that a small liberal state can be a proactive player with smart and effective influence vis-à-vis a great power. In its so far successful economic and trade engagement with China, New Zealand has demonstrated the use of smart influence, such as intrinsic material resources, relationship building, agenda setting, and normative power. It has gained the small liberal state an upper hand, not only to reap economic benefits in the FTA and BRI cooperation with China, but also to actively influence China's top foreign policy initiatives, such as the institutional design of the AIIB and the extension of the BRI to the South Pacific.

Despite the limitations of this chapter, which is based on a specific economic issue of BRI and trade, New Zealand's success in this case suggests that engagement is an effective response to China's rising ambition of providing regional and international leadership. The more ambitious China's initiative is—often considered by the West as threatening and

destabilizing—the more necessary it is to participate, insofar as multilateral participation has the potential to dilute China's institutional and political dominance. China seems to have more trust in small states, particularly New Zealand, whom China is willing to learn from and work with to prepare for bigger deals with larger players. New Zealand often makes the most of this particular power and is smart about where it contributes effectively when it can see the opportunity.

However, New Zealand's smart influence does come with limits and challenges. Rising inequality and environmental degradation are some of the direct consequences. Although New Zealand has a smart influence to lead China's AIIB and BRI toward an institutional design based on liberal multilateralism, this influence primarily exists in the early stages and is fleeting. New Zealand's influence on the AIIB's governance has diminished in the long term, with merely 0.5% investment shares. As for BRI cooperation, even with increased multilateral mechanisms, New Zealand will still have to deal with China's different capital control and foreign exchange systems and manage international projects on a case by case basis (Yu 2017b).

Moreover, China ultimately aims at political influence on local politics through the vehicle of economic investment. There is a tacit social contract behind the FTA and BRI that granting access to its massive market and capital investment is a "favor" that the host country will need to return sooner or later. This political influence has already caused most liberal countries to dampen down their criticism about human rights in China and it has divided them on the South China Sea dispute, or in New Zealand's case to drop steel dumping investigations. In other words, instead of socializing China into the liberal world, New Zealand will have to bear the consequences of China's growing political influence on its own domestic politics and foreign policy.

In response to these limits and challenges, New Zealand should: develop policies to cautiously manage the scope and depth of involvement when trading with China, under the BRI or the upgrade of the FTA; strategically diversify its trading partnerships beyond China, toward Asia and South America for example; and carefully protect the existing trust with its traditional allies, by living up to the goal that trading is a means to eventually liberalize China through democratic and multilateral norms.

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Part III

International Trade, Foreign Direct Investment, and BRI

11

The Overall Development of the Belt and Road Countries: Measurement, Ranking, and Assessment

Biliang Hu, Qingzhong Pan, and Shuyu Wu

1 Introduction

Ever since President Xi Jinping referred to the Belt and Road Initiative (BRI) in his speeches in Kazakhstan and Indonesia in 2013, Belt and Road Countries (BRCs), most of which are developing and less developed countries, have attracted more attention from academia. Most of the research conducted by Chinese scholars focuses on the theoretical foundations and strategic issues associated with the BRI (Huang 2016; Liu 2015; Jin 2015; Yuan 2014; Liu 2014; Li and Li 2015; Shen and Xiao 2014; Lu et al. 2015; Chu and Gao 2015; Lin and Wang 2015). Liu (2015) argued that the core character of the BRI that differentiates it

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from past globalization campaigns is that it calls for "peace and cooperation, openness and inclusiveness, mutual learning and win-win." Huang (2016) concluded that while infrastructure investment plays a central role, the BRI is far more comprehensive since it covers cooperation in all aspects, from policy dialogue to trade, from financial cooperation to people-to-people exchange. In addition to strategic analyses, scholars also researched economic performance and cooperative outlook in the BRCs from different perspectives. By calculating the amount of China's overseas direct investment via mergers and acquisition, Du and Zhang (2018) found that China's state-owned enterprises play a leading role in the infrastructure sectors, and target destinations are more likely to be resource-abundant regions or countries, such as Central and West Asia, Western Europe and Russia. Lai and Guo (2017) worked out an indicator called the One Belt One Road Exchange Rate Index (OBORR) and broke down the indicator into different components to analyze the financial risks associated with BRCs investment. They found that in the short term, the fluctuations of OBORR were greater than that of the RMB effective exchange rate. Based on this statistical finding, they concluded that the government should promote the establishment of clearing houses in the BRCs and develop more financial hedges, such as currency swaps and forwards, to protect Chinese enterprises from exchange rate risks.

According to the official definition, the BRCs refers to the 65 countries along the Silk Road Economic Belt and the Twenty-First-Century Maritime Silk Road, which include China, Mongolia, Russia, five countries in Central Asia, 19 countries in West Asia and North Africa, 19 countries in Central and Eastern Europe, 11 countries in Southeast Asia, and eight countries in South Asia. These countries have a total population of 4.6 billion, which accounts for 62.2% of the world's total; the land area is 50 million square kilometers, 38.5% of that of the world; and a total GDP of US$22.9 trillion, 30.9% of the world's aggregate GDP. In other words, nearly two-thirds of the world's population in the region has created nearly one-third of the world's output, on one-third of the land.[1] As mentioned above, most of the BRCs belong to middle income countries according to the World Bank benchmark. For these countries, development, which is a multidimensional concept, remains the most important issue. It is widely recognized that GDP growth and the eradication of poverty is the core of development, and is listed as the top goal

in the UN's Millennium Development Goals and Sustainable Development Goals (SDGs). However, development covers far more topics than poverty elimination. Reynolds (1969) claimed that the universe of less developed countries is heterogeneous, and the central task of a development economist is to understand the economic mechanism of the less developed countries (e.g., what determines their rate of increase in factor supplies and the total factor productivity). Chenery and Syrquin (1975), by establishing a complicated cross-border model, also found that during the development of a less developed country, the structure of the economy changes. There will be upgrades in industry from a primary phase of industrialization to advanced phases. Urbanization will accelerate and a higher percentage of people will have access to better education. In its annual report, the World Bank (1999) pointed out that poor countries and poor people differ from rich ones not only because they have less capital but because they have less knowledge. Therefore, an essential task for developing countries is to spread knowledge about technology and attributes. Stiglitz (2011) added some new thoughts to traditional development economic theory. He questioned the Washington Consensus and argued that there should be a new structural approach to development rather than the single path of market-oriented policy framework, or so-called American style capitalism. The aftermath of the global financial crisis provided development economists with a new perspective on the flaws in the reigning paradigm.

Development theories established the theoretical foundation for our research on the BRCs. For example, we incorporated Chenery's theory of economic structural changes and the UN's SDG framework to select the sub-indicators reflecting different aspects of development. Therefore, our overall rankings of the BRCs reflect a general assessment of country development from different angles, including economic development, government institutions, structural transformation, social development, and so on. This research is unique compared to other research on BRC rankings in that it is comprehensive and profound with solid development economic foundations. Rankings such as the Industrialization and Informatization Index, designed by the China Information Technology Industry Federation (2017), and the Trade Competitiveness Index (2016), designed by the State Information Center focused only on one specific aspect of BRC's development.

2 Selection of Indicators to Measure Overall Development Levels of the BRCs

In order to calculate the overall development levels of BRCs, we need first to accurately select the measurement indicators, for which it is important to distinguish the concept of development from that of growth. Growth generally refers to economic growth, that is, growth of wealth or of gross domestic products. Important as it is, it is only one aspect of development, while the overall development of a country is a much broader concept. It covers a wide range of social improvements, including economic growth, structure changes, resources utilization, income redistribution, social development, environment protection, better institutions, and so on. Referring to Chenery's theory and the UN's SDG framework, we considered eight categories of development and selected corresponding sub-indicators to measure the level of development in each category. The eight categories are economic development, governance, resource endowment, environmental protection, social development, business environment, structural change, and size of country.

2.1 Economic Development

We have chosen three indicators—nominal GDP, GDP per capita, and real GDP growth rate—to reflect the economic development level of the BRCs. The reason for choosing nominal GDP is that this index can reflect the overall economic power and the aggregate economic size of a country. The reason for choosing GDP per capita is that this indicator reflects people's standard of living. And the reason for choosing real GDP growth rate is it represents a country's speed of economic growth. These three indicators draw a general picture of the economic development level of a BRC.

2.2 Governance

We chose the indicators used by the World Bank to measure the six aspects of level of governance, that is, political stability, government efficiency, accountability, regulations, rule of law, and corruption control.

The World Bank believes that governance covers a range of traditions and construction of institutions through which governments are able to manage their countries. Practices have proved that this set of indicators: can better assess transparency, accountability, and rule of law; can better reflect a government's policymaking and implementation capacity; and can measure whether the interests of the people are fully respected, so as to better assess the effectiveness of operation of the government departments. Therefore, we adopted these six indicators to evaluate the level of governance of BRCs.

2.3 Resource Endowment

We selected the three indicators of arable land per capita, water resources per capita, and fossil energy per capita to reflect the resource endowments of BRCs. A rich reserve of arable land is one necessary condition for agriculture to develop and for an economy to take off; affluent water resources contribute to the rapid development not only of agriculture, manufacturing, and other industries, but they also contribute to people's livelihood. The economic development of a considerable number of BRCs depends mainly on oil, natural gas, and other energy exports, so for these countries, fossil energy resources have a direct impact on the potential and direction of their long-term development.

2.4 Environmental Protection

We have selected the two indicators of carbon dioxide emissions per capita and forest coverage rate to reflect the environmental protection and condition of BRCs. This is because carbon dioxide emissions per capita can best present the energy consumption of economic growth; and the forest coverage rate is able to reflect a country's environmental conditions.

2.5 Social Development

Four indicators have been chosen to reflect the level of social development of BRCs: life expectancy, average years of education, unemployment rate,

and the percentage of female laborers in the workforce. In the light of the indicators chosen by the UN Human Development Index, we also assessed levels of social development based on health, education, and economic development. Life expectancy can reflect the quality of life and health conditions of people in different countries; the average years of education reflects the human capital level; the unemployment rate reflects the source and level of national income; the percentage of female laborers in the workforce shows the degree of gender equality and the engagement level of women in the labor market, which is also an important measurement of social progress.

2.6 Business Environment

The World Bank's business environment index is used by this research to assess the business environment of BRCs. This index is divided into two sections to measure the effectiveness of government regulation of enterprises and the completeness of national legal systems. The former is used to measure the regulatory procedures and efficiency involved in the establishment of enterprises, handling construction permits, obtaining electricity, property registration, payment of taxes, and cross-border trade; the latter is used to evaluate the soundness of legal and regulatory frameworks, such as access to credit, protection of investors, contract enforcement, bankruptcy, employment, and other aspects. From the perspective of enterprises, these indicators assess procedures, time, and costs required to complete a transaction according to the relevant laws and regulations. The business environment can be clearly reflected by an index based on these indicators.

2.7 Structural Transformation

We have selected two indicators, the urbanization rate and the proportion of value-added from manufacturing to the aggregate GDP, to reflect the country's economic structural change. Urbanization rate reflects the changes and transformation from rural society to urban society; and the proportion of manufacturing value-added in total GDP reflects the level of industrialization. Since most of the BRCs are developing countries, industrialization and urbanization are of great importance to their overall

development, therefore we have chosen these two indicators to assess structural changes and transformation.

2.8 Country Size

Countries with different sizes have different developmental paths and strategies, and development has different effects. We have selected two indicators, total population and total land area, to evaluate the size of BRCs. Economic development has a certain size effect, populated countries have a larger consumption and a bigger labor market, and a country with a vast territory means more abundant natural resources. Therefore, countries with a larger population and land area have greater advantages in the process of economic development.

3 Measurement and Ranking Methods of the Overall Development Levels of the BRCs

Our calculation and sequencing of the level of overall development of BRCs were based on measurements from comprehensive development indices. To calculate the overall (comprehensive) development index, we first constructed an assessment model with a two-tier structure to reflect the main aspects and content; the calculated value based on this content is the comprehensive development indices of different countries.

The two-tier assessment model we designed included first-level indicators related to the eight aspects of economic development, governance, resource endowment, environment protection, social development, business environment, structural transformation and size effect. Each first-level indicator was divided into several secondary indicators, and those eight aspects had 23 secondary indicators in total. There are parallel relations between different indicators at the same level, and the secondary indicators are subordinate to the first-level indicators. The relationship between the indicators is shown in Fig. 11.1.

In calculating the overall development index, we used a low-to-high, layer-by-layer, weighted arithmetic average quantitative calculation

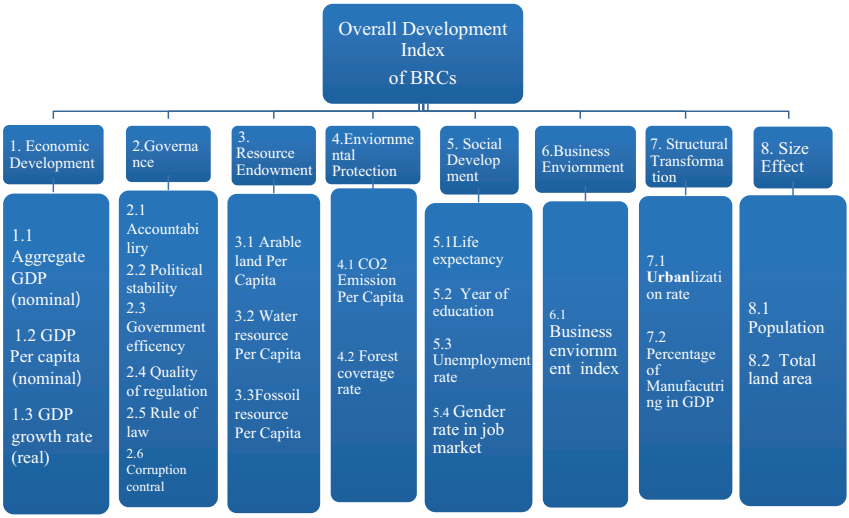

Fig. 11.1 Evaluation indices structure of overall development levels of BRCs

method. This means the overall comprehensive development index was obtained by equal weighting of the eight first-level indicators, and the value of each first-level index is determined by all the secondary indicators subordinate to the first-level indicators through equal weighting. The value of the secondary indicator is derived from its actual statistical data.

According to the different meanings of the indicators, there are two types of evaluation for the secondary indicators: one type is the "unemployment rate" (5.3) and the "carbon dioxide emissions per capita" (4.1), which are given lower assessment scores when the number is bigger, that is, the country with the biggest number is rated as zero on the indicator, and the country with the smallest number is rated as full score; the second types is that the bigger the original value of the secondary index, the higher the assessment score, so the country with the biggest number is given a full score on the corresponding indicator, and the country with the smallest number is rated as zero. This type is more common.

The evaluation model is calculated from data matrix (DATA), score matrix (SCORE) and rank matrix (RANK). The calculation process is divided into three steps.

Step 1. Constructing DATA matrix

The matrix has a total of 65 rows and 23 columns, and its elements are X_{ij}, and X_{ij} which indicate the original data of the ith country ($i = 1, \ldots, 65$) corresponding to the jth secondary indicator ($j = 1, \ldots, 23$). Each column of the DATA matrix corresponds to the original data of all countries under a certain index, and the units of the different columns are different. Each line corresponds to the original data of a country under all indicators. Thus, the DATA matrix can be written as:

$$\text{DATA} = \begin{bmatrix} X_{11} & X_{12} & \cdots & X_{123} \\ X_{21} & X_{23} & \cdots & X_{223} \\ \vdots & \vdots & \vdots & \vdots \\ X_{651} & X_{652} & \cdots & X_{6523} \end{bmatrix}_{65\times 23}$$

Step 2. Constructing SCORE matrix

First, according to the matrix, construct a secondary index score matrix (SCORE$^{(2)}$). The SCORE$^{(2)}$ matrix has a total of 65 rows and 23 columns, and its element is $S_{ij}^{(2)}$. $S_{ij}^{(2)}$ indicates the results of the ith country ($i = 1, \ldots, 65$) corresponding to the score of the secondary indicator ($j = 1, \ldots, 23$). Each column of the Score$^{(2)}$ matrix corresponds to the score of all countries under a certain secondary index. Each row of the Score$^{(2)}$ matrix corresponds to the score of a country under all secondary indicators.

For type one: the bigger the number, the lower the score. Set the original data to take the minimum value $\min_{i=1,\ldots,n}\{X_{ij}\}$ of the national score as the full score, the original data to the maximum value $\max_{i=1,\ldots,65}\{X_{ij}\}$ of the national score as zero. The formula of $S_{ij}^{(2)}$ is, $S_{ij}^{(2)} = \dfrac{\max_{i=1,\ldots,n}\{X_{ij}\} - X_{ij}}{\max_{i=1,\ldots,n}\{X_{ij}\} - \min_{i=1,\ldots,n}\{X_{ij}\}} \times 100$ and $0 \leqq S_{ij}^{(2)} \leqq 100$. This formula is used for both the unemployment rate (5.3) and the per capita carbon dioxide emissions (4.1).

For type two: the bigger the number, the higher the score. Set the original data to take the maximum value $\max_{i=1,\ldots,n}\{X_{ij}\}$ of the national score as the full score, the original data to the minimum value $\min_{i=1,\ldots,65}\{X_{ij}\}$ of the national score as zero. The formula of $S_{ij}^{(2)}$ is $S_{ij}^{(2)} = \dfrac{X_{ij} - \min_{i=1,\ldots,n}\left\{X_{ij}\right\}}{\max_{i=1,\ldots,n}\left\{X_{ij}\right\} - \min_{i=1,\ldots,n}\left\{X_{ij}\right\}} \times 100$, and $0 \leqq S_{ij}^{(2)} \leqq 100$. This formula is used for other secondary indicators.

The following matrix of $\text{SCORE}^{(2)}$ is obtained by calculating each element of the $\text{SCORE}^{(2)}$ matrix from the above formula:

$$\text{SCORE}^{(2)} = \begin{bmatrix} S_{11}^{(2)} & S_{12}^{(2)} & \cdots & S_{123}^{(2)} \\ S_{21}^{(2)} & S_{23}^{(2)} & \cdots & S_{223}^{(2)} \\ \vdots & \vdots & \vdots & \vdots \\ S_{651}^{(2)} & S_{652}^{(2)} & \cdots & S_{6523}^{(2)} \end{bmatrix}_{65\times 23}$$

Then, according to the $\text{SCORE}^{(2)}$ matrix, construct a primary index score matrix ($\text{SCORE}^{(1)}$). The $\text{SCORE}^{(1)}$ matrix has a total of 65 rows and 8 columns, whose elements are $S_{ij}^{(1)}$. $S_{ij}^{(1)}$ indicates the results of the ith country ($i = 1, \ldots, 65$) corresponding to the score result of the jth first level indicators ($j = 1, \ldots, 8$). Each column of the $\text{SCORE}^{(1)}$ matrix corresponds to the score of all countries under a certain level. Each row of the $\text{SCORE}^{(1)}$ matrix corresponds to the score of a country under all the first-level indicators. Assuming that the primary indicators of the jth ($j = 1, \ldots, 8$) first-level indicators is the sth column to the tth column in the $\text{Score}^{(2)}$ matrix, the weight of the pth ($s \leqq p \leqq t$) column is $w_p^{(2)} \geqq 0$. Then, $S_{ij}^{(1)}$ equals to the weighted average of all secondary indicators, the formula is $S_{ij}^{(1)} = \sum_{p=s}^{t}\left(S_{ip}^{(2)} \cdot w_p^{(2)}\right) / \sum_{p=s}^{t} w_p^{(2)}$, and $0 \leqq S_{ij}^{(1)} \leqq 100$. This report selects the weight average as 1, and each element of the Score[1] matrix is calculated, and thus the following $\text{SCORE}^{(1)}$ matrix is obtained:

$$\mathrm{SCORE}^{(1)} = \begin{bmatrix} S_{11}^{(1)} & S_{12}^{(1)} & \cdots & S_{18}^{(1)} \\ S_{21}^{(1)} & S_{23}^{(1)} & \cdots & S_{28}^{(1)} \\ \vdots & \vdots & \vdots & \vdots \\ S_{651}^{(1)} & S_{652}^{(1)} & \cdots & S_{658}^{(1)} \end{bmatrix}_{65\times 8}$$

Finally, according to the $\mathrm{SCORE}^{(1)}$ matrix, the development index score matrix (SCORE) is constructed. The SCORE matrix has a total of 65 rows and 1 column, and its elements are S_i. S_i to indicate the results of the ith ($i = 1, \ldots, 65$) country corresponding to the scoring results of the development index. Assuming that the weight of the jth ($j = 1, \ldots, 8$) level indicator is $w_j^{(1)} \geqq 0$. Then, S_i equal to the weighted average of the eight first-level indicators, the formula is $S_i = \sum_{j=1}^{8} \left(S_{ij}^{(1)} \cdot w_j^{(1)} \right) / \sum_{j=1}^{8} w_j^{(1)}$, and $0 \leqq S_i \leqq 100$. This report selects the weight average as 1, and each element of the SCORE matrix is calculated, and thus the following matrix is obtained:

$$\mathrm{SCORE} = \begin{bmatrix} S_1 \\ S_2 \\ \vdots \\ S_{65} \end{bmatrix}_{65\times 1}$$

Step 3. Constructing RANK matrix

First, according to the $\mathrm{SCORE}^{(2)}$ matrix, to build a secondary indicator rank matrix ($\mathrm{RANK}^{(2)}$). The $\mathrm{RANK}^{(2)}$ matrix has a total of 65 rows and 23 columns, and its elements are $R_{ij}^{(2)}$. $R_{ij}^{(2)}$ indicates the sorting results for the ith ($i = 1, \ldots, 65$) corresponding to the ranking result of the jth ($j = 1, \ldots, 23$) secondary indicators. Each column of the $\mathrm{RANK}^{(2)}$ matrix corresponds to the ranking result for all countries under certain secondary indicators. Each row of the $\mathrm{RANK}^{(2)}$ matrix corresponds to the

sorting result of a country under all secondary indicators. Rank the SCORE$^{(2)}$ matrix elements in the order from high to low, then the order of $R_{ij}^{(2)}$ equals to the order of $S_{ij}^{(2)}$, the formula is $R_{ij}^{(2)} = \mathrm{Rank}\left\{S_{ij}^{(2)} \middle| \left[S_{ij}^{(2)}\right]_{i=1,\ldots,65}\right\}$, and $1 \leqq R_{ij}^{(2)} \leqq 65$. $R_{ij}^{(2)} = 1$ indicates the country that ranks highest of 65 countries, ranking the first; $R_{ij}^{(2)} = 65$ indicates the country that gets the lowest score in 65 countries, ranking the last. The formula is then calculated for each element of the RANK$^{(2)}$ matrix, resulting in the following RANK$^{(2)}$ matrix:

$$\mathrm{RANK}^{(2)} = \begin{bmatrix} R_{11}^{(2)} & R_{12}^{(2)} & \cdots & R_{123}^{(2)} \\ R_{21}^{(2)} & R_{23}^{(2)} & \cdots & R_{223}^{(2)} \\ \vdots & \vdots & \vdots & \vdots \\ R_{651}^{(2)} & R_{652}^{(2)} & \cdots & R_{6523}^{(2)} \end{bmatrix}_{65\times 8}$$

Then, according to the SCORE$^{(2)}$ matrix, to build a secondary indicator rank matrix (RANK$^{(1)}$). The RANK$^{(1)}$ matrix has a total of 65 rows and 8 columns, and its elements are $R_{ij}^{(1)}$. $R_{ij}^{(1)}$ indicates the sorting results for the ith ($i = 1, \ldots, 65$) corresponding to the ranking result of the jth ($j = 1, \ldots, 8$) secondary indicators. Each column of the RANK$^{(1)}$ matrix corresponds to the ranking result for all countries under certain secondary indicators. Each row of the RANK$^{(1)}$ matrix corresponds to the sorting result of a country under all secondary indicators. Rank the SCORE$^{(1)}$ matrix elements in the order from high to low, then the order of $R_{ij}^{(1)}$ equals to the order of $S_{ij}^{(1)}$, the formula is $R_{ij}^{(1)} = \mathrm{Rank}\left\{S_{ij}^{(1)} \middle| \left[S_{ij}^{(1)}\right]_{i=1,\ldots,65}\right\}$, and $1 \leqq R_{ij}^{(1)} \leqq 65$. $R_{ij}^{(1)} = 1$ indicates the country ranks highest in 65 countries, ranking the first; $R_{ij}^{(1)} = 65$ indicates the country gets the lowest score in 65 countries, ranking the last. The formula is then calculated for each element of the RANK$^{(1)}$ matrix, resulting in the following RANK$^{(1)}$ matrix:

$$\mathrm{RANK}^{(1)} = \begin{bmatrix} R_{11}^{(1)} & R_{12}^{(1)} & \cdots & R_{123}^{(1)} \\ R_{21}^{(1)} & R_{23}^{(1)} & \cdots & R_{223}^{(1)} \\ \vdots & \vdots & \vdots & \vdots \\ R_{651}^{(1)} & R_{652}^{(1)} & \cdots & R_{6523}^{(1)} \end{bmatrix}_{65\times 8}$$

Finally, according to the SCORE matrix, construct a second indicator rank index matrix (RANK). The RANK matrix has a total of 65 rows and 1 column, and its elements are R_i. R_i to represent the ranking result of the ith ($i = 1, \ldots, 65$) national development index, then the column elements of the SCORE matrix are arranged from high to low, the rank of R_i is equal to that of S_i. The formula is $R_i = \mathrm{Rank}\{S_i | [S_i]_{i = 1, \ldots, 65}\}$, and $1 \leqq R_i \leqq 65$. $R_i = 1$ indicates the country ranked highest in 65 countries; $R_i = 65$ means the country with the lowest score in 65 countries in terms of this indicator, ranking last. Thus, the RANK matrix can be written as:

$$\mathrm{RANK} = \begin{bmatrix} R_1 \\ R_2 \\ \vdots \\ R_{65} \end{bmatrix}_{65\times 1}$$

4 Data Sources

We are confident of the reliability of our research, since most of the data comes from the widely cited databases of international organizations. For example, we generated most of the data from the World Development Indicators databases of the World Bank. Data for some thematic research comes from other authoritative databases, such as the Global Governance Index and Business Environment Index from the World Bank, databases from the UN's Food and Agriculture Organization, Development

Program, and Industrial Development Organization. We also generated data from some frequently used thematic databases, such as the Global Eco-Environment Remote Sensing Monitoring Databases, BP's Energy Databases, and the St. Louis Fed Economic Databases.

The rankings in the following tables and graphs were generated using data from 2014. For countries that lack data for the corresponding years, we used a linear interpolation method to fill the blanks—this is based on the available data of the previous three years, to obtain an average value, and then use the average value to represent the missing value of that year.

5 Results and Rankings

Based on the methods outlined in Sect. 4, Table 11.1 shows the scores and rankings for the eight subcategories of development, as well as the overall development scores and rankings obtained.

According to our assessment, the top 20 countries with the highest level of country development scores are Singapore, China, Malaysia, Estonia, Lithuania, Latvia, Czech Republic, Slovenia, Russia, Israel, Brunei, Poland, Slovakia, Georgia, Hungary, Qatar, Thailand, Bulgaria, Romania, and Belarus. Countries with the lowest level of country development scores are Afghanistan, Syria, Yemen, Iraq, Tajikistan, Pakistan, Uzbekistan, Palestine, Egypt, Turkmenistan, Bangladesh, Nepal, Iran, Timor-Leste, Myanmar, Maldives, Bosnia and Herzegovina, Cambodia, Kyrgyzstan, and Ukraine. Fig. 11.2 shows details of all BRC rankings.

6 Main Statistical Findings

The statistical results shown above may provide new insights into the way we learn about the BRCs. Not only can we see the development levels of these countries from different perspectives, but we may dig out the potential problems these countries are faced with. From the sub-indices on economic development, governance, resource endowment, and structural transformation, we can generate four conclusions.

Table 11.1 Scores and rankings for BRCs development levels (2014)

Country development ranking	Country	Ranking of sub-indices								Score (full score 100)
		Economy	Governance	Resources	Environment	Society	Business environment	Structure	Size	
1	Singapore	3	1	65	41	2	1	1	51	56.1
2	China	1	40	54	37	26	39	2	1	52.4
3	Malaysia	13	15	23	5	23	3	4	23	51.2
4	Estonia	25	2	12	29	3	6	24	55	48.9
5	Lithuania	31	5	6	18	11	5	13	46	48.8
6	Latvia	42	8	8	7	13	4	32	48	48.3
7	Russia	26	46	4	24	12	27	23	3	47.5
8	Czech Republic	35	3	30	33	4	17	5	36	47.2
9	Slovenia	16	6	44	9	5	13	31	59	47.1
10	Poland	22	4	31	32	8	10	25	22	45.8
11	Israel	7	11	61	57	1	11	8	42	45.2
12	Georgia	39	16	25	12	20	2	43	43	45.1
13	Brunei	44	9	5	13	19	29	20	64	44.8
14	Slovakia	33	7	36	19	16	14	28	44	44.6
15	Hungary	28	12	20	31	9	24	11	35	43.8
16	Qatar	2	13	3	65	36	12	10	60	42.5
17	Thailand	57	36	33	25	22	8	9	15	42.0
18	Romania	43	19	18	27	15	30	18	26	41.8
19	Bulgaria	55	22	14	26	21	18	19	38	41.6
20	Belarus	53	44	11	17	6	23	3	30	41.4
21	Bhutan	34	17	2	2	50	43	61	58	40.7
22	United Arab Emirates	4	10	26	62	44	7	21	39	40.1
23	Indonesia	19	35	41	6	46	51	12	4	39.5

(*continued*)

Table 11.1 (continued)

Country development ranking	Country	Ranking of sub-indices								Score (full score 100)
		Economy	Governance	Resources	Environment	Society	Business environment	Structure	Size	
24	Montenegro	54	20	35	4	30	22	51	62	39.4
25	Croatia	58	14	29	20	24	31	36	45	39.3
26	Turkey	30	28	32	38	47	20	14	11	38.2
27	Macedonia	45	21	42	15	54	9	42	57	38.2
28	Vietnam	23	42	52	11	18	42	41	14	37.1
29	Kazakhstan	21	41	1	59	7	32	46	6	37.0
30	Philippines	18	33	55	23	40	41	27	13	36.5
31	Armenia	47	37	48	36	29	15	34	52	36.1
32	Mongolia	11	26	19	54	27	33	44	12	36.0
33	Moldova	41	38	16	35	10	26	49	50	36.0
34	India	6	39	53	28	58	58	58	2	35.8
35	Saudi Arabia	8	31	21	61	51	16	16	8	35.2
36	Serbia	64	23	17	30	35	40	33	41	35.1
37	Bahrain	9	25	51	63	38	21	7	63	35.0
38	Laos	14	45	9	1	39	55	59	32	34.8
39	Sri Lanka	37	34	56	14	25	37	57	31	34.7
40	Oman	27	18	37	60	53	19	26	29	34.3
41	Albania	56	24	27	21	31	44	52	54	34.1
42	Jordan	48	27	62	53	52	45	6	40	33.5
43	Azerbaijan	50	47	34	39	14	25	55	37	32.4
44	Lebanon	51	48	60	42	37	36	17	49	32.0
45	Ukraine	65	49	7	40	17	49	29	17	31.7
46	Kuwait	29	30	10	64	43	38	15	53	31.6
47	Cambodia	17	52	24	3	34	56	60	28	31.3

(*continued*)

Table 11.1 (continued)

Country development ranking	Country	Ranking of sub-indices								Score (full score 100)
		Economy	Governance	Resources	Environment	Society	Business environment	Structure	Size	
48	Kyrgyzstan	46	54	28	48	28	28	48	33	30.7
49	Bosnia and Herzegovina	59	32	22	16	55	53	54	47	30.5
50	Maldives	15	29	64	51	41	34	64	65	30.5
51	Myanmar	10	61	15	10	49	64	35	16	29.1
52	East Timor	36	50	43	8	57	63	37	61	28.5
53	Iran	32	57	38	56	56	46	30	7	28.4
54	Nepal	38	51	47	22	42	35	65	25	28.4
55	Turkmenistan	5	60	13	58	48	52	38	24	27.8
56	Bangladesh	24	53	57	34	45	59	45	10	27.5
57	Uzbekistan	12	59	49	47	33	60	39	21	26.9
58	Egypt	52	55	59	52	59	47	40	9	26.0
59	Tajikistan	20	58	45	43	32	61	50	34	25.7
60	Pakistan	40	56	50	45	60	48	53	5	25.7
61	Palestine	62	43	63	46	62	54	22	56	25.6
62	Iraq	63	62	46	55	63	57	47	19	19.2
63	Yemen	49	63	58	50	64	50	62	20	18.9
64	Syria	61	65	40	49	61	62	56	27	18.2
65	Afghanistan	60	64	39	44	65	65	63	18	14.9

Source: Calculated by the Emerging Markets Institute and the Belt and Road Research Institute of Beijing Normal University.

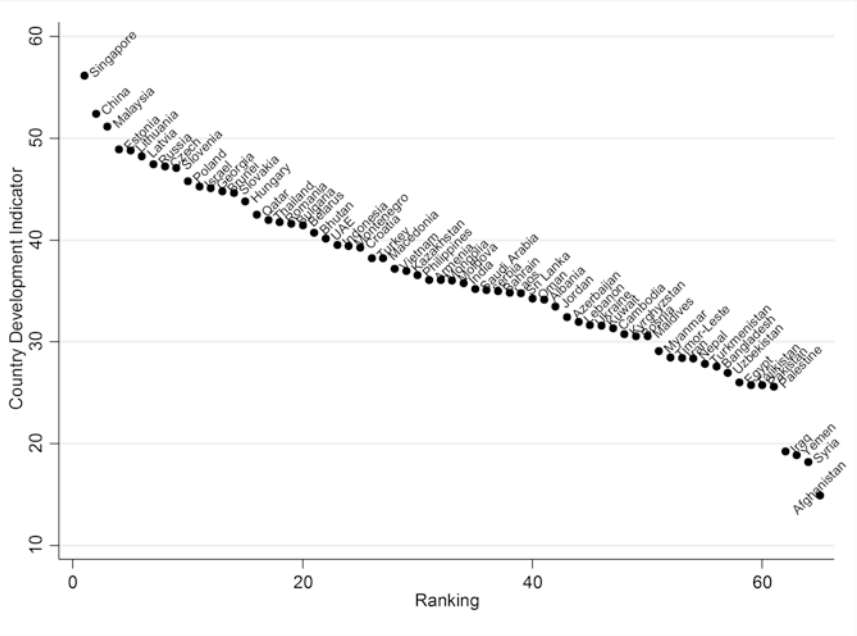

Fig. 11.2 Scores and rankings of the Country Development Indicator of the BRCs (2014). Source: Emerging Markets Institute and the Belt and Road Research Institute of Beijing Normal University

6.1 Political Stability and Good Governance are of Vital Importance in the Development of BRCs

Countries that are not politically stable or have some problems with their governance are basically the most underdeveloped countries in the region. While countries with good governance have mainly been ranked at the highest level of overall (comprehensive) development. From the overall development level point view, the bottom four countries are Afghanistan, Syria, Yemen, and Iraq, they are also the four countries that rank low in governance, with only a slight difference in ranking, which is Syria, Afghanistan, Yemen, and Iraq. Countries that rank in the last ten in terms of overall development levels, are mostly the last ten countries in ranking for political stability and governance, including Pakistan, Tajikistan, and Uzbekistan.

In contrast we found that some countries have high overall development levels because of their high levels of political stability and good governance but are disadvantaged in terms of resources and size, as well as economic development (except for Singapore), but they rank top in overall (comprehensive) development levels. These six countries are Singapore (1), Estonia (2), the Czech Republic (3), Poland (4), Lithuania (5), and Israel (11).

It shows that political stability is the basic premise of national development and that there will not be any development without political stability. Therefore, it is imperative to make every effort to promote political stability and strive to enhance capacity building to improve the levels of good governance of BRCs.

6.2 The Overall Level of Economic Development is Heterogeneous Among the BRCs

The average GDP per capita of 65 BRCs in 2015 was US$10,274. There were 18 high-income countries with an average GDP per capita of US$25,765; 22 countries with medium to high income and an average GDP per capita of US$6560; and 23 low-income countries with an average GDP per capita of US$2186; two low-income countries (Afghanistan, Nepal), had an average GDP per capita of only US$661. The average GDP per capita of high-income countries is 39 times the average GDP per capita of low-income countries. Of the 18 high-income countries, 12 are among the top 16 in the overall comprehensive development levels, suggesting that good economic development contributes directly to developments in other aspects.

Seen from the regional economic development of BRCs, there are six countries in Central and Eastern Europe in the top ten, accounting for 60%; and there are 11 countries in Central and Eastern Europe in the top 20, accounting for 55%. In total, there are only 19 Central and Eastern European countries out of 65 BRCs, accounting for 29%. This indicates that the overall level of development in Central and Eastern Europe is relatively high. While in the ten countries with the lowest level of overall development, there are six countries in Western Asia and North Africa, accounting for 60%, which is directly related to the long-standing political turmoil in the Middle East.

6.3 Potential for Cooperation is High as Resource Endowment is Unbalanced Among BRCs

World fossil energy production in 2015 totaled 11.39 billion tons of oil equivalent, of which BRCs produced 6.93 billion tons of oil equivalent, accounting for 61%. North American region only accounts for 20%, and in South America and Africa production only accounts for 5.4% and 6.5%. The main oil-exporting countries along the Belt and Road are concentrated in the Middle East region. The BRCs have 70% of the world's total coal production (China ranked first in the world, accounting for 48%; India ranked third, accounting for 7%; Indonesia accounted for 6%; Russia accounted for 5%); 57% of oil production (Saudi Arabia alone in 2015 produced 13% of the world's total, ranking first; Russia also produced more than 500 million tons, accounting for 12.4%, ranking third in the world); 53% of natural gas (17% in the Middle East, 16% in Russia, and 12% in China, Southeast Asia and India); and 47% of electricity. The BRCs region is the world's most important energy production base.

From the point of view of consumption, in 2015 the total consumption of global fossil fuels was 11.3 billion tons of oil equivalent, of which BRCs consumed 5.9 billion tons of oil equivalent, accounting for 52%; and they consumed 72% of the world's coal, 46% of natural gas, and 40% of the oil. China consumed 50% of the world's coal in 2015, ranked first in the world; India consumed 10%, ranked second in the world. In the same year China's oil consumption ranked second in the world, India ranked third, and Russia ranked fifth. Russia ranked second in the world's natural gas consumption, China ranked third, and the two countries consumed more than 60% of the world's natural gas. The per capita fossil energy consumption level of BRCs is still below the global average, which is only half the level of the EU, so the potential for growth is still great. According to BP's forecast in previous years, primary energy consumption of developing countries in 2030 will account for 93% of the global consumption, thus energy consumption of BRCs will continue to grow.

Although the energy production and consumption of BRCs are large, the production of many energy consuming countries cannot meet their needs due to the large gap between production and consumption, such as

in India. China needs to import a lot of oil and gas. At the same time, in many energy-producing countries production is much higher than consumption, as in many countries in the Middle East, Russia, Kazakhstan, and so on, which provides a huge opportunity for energy cooperation among BRCs and will help to facilitate the mutually beneficial and win-win development of these countries.

6.4 Structural Transformation Accelerated for BRCs

First, the development momentum of national manufacturing industry in BRCs is very strong, the proportion of value-added of manufacturing has grown to 22.4% of GDP, which makes it the region with fastest average growth rate in the world; value-added from manufacturing has rapidly increased from only 17.8% of the world's total in 1990 to 40.3% in 2015, which shows the significant comparative advantage in manufacturing industry.

Second, the rapid urbanization of BRCs has increased 1.3 percentage points annually from 1960 to 2014, which is much higher than the world average in the same period (0.4 percentage points annually). In 2014, the urbanization rate of BRCs reached an average of 46.8%, and BRCs urbanization has continued to grow rapidly.

7 Policy Implications

With the unbalanced levels of development and the great challenges ahead, the BRCs have great potential to cooperate and achieve Pareto improvement under the framework of BRI. Based on our calculations and findings the BRCs should take the following strategies to enhance development and to realize common prosperity.

1. *BRCs should continue to adhere to opening-up development strategy.*

Among BRCs, countries with the highest levels of overall development happen to be those more open to the world. A typical example is

Singapore. Although lacking in natural resources, Singapore has the highest level of overall development, a main contributor to this is its opening-up policy. The situation in Central and Eastern European countries is similar. Due to their openness, especially to Western European countries, their overall development levels are significantly higher. The BRI provides the BRCs with new historical opportunities, in which BRCs will realize faster development through deeper regional integration.

2. *BRCs should preserve stable governance to create a favorable political environment for further development.*

The most important strategy and task in West and South Asia, and North Africa is to stabilize political situations, to avoid long-standing political turmoil, and to create favorable political environments and a foundation for development. To enhance their levels of development other countries mainly need to improve good governance in a period of rapid transformation, adhere to the rule of law, provide better education for their people, improve the business environment, curb corruption, and enhance government management capacity.

3. *BRCs should grasp the new opportunities under the BRI.*

They should enhance cooperation with the Asian Infrastructure Investment Bank, Silk Road Fund, and other new financing arrangements, to promote infrastructure investment, which may not only increase their domestic economic growth in the short run, but also increase regional interconnectivity and expand their growth potential in the long run.

4. *BRCs should make intensive use of agricultural resources, improve agricultural production efficiency, and ensure food security.*

Poverty is a common problem in BRCs, with 25 countries still trapped in poverty. For these countries, the primary task of development is to address the problems of food and clothing. Therefore,

deepening agricultural reform and promoting rural development are of particular importance to these countries.

5. *BRCs, especially those countries rich in oil and commodity products, should make full use of their resource endowment and strengthen their cooperation with large energy consumers in this region, such as China and India, to achieve a win-win situation.*

6. *BRCs should encourage cooperation in the financial sector to provide adequate financing for development.*

Under the framework of the BRI, China is active in providing more funds for projects related to infrastructure construction, industrialization, and urbanization of the BRCs. Therefore, BRCs tend to gain more opportunities to obtain development funds from China.

7. *BRCs should strive to achieve sustainable development.*

Countries that are lagging behind can directly promote sustainable development through the implementation of a leap-forward development strategy, and strive for effective participation in the Belt and Road construction with the UN 2030 sustainable development agenda; for most countries, they need to adjust current development plans and actions according to the UN's SDGs, so as to promote the transformation of development strategies and plans. At the same time, BRCs should strengthen cooperation in sustainable development and jointly promote regional sustainable development.

Notes

1. Data sourced from world development indicators databases from the World Bank. Detailed data can be found at http://data.worldbank.org.cn/. We used the corresponding data in 2015 to generate these conclusions.

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12

Effects of Trade Facilitation Measures on Trade Between China and Countries Along the Belt and Road Initiative

Juan Zhang and Zhouhong Wu

1 Introduction

The Belt and Road Initiative (BRI) proposed by China has five major goals, that is, policy coordination, facilities connectivity, unimpeded trade, financial integration, and people-to-people bonds. As trade facilitation and liberalization are ways to realize unimpeded trade, they attract a lot of attention. Although there is no consensus on its definition in the context of public policy, trade facilitation means simplifying and coordinating international trade systems and procedures. Trade facilitation aims to design a logical, transparent, and predictable environment for international economic communication, including customs procedures, and coordinated trade and transportation laws that are accepted globally, in order to secure the cross-border flow of goods and information. In the process of globalization, more issues were incorporated under

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trade facilitation, such as, the trade environment, the transparency and professionalization of customs procedures, and the unity of international and regional trading standards.

Trade facilitation is a key issue in international negotiation and policymaking. The Regional Comprehensive Economic Partnership, as a free trade agreement (FTA), is expected to impact over half of the global population in countries that make up 30% of global economic output and trade (Li et al. 2017). This FTA entered into force on February 22, 2017, following its ratification by two-thirds of the World Trade Organization (WTO) membership. It is estimated that the full implementation of the FTA will reduce trade costs by an average of 14.3% and boost global trade by up to US$1 trillion per year, with the biggest gains in the poorest countries (WTO 2017). As the BRI is new, there has been little research on the effects of trade facilitation on the trade between China and the Belt and Road countries (BRC) up to now.

This chapter examines this topic and is structured as follows. Section 2 is the literature review. Section 3 contains a trade facilitation index (TFI) system to evaluate the BRC and to study empirically the effects of trade facilitation on bilateral trade between China and these countries. Section 4 offers the conclusions and implications.

2 Literature Review

Trade facilitation is one of the most important issues in international trade agreement negotiations and domestic policymaking. As countries hope to improve trade and efficiency, they turn to trade facilitation measures. Some researchers have estimated the effects of various trade facilitation measures on trade. Engman (2005) and Francois et al. (2005) find positive relationships in their survey. Moïsé et al. (2011) built many trade facilitation indicators and found they could reduce trade costs by up to 10%. Countries that are primarily involved in the global value chain as suppliers (Hoekman and Shepherd 2015), and the least developed countries (Flentø and Ponte 2017), will gain benefits from trade facilitation initiatives such as WTO trade negotiation.

Countries that have signed FTAs find that close economic integration and a reduction of administrative barriers often lead to higher trade levels. Handley and Limão (2015) found trade-creating effects of EU accession for Portugal. Chen and Novy (2011) estimated that EU countries within the Schengen area, which are not subject to border controls, enjoyed 10% lower trade frictions than other EU countries. Hornok and Koren (2015) drew up a gravity model and estimated the ad valorem equivalent in Spanish shipment export data; they found a 50% reduction in per shipment costs equal to a 9% reduction in tariffs. The concept of multilateral resistance means that trade depends not only on a specific trade barrier measured in absolute terms, but also on its weight in the existent trade network (Anderson and van Wincoop 2003). Hübler (2016) introduced a new trade model combining the gravity model and a network analysis, using the World Input-Output Database, and found that the optimal trans-Pacific trade barrier between North America and Asia is estimated to be one-third of the current trade barrier. Shepherd (2016) found that over the 2002–2010 period, APEC taken as a whole did not meet the 10% trade cost reduction goal, however, about one-third of the forum's membership for which consistent data are available met or exceeded the 10% reduction goal.

Infrastructure is an important determinant of trade costs, bilateral trade, and comparative advantage (Yeaple and Golub 2007). Francois and Manchin (2013) used a panel of bilateral trade and a Poisson estimator, extended with the Baier and Berstrand method for multilateral resistance and to account for firm heterogeneity and selection, and found that trade depends on institutional quality and exporter and importer access to well-developed transport and communications infrastructure. Poor domestic infrastructure is often criticized as a key impediment for accessing international markets. Therefore, some scholars studied the impact of investment in infrastructure on international trade. Using Turkish international trade data at provincial level and changes in road capacity connecting them to Turkish international gateways, Coşar and Demir (2016) estimated the distance elasticity of trade associated with road capacity, and found the value of a 10-year stream of trade flows generated by a one-dollar investment in road infrastructure ranges from US$0.7 to US$2.

Some researchers compared the cost of domestic and international transportation infrastructures and emphasized the importance of investing in domestic transportation infrastructures. Anderson and van Wincoop (2004) estimated that domestic distribution costs are more than twice as high as international transportation costs (55% versus 21%). Rousslang and To (1993) documented that domestic freight costs on US imports are in the same order of magnitude as international freight costs. Reports by international organizations revealed similar points on policy initiatives. The WTO (2004) emphasized that an inadequate transportation infrastructure and an inefficient logistics sector can severely impede a developing country's competitiveness. The World Bank (2009) cited trade facilitation, incorporating domestic transportation, as its "largest and most rapidly increasing trade-related work." With rapid development in ICT, electronic customs innovation is taken as an improvement in governmental infrastructures to facilitate trade (Raus et al. 2009; Urciuoli et al. 2013).

BRC play an important role in global manufacturing, trade, and investment, but their trade facilitation has developed unevenly (Hanouz et al. 2014). The designing, building and operating of infrastructure is a key field for cooperation in BRI, and is also key to trade facilitation. Based on the border effect model, McCallum, Liang and Zhang (2016) found strong border shielding effects between China and neighboring countries, and that border effects are higher for exports than for imports. Infrastructure connectivity can significantly lower border shielding effects, wherein the contribution of air infrastructure is the highest and that of rail and ICT infrastructures is lower. Gong and Yin (2016) built a heterogeneous stochastic frontier model, using panel data of 29 provinces in China for 1998–2013, and found: a time saving in rail transportation; that distance narrowing could effectively improve export efficiency; and that distance narrowing of rail transportation could also moderate the fluctuation of export efficiency.

As the BRI is expected to improve infrastructure interconnectivity and unimpeded trade, and trade facilitation is a key issue influencing trade, it is necessary to evaluate the trade facilitation of BRC and study the effects of trade facilitation on bilateral trade between China and BRC.

3 Model, Data, and Regression

3.1 Trade Facilitation Evaluation

3.1.1 TFI System Establishment

This chapter studies previous TFI systems and attempts to build a new one. Wilson et al. (2003) measured trade facilitation against port efficiency (PE), customs environment (CE), regulatory environment (RE), and electronic business (e-business, EB), and found trade had a significant positive relationship with PE, and that other variables also contribute to trade. Based on the index system of Wilson et al. (2003) and secondary indicators from the World Economic Forum's *Global Competitiveness Report* (*GCR*), introducing financial environment (FE) as a level indicator, this chapter tries to build a TFI system reflecting the five factors of PE, CE, RE, EB, and FE, with 14 secondary indicators (see Table 12.1).

3.1.2 Trade Facilitation Evaluation Based on Analytic Hierarchy Process (AHP)

Weight Determination

The indicators in Table 12.1 are not measured in the same way, so they cannot be compared directly. Normalization is an effective way to address this, which requires all the original data to minus the minimum value of the index obtained, and then divide by the difference between the maximum and minimum values, the formula is:

$$Y_i = \frac{X_i - X_{iMIN}}{X_{iMAX} - X_{iMIN}},$$

wherein, X_i represents the original data, X_{iMIN} represents the minimum value of the index obtained, X_{iMAX} represents the maximum value of the

Table 12.1 Trade facilitation index system

Level indicators	Secondary indicators	Assessment criteria
Port efficiency (PE)	a1 Ports	1–7 points scoring criteria; higher is better
	a2 Air transport	1–7 points scoring criteria; higher is better
	a3 Burden of customs procedures	1–7 points scoring criteria; higher is better
Customs environment (CE)	b1 Irregular payments and bribes	1–7 points scoring criteria; higher is fewer
	b2 Trade barriers	0–100 points scoring criteria; higher is fewer
	b3 Corruption	0–100 points scoring criteria; higher is fewer
Regulatory environment (RE)	c1 Transparency of government policymaking	1–7 points scoring criteria; higher is better
	c2 Judicial independence	1–7 points scoring criteria; higher is better
	c3 Reliability of police services	1–7 points scoring criteria; higher is better.
Electronic commerce (EB)	d1 Internet users	Percentage proportion of Internet users in country/ region population
	d2 Fixed broadband Internet subscriptions	Number of fixed broadband Internet subscribers per 100 people
	d3 Usage of latest technologies	1–7 points scoring criteria; higher is better
Financial environment (FE)	e1 Availability of financial services	1–7 points scoring criteria; higher is better
	e2 Affordability of financial services	1–7 points scoring criteria; higher is better

index obtained, Y_i represents the normalized value of original data. This chapter selects Chinese trade partners' data, from 64 BRC, standardized, and calculates the secondary indicators for a TFI system.

The ultimate contribution of trade facilitation is reflected in reduced trade transaction costs and increased international trade. Therefore, it is reasonable to weight the secondary indicators by measuring their influence on trade. In a similar way, level indicators are given weight. The formulas are:

$$TFI = \sum_{i=1}^{5} A_i W_i$$

$$W_i = \sum_{j=1}^{3} B_j V_i,$$

wherein, A_i is the level indicator weight, B_j is the secondary indicator weight.

Data Source

This chapter empirically studies the effects of trade facilitation on trade between China and other BRC through index system building and model building, which is limited to available data. This study selected data from 64 countries over the period 2011 to 2014. The original data was sourced from the World Economic Forum's *GCR*.

Trade Facilitation Evaluation System Model

According to principal component analysis, the trade facilitation evaluation system model is established with the formulas (12.1)–(12.6):

$$TFI = 0.22 \times PE + 0.09 \times CE + 0.21 \times RE + 0.20 \times EB + 0.28 \times FE \tag{12.1}$$

$$PE = (a1 + a2 + a3)/3 \tag{12.2}$$

$$CE = 0.56 \times b1 + 0.09 \times b2 + 0.35 \times b3 \tag{12.3}$$

$$RE = (c1 + c2 + c3)/3 \tag{12.4}$$

$$EB = 0.3 \times d1 + 0.43 \times d2 + 0.27 \times d3 \tag{12.5}$$

$$FE = (e1 + e2)/2 \tag{12.6}$$

This chapter evaluates and compares the trade facilitation of countries along the BRI during 2011–2014 (see Table 12.2).

Table 12.2 Rank and score of trade facilitation of BRC (2011–2014)

Country	Rank	2011	Rank	2012	Rank	2013	Rank	2014
Afghanistan	54	–	54	–	56	–	55	–
Albania	27	6.69	29	7.18	30	7.40	27	7.77
Armenia	33	6.15	40	5.21	35	6.68	31	7.13
Azerbaijan	30	6.51	19	7.97	19	8.59	37	5.78
Bahrain	12	9.24	4	10.64	3	10.98	4	10.99
Bangladesh	51	3.89	51	3.90	52	3.99	50	4.00
Belarus	55	–	55	–	57	–	56	–
Bhutan	56	–	56	–	41	5.21	38	5.58
Bosnia and Herzegovina	23	7.02	23	7.65	24	8.09	57	–
Brunei	21	7.43	21	7.84	25	8.07	58	–
Bulgaria	20	7.44	22	7.74	22	8.25	22	8.41
Cambodia	50	3.92	48	4.28	51	4.09	51	3.94
Croatia	13	9.01	12	9.57	14	9.23	13	9.62
Czech Republic	8	9.58	9	9.94	9	10.04	11	10.18
Egypt	38	5.56	35	5.94	37	6.35	32	6.68
Estonia	1	10.77	2	11.13	2	11.21	2	11.37
Georgia	37	5.59	33	6.48	31	7.13	26	8.00
Hungary	10	9.52	13	9.23	10	9.98	9	10.24
India	42	4.84	42	4.97	45	5.15	44	4.68
Indonesia	45	4.53	41	5.06	43	5.19	41	5.20
Iran	46	4.32	43	4.76	44	5.17	39	5.57
Iraq	57	–	57	–	58	–	59	–
Israel	2	10.47	5	10.37	7	10.39	7	10.58
Jordan	25	6.80	32	6.51	34	6.88	30	7.16
Kazakhstan	34	6.13	28	7.22	26	8.04	24	8.10
Kuwait	29	6.54	17	8.48	17	8.73	19	8.57
Kyrgyz Republic	47	4.28	49	4.20	46	4.76	43	4.74
Lao	58	–	58	–	49	4.38	45	4.64
Latvia	7	9.71	8	10.02	6	10.45	5	10.93
Lebanon	32	6.30	25	7.35	21	8.31	18	8.59
Lithuania	11	9.50	7	10.07	12	9.78	10	10.21
Macedonia	18	7.55	18	8.12	18	8.69	16	8.76
Malaysia	14	8.69	14	9.07	13	9.43	17	8.61
Maldives	59	–	59	–	59	–	60	–
Moldova	31	6.34	31	6.51	33	7.02	29	7.59
Mongolia	49	3.98	45	4.62	48	4.40	47	4.57
Montenegro	17	7.64	44	4.64	27	7.91	23	8.27
Myanmar	60	–	60	–	55	2.80	54	2.83
Nepal	52	3.67	50	3.97	50	4.18	48	4.41
Oman	16	8.27	16	8.56	23	8.24	20	8.50
Pakistan	43	4.66	46	4.40	47	4.71	49	4.37
Palestine	61	–	61	–	60	–	61	–

(*continued*)

Table 12.2 (continued)

Country	Rank	2011	Rank	2012	Rank	2013	Rank	2014
Philippines	36	5.62	36	5.84	38	6.32	36	6.40
Poland	15	8.47	15	8.76	16	8.91	14	8.79
Qatar	9	9.54	3	10.71	5	10.83	6	10.82
Romania	26	6.78	27	7.30	28	7.73	25	8.03
Russia	22	7.10	24	7.47	15	9.09	15	8.78
Saudi Arabia	19	7.50	20	7.85	20	8.38	21	8.48
Serbia	28	6.58	30	6.77	32	7.10	42	4.78
Singapore	6	9.75	1	11.77	1	11.76	1	11.64
Slovak Republic	5	10.14	11	9.61	11	9.98	12	9.86
Slovenia	4	10.24	6	10.29	8	10.11	8	10.25
Sri Lanka	41	5.03	39	5.26	42	5.21	40	5.41
Syria	44	4.63	62	–	61	–	62	–
Tajikistan	48	4.26	47	4.39	62	–	46	4.59
Thailand	35	5.86	34	6.15	36	6.53	33	6.65
Timor-Leste	62	–	53	2.86	54	3.00	53	2.93
Turkey	24	7.01	26	7.31	29	7.55	28	7.63
Turkmenistan	63	–	63	–	63	–	63	–
Ukraine	40	5.34	38	5.77	40	5.93	34	6.59
United Arab Emirates	3	10.26	10	9.92	4	10.92	3	11.14
Uzbekistan	64	–	64	–	64	–	64	–
Vietnam	39	5.49	37	5.84	39	6.15	35	6.52
Yemen	53	3.32	52	3.77	53	3.89	52	3.92

Note: – = data not available

3.2 Empirical Analysis of the Impact of Trade Facilitation on Trade Flows

3.2.1 Methodology

Gravity models are widely used to find determinants of bilateral trade because of their sophisticated theoretical foundations. According to the gravity models developed by Tinbergen (1962) and Pöyhönen (1963), the size of bilateral trade has a positive relationship to gross economic output, but has a negative relationship to distance. This chapter builds a gravity model with trade facilitation indicators based on Linnemann (1966) to evaluate the effects of trade facilitation measures on trade between China and BRC. It uses a basic regression model as in Eq. (12.7) to show the effects of trade facilitation on bilateral trade as a whole, and

uses a revised regression model as in Eq. (12.8) to show the separated effects of level indicators. The study chose China and 64 BRC because of the limited data available.

$$\ln Trade_j = \alpha_0 + \alpha_1 \ln GDP_j + \alpha_2 \ln P_j + \alpha_3 \ln D_j + \alpha_4 \ln TFI_j + \alpha_5 Border_j + \alpha_6 Policy_j + \varepsilon_j \tag{12.7}$$

$$\ln Trade_j = \alpha_0 + \alpha_1 \ln GDP_j + \alpha_2 \ln P_j + \alpha_3 \ln D_j + \alpha_4 \ln PE_j + \alpha_5 \ln CE_j + \alpha_6 \ln RE_j + \alpha_7 \ln EB_j + \alpha_8 \ln FE_j + \alpha_9 Border_j + \alpha_{10} Policy_j + \varepsilon_j \tag{12.8}$$

3.2.2 Variable Description and Data Source

The meaning and source of variables in Eqs. (12.7) and (12.8) are shown in Table 12.3.

Table 12.3 Variables description

	Variables	Meaning	Source
Dependent variable	$Trade_j$	Export from China to country j	Chinese Statistic Yearbook
Independent variables	GDP_j	Nominal GDP of country j	World Bank
	P_j	population of country j	World Bank
	D_j	spatial distance between the capitals of China and country j	Google distance
	TFI_j	trade facilitation index	evaluated in this chapter
	PE_j	port efficiency	evaluated in this chapter
	CE_j	customs environment	evaluated in this chapter
	RE_j	regulatory environment	evaluated in this chapter
	EB_j	electronic commerce	evaluated in this chapter
	FE_j	financial environment	evaluated in this chapter
	$Border_j$	whether China borders on country j; 1 = yes, 0 = no	Google Map
	$Policy_j$	whether China signed FTA with country j; 1 = yes, 0 = no	MOFCOM

3.2.3 Regression Results

The study tested the effects of trade facilitation on China's trade flows with 64 countries along the Belt and Road using panel data and Eviews 8. Using an OLS estimation, regression analyses were conducted according to Eq. (12.7), with the results in Model 1 and Model 2 (see Table 12.4). Model 1 and Model 2 show that GDP, BRC population, the distance between China and partner BRC, and whether the partner country signed an FTA with China, all have a significant impact on bilateral trade; however, whether China borders on the partner country has an insignificant impact. The signs of the coefficients comply with the theoretical expectation. GDP, population, TFI, and whether China signed FTA with partner country have positive relationships with bilateral trade, while distance has a negative relationship with bilateral trade. The impact of TFI on bilateral trade is the biggest among these factors, and GDP has the lowest impact.

As TFI has the biggest impact on bilateral trade in Model 1 and Model 2, the authors wondered about the impact of its components and used five level indicators of TFI as independent variables, resulting in regressions according to Eq. (12.8) with OLS estimation, and got the results in Model 3 and Model 4 (See Table 12.4). Model 3 shows that RE and FE are not statistically significant, suggesting that bilateral trade flows between China and other BRC have statistically insignificant relationships with national regulatory and financial environments. However, these environments are critical indicators of TFI in *GCR* from the World Economic Forum. Eq. (12.1) shows that RE (with coefficient 0.21) and FE (with coefficient 0.28) play important roles in trade facilitation, and indicates that RE and FE make a strong contribution to trade facilitation, but have little impact on bilateral trade, which might be the result of inefficient administration. Model 4 shows the regression results without RE and FE and reveals that PE has the biggest impact and a positive relationship with bilateral trade flows, which shows that as part of trade facilitation, infrastructure has a significant impact on bilateral trade flows.

Table 12.4 Regression results

Variables	Model 1	Model 2	Model 3	Model 4
Con.	3.18	2.63	5.82**	5.02**
	(1.15)	(1.12)	(2.36)	(2.19)
ln GDP_j	0.19***	0.25***	0.12**	0.14***
	(3.86)	(5.06)	(2.37)	(2.82)
ln P_j	0.61***	0.57***	0.73***	0.74***
	(9.68)	(10.05)	(10.38)	(10.57)
ln D_j	−0.80***	−0.76***	−1.09***	−1.04***
	(−2.58)	(−2.97)	(−4.07)	(−4.09)
ln TFI_j	3.52***	2.01***		
	(8.07)	(8.07)		
ln PE_j			3.19***	2.31***
			(2.63)	(4.24)
ln CE_j			−0.84**	−1.49***
			(−3.14)	(−4.04)
ln RE_j			−1.28	
			(−1.10)	
ln EB_j			1.54***	1.56***
			(3.40)	(3.44)
ln FE_j			0.50	
			(1.00)	
$Border_j$	−0.17			
	(−0.61)			
$Policy_j$	0.79***	0.82***	0.66***	0.72***
	(3.23)	(3.23)	(2.89)	(3.18)

Note: ** = significance level of 5%
*** = significance level of 1%
t-value in brackets

4 Conclusions and Implications

This chapter builds a TFI system to assess the trade facilitation of 64 BRC during 2011–2014, then uses gravity models to study the effects of trade facilitation measures on trade flows between China and BRC. The results show that trade facilitation has the biggest positive relationship with bilateral trade. When looking into the level indicators, the study found that the variables RE and FE have no significant impact on bilateral trade, while PE is a key factor in promoting bilateral trade.

This chapter only studies the effects of TFI as a whole on bilateral trade between China and BRC and the individual effects of level indicators in a TFI system. However, it is necessary to study the effects of secondary

indicators in further research to tell the specific origin of different impacts on bilateral trade and to guide any decision making. Data on trade facilitation is updated continually, so it will be possible to reflect changes in trade facilitation among the BRC and their effects on bilateral trade in further research.

As facilities connectivity and unimpeded trade are two key issues in BRI, they have important implications for policymaking and economic development. The BRC should highlight their trade facilitation and guide investment and management in port, air transport, and ICT infrastructure. Besides the access to transport and ICT infrastructures, it is of great importance to improve their quality of service and to reduce the burden of customs procedures. The BRC are advised to improve their regulatory and financial environments to raise their administrative efficiency. A way to improve their RE is by making government policy more transparent, judicial systems more independent, and police services more reliable. The FE in BRC could be improved by making financial services readily available and more affordable. As more supply contributes to more competition and better service in transport and ICT infrastructures and financial departments, it is necessary to lower the entry barriers to these sectors for both domestic and foreign companies.

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13

How the Belt and Road Initiative Affects China's Outward FDI: Comparing Chinese Independent Firms and Business Group Affiliates

Ping Lv, Chenxi Guo, and Xuchang Chen

1 Introduction

The recent evolution of internationalization has been characterized by significant growth in outward foreign direct investment (OFDI) by emerging market firms. From the Reform and Opening-up policy in 1979, to the Going Global initiative in 1999, WTO entry in 2001, and final liberalization of OFDI by private firms in 2003, China has experienced a gradual process of liberalization of its OFDI regime, in line with the country's overall economic reforms (Kiggundu and Hui 2008). According to the 2016 *Statistical Bulletin of China's Outward Foreign Direct Investment*, China's OFDI in 2016 reached a peak of US$1961.50

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billion, an increase of 34.7% compared to the previous year. By the end of 2016, 2.44 million domestic investing entities had established about 37,200 overseas subsidiaries, spread over 190 countries (regions) globally. Therefore, attention has been paid to the forces driving OFDI from China, including market potential (Liu et al. 2017), natural resources (Kang and Liu 2016), FDI openness (Carlos and Ricardo 2011), industrial structure and human resources (Wang et al. 2012), and so on. A new institution economics theory has been applied to explain Chinese OFDI. Institutional theory argues that the institutional environment determines trading customs and organizational structures of emerging countries' firms. Given that social and cultural environments have a profound influence on factor markets, the formation and evolution of enterprise groups in emerging countries are greatly influenced by institutional factors (Khanna and Yafeh 2007; Khanna and Rivkin 2001). Some scholars have pointed out that the institutional environment is likely to have far-reaching effects on the internationalization decisions of Chinese firms, due to state control of the Chinese economy (Du and Boateng 2015; Scott 2002; Yang and Deng 2015).

In September 2013 Chinese President Xi called for building "the Silk Road Economic Belt" when he visited Kazakhstan. A month later he delivered a speech in the Indonesian Parliament, again proposing the joint construction of "the Twenty-First-Century Maritime Silk Road." By taking the silk road economic belt and the twenty-first-century maritime silk road as its axes, the Belt and Road Initiative (BRI) is now the largest platform for national cooperation and reflects the new approach of China's development and diplomatic strategy. The BRI has been written into the national development strategy as a further extension of the Going Global strategy; what impact BRI will have on Chinese OFDI is still unknown, and it is our first research question.

Furthermore, in emerging economies the existence of business groups is usually regarded as a substitute for inefficient institutions.[1] However, the substitution effect of business groups may decline with the enhancement of external markets and institutional environments (Chang 2003; Khanna and Palepu 1997; Kim 2010). For example, the BRI has greatly improved the institutional environment of China's OFDI. In particular, it has deregulated overseas investment significantly through the

new management mechanism called "recordation mainly and supplemented with confirmation," which may affect the control of business groups in their affiliates' OFDI strategies. Therefore, our second research question looks at whether the BRI has different impacts on various types of firms (such as business group members versus independent firms).

The extant studies on the effectiveness of the BRI are confined to qualitative analyses, so knowledge of how market institutional reform affects the special organizational form of business groups remains inconsistent. By using the data on Chinese listed independent and business group member firms during 2010–2015, this chapter examines the relationship between the BRI and Chinese OFDI strategy, particularly the impact of the BRI on independent firms and business group members. First, our empirical results show that the BRI promotes Chinese independent firms' OFDI. Improvements in the home country's institutional environment reduces the risks and restrictions on firms' overseas operations and has a positive effect on independent firms' overseas investments. This result is in line with Luo et al. (2010). Second, the BRI motivates Chinese OFDI by business group members, and there is a complementary effect between business groups and institutional reform. As a substitute for institutional imperfection in emerging economies, we found that the business groups' substitution effect does not decrease in the process of institutional reform (Bhaumik et al. 2016). Finally, the BRI has larger positive effects on business group members than on independent firms. One possible reason is the heterogeneity between independent firms and business group members. The competitive advantages developed by the accumulation of resources and capabilities can be transferred effectively into new product markets and new foreign markets. In the meantime, business group members can obtain government funds and policy support with the backup of business groups, known as the "snowball effect." However, all this is not available to independent firms. Another possible reason is that the BRI is in the early stages of multinational cooperation, which mainly aims to improve the infrastructure in host countries, and carries a high investment risk. Compared with independent firms, the group members' vulnerability to overseas investment risks are reduced, due to the financial and policy support provided by business groups.

2 Theoretical Analyses and Hypotheses Development

As for the determinants of internationalization, early scholarly attention has been largely focused on a firm's specific resource capability and the institutional environment of host countries (Henisz and Zelner 2005; Lu et al. 2014). However, given that Chinese firms remain at a relatively early stage of internationalization, it turns out that their strategic resources are usually weaker than those of their global rivals (Hitt et al. 2001; Nolan 2001), so the possession of resources may not result in internationalization. A body of theoretical work has emerged concerning the institutional theory of overseas strategies that helps to explain the distinctiveness in the behavior of Chinese OFDI (Peng 2002; Wright et al. 2005). You (2017) highlights the importance of government policies; while Buckley et al. (2007) summarize five key stages for Chinese OFDI policy development: (1) cautious internationalization (1979–1985); (2) government encouragement (1986–1991); (3) expansion and regulation (1992–1998); (4) implementation of the Going Global policy (1999–2001); and (5) post-WTO period (since 2001).

Although Chinese firms possess fewer strategic resources than developed countries, appropriate government support associated with FDI policies in the home country may enhance firm capabilities to take risks, compensating for the lack of international experience and knowledge about foreign markets, and accelerating the internationalization process (Buckley et al. 2010). In emerging markets, government support from the home country can be crucial for firms' OFDI (Lu et al. 2014). For example, Chinese firms became high performers in overseas investments after the Going Global policy. In September 2013 Chinese President Xi Jinping delivered the speech "Promote People-to-People Friendship and Create a Better Future" at Kazakhstan's Nazarbayev University, in which he called for building the Silk Road Economic Belt jointly and stimulating common development across a vast region. A month later, in the Indonesian Parliament, President Xi called for the creation of the Asian Infrastructure Investment Bank (AIIB) to provide infrastructure construction services to Asian countries, including ASEAN, and for China

and Indonesia to jointly build the Twenty-First-Century Maritime Silk Road. So far, China has declared the BRI as its new national development strategy. As an extension of its Going Global strategy, the BRI advances the institutional environment of Chinese firms' OFDI and loosens controls on overseas investment. Tables 13.1 and 13.2 present the BRI related policies and countries, respectively.

Table 13.1 Relevant policies on the BRI

Date	Conference or policy documents	Policy content
November 2013	Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform	Speed up the pace of opening border areas, and allow key ports, border cities, and economic cooperation zones in the border areas to implement special modes and policies with regard to personnel exchange, processing and logistics, tourism, and other areas. Set up development-oriented financial institutions, accelerate the construction of infrastructure connecting China with neighboring countries and regions, and work hard to build a Silk Road Economic Belt and a Maritime Silk Road, so as to form a new pattern of all-round opening.
December 2013	Overall requirements and major tasks for economic work in 2014	Promote the construction of the Silk Road Economic Belt, formulate strategic planning, strengthen the infrastructure construction for Asian connectivity. Build the twenty-first century Maritime Silk Road, strengthen sea lanes for Asian connectivity, and intertwine mutual interests.
March 2014	The Second Session of the Twelfth National People's Congress	Intensify the planning and building of the Silk Road Economic Belt and the twenty-first century Maritime Silk Road; promote construction of the China–Pakistan and the Bangladesh–China–India–Myanmar economic corridors. Speed up infrastructure connectivity with neighbors by launching a number of major projects, and enhance international economic and technological cooperation.

(*continued*)

Table 13.1 (continued)

Date	Conference or policy documents	Policy content
November 2014	The eighth meeting of the Central Leading Group on Financial and Economic Affairs	Establish the Silk Road Economic Belt and the twenty-first century Maritime Silk Road, initiate the establishment of the AIIB and the Silk Road Fund. President Xi emphasizes that the AIIB is designed to provide financing support for countries along the Belt and Road to carry out infrastructure, and the Silk Road Fund is to directly support the construction of the BRI using China's capital strength.
November 2014	Connectivity Spearheads Development and Partnership Enables Cooperation	Invest US$40 billion in the establishment of the Silk Road Fund. The core content of the first step of the BRI includes: breakthroughs in transport infrastructure development; giving priority to railway and highway projects linking China to neighboring countries; realize early connectivity among Asian countries.
December 2014	Central Economic Working Conference	Officially list the BRI as a focus regional economy development strategy in 2015. President Xi emphasizes the implementation of the BRI, Beijing–Tianjin–Hebei integration initiative, and Yangtze economic belt strategy.
February 2015	Third Session of the Twelfth National People's Congress	Incorporate the establishment of BRI with regional development and opening up, enhance the construction of the new Eurasian land bridge and coastal and border ports fulcrums.
March 2015	Strategic Agenda for the establishment of the Silk Road Economic Belt and the twenty-first century Maritime Silk Road	Strengthen the transportation infrastructure connectivity of neighboring countries, promote the facilitation of international road transport.

Resources: The State Council, the National People's Congress of the PRC, Ministry of Commerce of the PRC

Table 13.2 Countries along the BRI

Area	Country	Amount
East Asia	Singapore, Thailand, Vietnam, Malaysia, Indonesia, Philippines, Burma, Kampuchea, Brunei, Laos, East Timor, Mongolia	12
West Asia	Kazakhstan, Uzbekistan, Turkmenistan, Kyrgyzstan, Tajikistan, Bangladesh, Pakistan, India, Sri Lanka, Nepal, Afghanistan, Maldives, Bhutan, Turkey, Iran, Russia	16
Middle East and North Africa	Iraq, Jordan, Qatar, Saudi Arabia, the United Arab Emirates, Yemen, Egypt, Lebanon, Israel, Kuwait, Oman, Bahrain, Azerbaijan, Georgia, Armenia, Syria, Palestine	17
Europe	Poland, Czech Republic, Hungary, Slovakia, Romania, Ukraine, Slovenia, Lithuania, Belarus, Bulgaria, Serbia, Croatia, Estonia, Latvia, Bosnia and Herzegovina, Albania, Macedonia, Moldova, Montenegro	19
Total		64

Resources: The State Council, the National People's Congress of the PRC, Ministry of Commerce of the PRC

Before the Going Global strategy, China was in the early stages of reform and opening up, with a volatile institutional system and market imperfections (Luo and Tung 2007). To avoid institutional and market disadvantages, independent firms tended to establish partnerships, such as business groups, and to form intra-group transactions to reduce transaction costs between firms, external capital, and labor markets (Holmes et al. 2016). The view that a business group is a substitute for external inefficient markets and poor institutional environments received support in previous studies looking at internal capital markets (Belenzon et al. 2013; Riyanto and Toolsema 2008), internal labor markets (Chung and Luo 2013; Belenzon and Tsolmon 2016), and internal transaction markets (Wan 2005). Business groups help their affiliates explore new opportunities, exploit new products, and expand to new markets through providing internal factor markets and policy support (Holmes et al. 2016).

For firms not affiliated to business groups, improvements in external institutional environments in emerging markets can lower the uncertainty and cost of market transactions. Specifically, support from the

home country can reduce the risks in overseas operations and firms' liabilities of foreignness (Luo et al. 2010). For instance, the promotion of BRI effectively reduces the restriction of administrative approval of firms' OFDI.[2] To push the BRI strategy, China has simplified customs procedures, optimized the clearance environment, and promoted trade facilitation by means of cooperation agreements with the customs, ports, and railway departments of countries along the route. By the end of 2016 China had signed bilateral agreements, multilateral agreements, and enterprise cooperation projects with more than 50 countries. Therefore, BRI facilitates OFDI by independent firms. We propose:

Hypothesis 1: *There is a positive relationship between the BRI strategy and the OFDI of independent firms.*

However, for firms affiliated to business groups, the improved institution may weaken (Chang and Hong 2002; Khanna and Palepu 2000) or have negative effects on their performance (Lee et al. 2008). At the same time, business groups in emerging markets are growing, and their internal efficiency is also increasing (Carney et al. 2011), but the number of business groups is not decreasing (Bhaumik et al. 2016). The dividend from institutional reform contributes to both independent firms and business group members. For example, as India's capital market and institutions have improved, business group members have received a higher return on assets (Chittoor et al. 2015), and Tobin's Q Ratio (Manikandan and Ramachandran 2015) than have independent firms. Therefore, the BRI might also stimulate business group members' OFDI. We propose:

Hypothesis 2: *There is a positive relationship between the BRI strategy and the OFDI of business group members.*

Comparing the impact of BRI on independent firms and business group members, we argue that the BRI is more likely to reinforce the OFDI tendency of business group members than independent firms. There are two possible reasons: *the heterogeneity of independent firms and business group members*, and *the stage of the BRI*. For the former reason, from the perspective of independent firms, their capabilities for catering

to perfect markets and seizing opportunities in the face of reform are weakened, due to the poorly functioning institutions. While, for business groups, their accumulated scale effect, organizational skills, reputation, experience, and social networks may offer their members a more efficient accessibility to new products and global markets in the context of BRI. In this process, compared with independent firms, business group members may gain more favorable resources and government support in light of their "parents'" competitive advantage (Carney 2008; Khanna 2015; Manikandan and Ramachandran 2015). These competitive advantages can be strengthened by reform dividends and expanded to other areas. For the second reason, the majority of participant countries in the BRI are middle- and low-income economies (see Table 13.2), with underdeveloped systems, insufficient infrastructure, and inefficient operations. The BRI is in the early stages of multinational cooperation at the time of writing, and it mainly aims to improve the infrastructure of the host country, such as railways, highways, ports, electricity, telecommunications, and energy pipelines. The infrastructure investment and operations are usually much more costly than ordinary commodity manufacturing. Therefore, compared with independent firms, business group members can access more capital and policy support from their parent corporations to defend against overseas investment risks. As a result, we propose:

Hypothesis 3: *Compared with independent firms, the BRI strategy has more positive effects on business group members.*

3 Data and Methodology

3.1 Data

Since the BRI was issued in 2013, to ensure the same time period before and after the policy, we used a sample of listed companies in the Shanghai and Shenzhen stock markets over the period 2010–2015. First, to identify if a company was independent or affiliated, we checked two reports: 2008 *China Large Business Groups*, and 2014 *Annual Development Report of China Large Business Groups*. Second, we used a firm's final controller

information from their 2015 annual reports as a double check. Third, we adopted the business group criteria issued by the State Administration for Industry and Commerce of China to determine whether the listed company was affiliated to a business group. A business group should satisfy the following requirements: (1) its core or parent company has a registered capital of RMB 50 million or more; (2) it has at least five member firms; (3) the total registered capital, including all core or parent companies and member firms, is more than RMB 100 million. We excluded delisted, ST (Special Treatment),[3] and missing data, which gave us 2456 listed firms as the final sample, among which 1554 were business group members and 858 were independent firms.

3.2 Measures

OFDI was used as the dependent variable in this study. It is worth stressing that the number of deals is a more appropriate unit of analysis than the value of the investment when investigating the OFDI of multinationals, because the location choice and motivation of the investment might be largely independent of the amount of capital invested (Amighini et al. 2014). Therefore, we used a dummy variable: OFDI is labeled as 1 if a firm has OFDI, 0 otherwise.

The two independent variables used are dummies. The first is BRI, were 1 means that the BRI policy has been implemented (2013 and after), and 0 means the BRI policy has not been implemented (before 2013). The second independent variable is the type of firm (affiliated). The variable takes the value 1 if the firm is affiliated to a business group and 0 if the firm is an independent one. Lu et al. (2014) support the empirical feasibility and robustness of dummy variables used in both dependent and independent variables.

In line with prior studies, control variables at firm level were incorporated into the econometric model, including firm size, firm age, industry, return on asset (ROA), research and development investment (R&D), ownership concentration, and dual (if chairman of the board and president are the same in one listed firm).

The measurement of all variables and data sources is listed in more detail in Table 13.3.

Table 13.3 Variables and data sources

Variables	Measurement	Data sources
Dependent variable		
OFDI	1 = firm has OFDI, 0 = otherwise	Ministry of Commerce
Independent variables		
BRI	1 = BRI has been implemented (2013 and after), 0 = otherwise.	Ministry of Commerce
Affiliated	1 = firm is affiliated to business group, 0 = firm is independent	2008 China Large Business Groups, 2014 Annual Development Report of China Large Business Groups, Firm's Annual Report
Control variables		
Firm age	Number of years since the founding of the firm	Firm's Annual Report
Industry	The industry a firm belongs to	Firm's Annual Report
Firm size	Log of number of employees	Firm's Annual Report
ROA	The return on equity of a firm	Firm's Annual Report
R&D	Research and development investment	Firm's Annual Report
Concentration	Herfindahl-Hirschman Index of the top five shareholders	Firm's Annual Report
Dual	1 = chairman of the board and president are the same, 0 = otherwise	Firm's Annual Report

3.3 Data Analysis Method

To test the hypothesis with respect to the impact of BRI on Chinese independent firms and business group members' OFDI, we adopted the commonly used Difference-in-Differences (DID) model to evaluate the effectiveness of the BRI policy. We used the following model specification:

$$OFDI_i^t\left(DOI_i^t\right) = \beta_0 + \beta_1 BRI + \beta_2 Affiliated + \beta_3 BRI \times Affiliated + \beta_4 F_{controli} + \beta_5 G_{controli} + \varepsilon_i^t$$

Since the seminal work by Ashenfelter (1978) and Ashenfelter and Card (1985), the DID model has been widely used in the fields of finance

and economics. According to Imbens and Wooldridge (2009), in natural experiments, since both the treatment group (the sample affected by the policy) and the control group (the sample not affected by the policy) come from a specific group that is affected by a target policy rather than a random group, the DID model is capable of removing systematic biases between the treatment and control groups, and examines changes in the treatment group before and after the implementation of the policy. In this study, we focused on the analysis of regression coefficient β_3, which is a double differencing statistic, measuring the net impact of the BRI on Chinese OFDI after considering changes in the control group.

3.4 Empirical Results and Discussion

Table 13.4 presents the descriptive statistics and correlations of the variables used in the study. Because the variance inflation factors are well below the recommended threshold of 10, multicollinearity is not a serious issue in our models.

Table 13.5 shows the empirical results of the DID model. Model M I-1 tests the effect of the BRI on independent firms' OFDI. The positive and significant coefficient in M I-1 indicates that the BRI can increase the probability of independent firms investing abroad. Hypothesis 1 is supported. This result is consistent with Luo et al. (2010) that improvement of the institutional environment in the home country reduces the risks and restrictions of overseas operations and facilitates Chinese OFDI of independent firms. As can be seen from Model I-2, the coefficient between the BRI and business group members is significantly positive. Hypothesis 2 is also supported. As a substitute for institutional weakness, the number of business groups did not decrease in the process of reform (Bhaumik et al. 2016). Since they benefit from the reform in the same way as non-affiliates, business groups and a perfect external institutional environment are mutually complementary. Hence, business group members can grow and expand into overseas markets with support from their parent corporations. The results indicate that the BRI can increase the probability of Chinese OFDI of both types of firms.

Table 13.4 Descriptive statistics and correlation matrix

Variable name		Mean	SD	1	2	3	4	5	6	7	8
1	OFDI	0.47	0.5								
2	Affiliated	0.75	0.43	0.017							
3	Age	14.24	5.76	−0.003	0.017						
4	Industry	0.51	0.5	0.304	0.009	−0.105					
5	Size	1.58	1.28	0.012	0.018	−0.005	−0.082				
6	ROA	5.17	55.14	−0.008	0.008	−0.017	0.002	−0.003			
7	R&D	0.67	0.15	0.039	0.007	−0.014	0.037	0.004	−0.001		
8	Concentration	0.55	0.24	0.077	0.014	0.166	−0.109	0.105	−0.015	0.022	
9	Dual	0.18	0.39	0.046	0.019	−0.034	0.099	−0.042	0.003	0.028	−0.095

Note: Correlations with absolute value greater than 0.012 are statistically significant at $p<0.05$(two-tailed)

Table 13.5 The effect of the BRI on OFDI strategies by independent firms and business group members

	M I-1	M I-2	M I-3	M I-4	M I-5
	Independent firms	Business group members	Before BRI	After BRI	Full sample
BRI*Affiliated					0.056*
BRI	0.002**	0.031*			0.086*
Affiliated			0.097*	0.104*	0.093**
Age	0.184***	0.157***	0.077***	0.123***	0.079***
Industry	0.114	0.136	0.162	0.144	0.087
Size	0.699***	0.754***	0.753***	0.889***	0.826***
ROA	0.655***	0.549***	0.650***	0.632***	0.691***
Research	0.348	0.339	0.474	0.423	0.325
Concentration	0.191***	0.228***	0.132***	0.105***	0.280***
Dual	0.190***	0.150***	0.283***	0.085***	0.274***
Cons	−8.697	−8.694			−8.697
Firm Fixed	Yes	Yes	Yes	Yes	Yes
Year Fixed	Yes	Yes	Yes	Yes	Yes
Wald chi2	693.51***	693.51***	693.16***	693.16***	693.16***
LL	−4607.2	−4607.2	−4607.2	−4607.2	−4607.2

Note: ***P<0.001, **P<0.01, *P<0.1

M I-3 and M I-4 examine the difference of pre- and post-BRI policy on independent firms and business group members' OFDI. The coefficients in M I-3 and M I-4 are significantly positive. This result shows that compared with independent firms, business group members were more likely to invest abroad both before BRI and after BRI. Furthermore, as we can see from the double differencing model M I-5, the coefficient of *BRI*Affiliated* is significant and positive, indicating that the BRI has a stronger effect on business group members than on independent firms. In other words, the BRI has greatly increased the probability of business group members undertaking OFDI while only slightly affecting independent firms. The first reason may be the heterogeneity between independent firms and business group members, since the latter can access more resources and policy support from their parent corporations. Another reason may be the early stage of multinational cooperation under BRI. The cooperation projects mostly focus on the development of host countries' infrastructure,

resulting in high risks. Due to the powerful financial and policy support from business groups, affiliates are more immune to overseas risks than non-affiliates.

4 Conclusion

For firms from emerging markets, improvements in host country institutional environments play an indispensable role in a firm's international strategies (Cui and Jiang 2012; Lu et al. 2014; Luo and Tung 2007). As a profound and positive policy after Going Global, the BRI strategy has played an important role in China's economic development, including Chinese OFDI, since its launch in 2013. However, the extant literature on the BRI strategy has only been limited to qualitative research. In addition, there is no consistent conclusion on how institutional reform affects business groups, a special organizational form, in emerging markets. Accordingly, in this chapter, we focus on how the BRI—a completely exogenous institutional reform—drives Chinese OFDI by two types of firms, namely independent firms and business group affiliates, by using data on listed companies from 2010 to 2015. The empirical results reveal that the BRI can advance OFDI by both independent firms and business group affiliates; furthermore, the BRI has a greater push effect on business group members' OFDI than on independent firms' OFDI.

The study makes several contributions to the international business literature. First, the existing literature on the impact of home country institutions on OFDI does not distinguish between independent firms and business group affiliates. Given the heterogeneity of resource endowments and corporate governance between independent firms and business group affiliates, the home country institutional environment may have different effects on their OFDI. Second, previous studies have been inconclusive about how improvements in external factor markets and institutional environments affect the substitution effect of business groups. In the absence of perfect institutions in emerging markets, business group members depend on their parent company to form a substitution effect to the external imperfect institutions. However, our empirical results show that as external institutional environments improve, this

substitution effect does not decrease (Bhaumik et al. 2016), but gradually evolves into a complementary effect between business groups and external institutional environments, which jointly facilitates the development of business group members. Third, prior studies on the BRI are confined to qualitative analyses. Our study empirically examines the effectiveness of the BRI policy on different types of Chinese firms.

This chapter is also of great practical significance. First of all, for policymakers, the improvement of the home country's institutional environment is an important driver for firms' OFDI. This conclusion is not limited to the BRI policy in the realm of international business, but can also be used in reference to institution design and reform in other areas. Second, business managers need to seize the opportunity of the BRI and reform dividends to advance their internationalization strategies. To go a step further, affiliate decision makers need to realize that the group's power and resources are central to a firm's international expansion and make good use of it. For dependent firms, seeking alliances or good relationships with groups or big enterprises may allow them to gain more competitive resources in international markets. Finally, our findings have important implications for advanced market managers. With the growing need for them to evaluate developing countries' OFDI firms as potential competitors, managers will benefit from identifying whether the firm is affiliated to a business group (Chari 2013). The results note that OFDI by affiliates has a higher possibility of posing a competitive threat in international markets.

Notwithstanding the pertinence and novelty of this study, we can identify some limitations and suggest avenues for further research. First, given that BRI cooperation is still in its infancy, we have only analyzed the data over a short period, 2010–2015. Future research may consider extending the data period. Second, as an institutional reform in international business, the BRI has coevolved as a complementarity, rather than as a substitution, with the business groups. This conclusion may not apply to institutional reform in other areas in emerging markets, which needs further discussion. Third, differences among groups may affect their affiliates to varying degrees, such as size, ownership, and diversification (Kim et al. 2004). To examine whether these differences could be reflected in the affiliates' OFDI might be an interesting avenue for extended theorizing about the role of business groups in overseas strategies.

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Notes

1. Given the widespread definitions of a business group, this chapter identifies them on the basis of ownership and control relationships, in line with Collin and Umans (2008), and defines a business group as an economic association, consisting of a controlling owner and separate corporations linked by ownership, contract form, social relations and the like. This chapter uses North's (1990) definition of institutions as being "the rules of the game in a society or, more formally, the humanly devised constraints that shape human interaction."
2. In 2013, the BRI was promoted as the national strategy in the Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform, which was adopted at the Third Plenary Session of the Eighteenth Central Committee of the Communist Party of China.
3. ST is a particular regulation for the exchange to prompt the risk to investors. In 1998 the Shanghai and Shenzhen Stock Exchanges announced special treatment for listed companies; if they had an abnormal financial status that could result in the termination of their shares, their stock would be marked with ST (Ni and Li 2011).

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14

Competitive Advantages of China's Agricultural Exports in the Outward-Looking Belt and Road Initiative

Vasilii Erokhin and Tianming Gao

1 Introduction

China's agricultural production and exports have undergone significant structural changes since market reforms started in China in 1978, allowing subsequent changes in comparative advantages of the country, such as shifting from land intensive agriculture to labor intensive manufacturing (Lim and Feng 2005). Consequently, the commodity composition of trade has changed and the export portfolio has become more consistent with China's comparative advantage, compared with the pre-reform period (Lardy 1994). With income growth and significant changes in consumption tastes and preferences during the 1980s to 2000s, there was a transition from chronic shortages to an equilibrium, or even excess, in supply of agricultural products in China (Cheng 2007), allowing the country to be self-sufficient in the main crops and to become a net

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exporter of many agricultural commodities. However, Wailes et al. (1998) pointed out that after 20 years of reforms the growth rates for China's agricultural trade were still slower than for total trade, and that the share of agricultural trade in total trade had declined, while agricultural trade roughly adhered to the laws of comparative advantage.

There have been attempts to study China's foreign trade policy. Dohmen (1976), Lu (1997), Mariani (2013), Hamrin and Zhao (1995), Wu (2006), and Liberthal (2004) provided an in-depth analysis of China's general foreign trade policy. Cass et al. (2003), Lardy (2002), Panitchpakdi and Clifford (2002), and Anderson et al. (2010) studied the implications of China's membership of the WTO on both China's internal policies and foreign trade. Recent studies of China's contemporary trade policy in relation to the BRI by Bondaz et al. (2015), Zhang (2016), Shah (2016), and Wong et al. (2017) acknowledged that the BRI could be an active driver of China's exports to Eurasia, but warned that the effective implementation of a trade policy over the medium- to long-term depended on the utilization of competitive advantages. He et al. (2016) carried out empirical research on agricultural trade between China and the BRI countries and concluded that both sides should strengthen and diversify trade cooperation on agricultural products on the basis of existing bilateral and multilateral mechanisms to achieve common development. However, according to Wong et al. (2017), despite China's desire to explore new market opportunities, increasing influence of China in Eurasia through the BRI will inevitably face antagonism from key regional economic powers. In such conditions, soft economic power and development of existing competitive advantages may provide a background for the promotion of China's exports in the region. Analysis of competitive advantages in China's export of agricultural products has received little attention because most studies on the competitiveness of China's exports were done on manufactured exports. This chapter attempts to analyze China's comparative and competitive advantages in trade of agricultural products. The authors' contribution is to test a tool for the assessment of the competitiveness of various agricultural commodities in China's export portfolio and to develop a set of policy measures aimed at diversifying exports for a nation's comparative advantage in terms of the implementation of the BRI.

2 Literature Review

There have been many approaches to measuring competitive advantages and export specialization of countries. One of the commonly accepted methodologies is the Balassa index of revealed comparative advantage (RCA) (Balassa 1965). In relation to China's agricultural trade, Tian et al. (2016) employed the Balassa index to assess the trade margins of China's agri-food export growth. Fang and Beghin (2000) studied comparative advantages in China's agricultural trade and discovered that the production of grains and oilseeds suffered from a comparative disadvantage over other crops in China. He (2010) modified the RCA index to the study the dynamics of China's agricultural trade patterns and found that China's comparative advantages had deteriorated during the previous decades. He et al. (2016) used RCA coupled with the Trade Complementarity Index to empirically analyze trade competition and complementarity of agricultural products between China and the BRI countries. The conclusion was that trade competition and complementarity of agricultural products between China and the BRI countries coexisted, but its complementarity appeared to be more remarkable.

However, the Balassa index by itself is insufficient for describing the competitive positions of particular products, since it identifies revealed comparative advantages rather than determining the underlying sources of such advantages. Also, the Balassa index does not allow for the division of comparative advantages into natural and acquired ones. One of the most efficient tools for identifying competitive advantages regarding export volumes of a country and its relative trade shares is the Vollrath index of relative trade advantage (RTA). It is a comparison of how well a country has performed in exporting a particular set of products compared to the total export of all its products (Vollrath 1985). The Vollrath index considers both exports and imports, and demonstrates net trade advantages and disadvantages. However, when assessing the competitiveness of particular products in a country's export portfolio, it is crucial to examine the extent to which the comparative advantages are consistent with competitiveness (Seyoum 2007).

There have been many attempts to increase the consistency between various measures and improve the relevance of analyses. One of the most interesting methods is testing RCA and RTA values using the Lafay index. This index considers the difference between each product's normalized trade balance and the overall normalized trade balance (Maitah et al. 2016). It also weights each product's contribution according to its particular importance in trade. Maitah et al. (2016) used a three-indices approach for the analysis of the positions of agricultural producers both in comparison to domestic producers from other sectors and in relation to their foreign competitors. Ishchukova and Smutka (2013a, b) analyzed specialization and competitive performance in the Russian agricultural sector and identified a group of products with relatively stable comparative advantage. Ishchukova (2013) and Benesova et al. (2017) implemented Balassa, Vollrath, and Lafay indices to discover the comparative advantages of agricultural exports and to distinguish several groups of commodities in the export portfolio of a country, depending on the amount of foreign exchange, comparative advantage, and trade balance.

A three-indices approach seemed very promising for assessing the competitiveness of an export portfolio, since it reveals comparative advantages of a country in its exports, discovers competitive advantages in both exports and imports, and weights each product's contribution to the export portfolio. However, the approach has never been implemented to assess comparative and competitive advantages of China's agricultural export. As distinguished from existing works for other countries, in this chapter the authors apply the three indices to the same dataset in relation to China and calculate the Lafay index not for individual regions, but for the same array of products constituting China's export portfolio. As a logical conclusion to the consequent comparison of the indices' values, products have been divided into groups depending on the concurrence of the indices, not on the relationship between comparative advantage and trade balance. Additionally, for each group there have been developed differentiated policy measures aimed at support, promotion, development, or establishment of a competitive advantage.

3 Methodology

To assess the competitiveness of particular products in a country's export portfolio, the study employed the five-stage process. In the first stage, the authors discovered the revealed comparative advantage of a country using the Balassa index:

$$RCA = \left(X_{ij} / X_{it}\right) / \left(X_{nj} / X_{nt}\right) = \left(X_{ij} / X_{nj}\right) / \left(X_{it} / X_{nt}\right), \quad (14.1)$$

where *RCA* = revealed comparative advantage; *X* = export; *I* = country; *j* = commodity group (domestic market); *t* = commodity group (international market); and *n* = group of countries.

According to the Balassa index, a country specializes in the export of a particular product if the market share of such product is above average or, equivalently, if the weight of the product in a country's exports is higher than the weight of the same product in the reference area's exports. For the purposes of this study, the Balassa index determines what commodity groups take the most important part in a country's export structure.

In the second stage, after identifying the products for which RCAs in export were above 1, the authors assessed relative trade advantages for the same dataset using the Vollrath index:

$$RTA = \left(\left(X_{ij} / X_{it}\right) / \left(X_{nj} / X_{nt}\right)\right) - \left(\left(M_{ij} / M_{it}\right) / \left(M_{nj} / M_{nt}\right)\right), \quad (14.2)$$

where *RTA* = relative trade advantage; *X* = export; *M* = import; *i* = country; *j* = commodity group (domestic market); *t* = commodity group (international market); *n* = group of countries.

After discovering the products for which RTAs were above 0, the authors applied the results to the RCAs, compared the two sets of products, and identified those export items that had advantages on both indices. The use of the two indices for the same dataset reduced the risk of random error.

Since both RCAs and RTAs are structural, it is important to eliminate the influence of cyclical factors (Zaghini 2003), which is why at the third stage the authors calculated the Lafay index:

$$LI_{ij} = \left(1000 / Y_i\right) * \left(2^* \left(X_{ij} M_i - X_i M_{ij}\right)\right) / \left(X_i + M_i\right), \qquad (14.3)$$

where: LI = Lafay index; X = export; M = import; i = country; j = commodity group.

After calculating the three indices for the same set of products, the authors identified those export items that had competitive advantages in all three cases, those that had no advantages at all, and those with advantages on one or two of the indices. At the fourth stage, the authors divided them into four groups according to their competitiveness (see Table 14.1).

When RCA > 1, RTA > 0, and LI > 0, the authors assumed that a product was positively competitive since all three indices showed an advantage. When a product showed an advantage on one or two of the indices, it was considered as conditionally competitive. For the remaining products not included in PC or CC groups, an arithmetical average of each of the three indices (RCA_{CNC+NC}, RTA_{CNC+NC}, LI_{CNC+NC}) was calculated. Those commodity groups where all three values of RCA_{av}, RTA_{av}, and LI_{av} were below RCA_{CNC+NC}, RTA_{CNC+NC}, LI_{CNC+NC}, respectively, were considered non-competitive. Export items for which at least one of the values of RCA_{av}, RTA_{av}, and LI_{av} was above RCA_{CNC+NC}, RTA_{CNC+NC}, LI_{CNC+NC}, respectively, were placed in the conditionally non-competitive group.

Table 14.1 Grouping of export products on their competitiveness

Groups	Competitiveness Criteria
Positively competitive (PC)	$RCA_{av} > 1$ $RTA_{av} > 0$ $LI_{av} > 0$
Conditionally competitive (CC)	$RCA_i > 1$, or/and $RTA_i > 0$, or/and $LI_i > 0$
Conditionally non-competitive (CNC)	$RCA_{av} > RCA_{CNC+NC}$
	$RTA_{av} > RTA_{CNC+NC}$
	$LI_{av} > LI_{CNC+NC}$
Non-competitive (NC)	$RCA_{av} < RCA_{CNC+NC}$
	$RTA_{av} < RTA_{CNC+NC}$
	$LI_{av} < LI_{CNC+NC}$

Source: Authors' development

In the final stage, the measures that should be applied to either support or increase competitiveness were identified so that production and export of PC and CC products could be supported in such a way as to implement or develop competitive advantage and thus expand exports; while CNC and NC products could be reoriented on the domestic market.

The above five-stage approach has been tested in the case of Chinese agricultural exports for 1995–2015 (32 major groups of export commodities).

4 China's Trade in Agricultural Commodities

China is one of the major global producers of agricultural products. Despite the world's biggest population of over 1.3 billion people, limited agricultural resources, and domination of smallholders in agriculture, China is largely self-sufficient in food, except for few agricultural commodities. With the fast development of China's foreign trade, China's trade in agricultural products has also grown rapidly. In 2015 China became the fourth-largest agricultural exporter, after the EU, the USA, and Brazil; and the fourth-largest agricultural importer, following the EU, the USA, and Japan. China has a diverse array of agricultural exports, the most important of which are fish (11.9% of total agricultural export in 2015), vegetables (10.8%), roots and tubers both prepared and preserved (10.5%), aquatic invertebrates (9.9%), crustaceans and mollusks (8.4%), and fruit and nuts (7.8%).

Despite the rapid growth of China's trade in agricultural commodities, many experts acknowledge that the country has a comparative advantage in producing and exporting only labor intensive horticultural products, such as vegetables and fruits (Huang and Chen 1999; Bonnariva 2011; Ni 2013; Lim and Feng 2005; Cheng 2007). Considering the limits of land, water, and other resources, it is seen as difficult for China to export large quantities of land intensive crops that are vital to China's food security (Ni 2013). China's agricultural growth depends much more on domestic demand, and agricultural resources are mainly used to produce major crops for domestic consumption (Cheng 2007). However, there is

a lot of room for improvement in the competitiveness of items other than labor intensive products in China's export portfolio.

For a better understanding of the current coherence between comparative and competitive advantages in China's agricultural exports, the authors calculated Balassa (RCA), Vollrath (RTA), and Lafay (LI) indices for the major commodity groups in China's export portfolio.

The Balassa index measures the degree of specialization of products in China's export portfolio. A country reveals comparative advantages in products for which RCA > 1. For China, fish and aquatic invertebrates, vegetable roots and tubers, crustaceans and mollusks, and tea and mate revealed comparative advantages (see Appendix 1, Table 14.3). Some of the products, such as preserved fruits and fresh fish, lost their comparative advantages in 2015 (in the case of fresh and chilled fish, after 2013). In general, China's labor intensive agricultural products have higher comparative advantages than the land intensive ones. As distinguished from Bonnariva (2011) and Ni (2013), the authors have not registered comparative advantage for labor intensive fruits and nuts. After 2011, China also lost comparative advantage in the export of vegetables. However, RCA is high for tea, spices, roots and tubers, and preserved fruit. The switch from being a large exporter to being a large importer of grains—which occurred in China in 1994 (Fang and Beghin 2000)—resulted in the loss of comparative advantage for land intensive wheat, maize, rice, and other cereals.

Analyzing the same set of products using the Vollrath index, the authors identified those export items with a relative trade advantage (RTA > 0) and then applied the RTA results to the previously calculated RCAs. The Vollrath index showed China's relative trade advantage in meat, dried and salted fish, eggs, flour, fruit and vegetable juices, sugar confectionery, and cereal preparations. Gray cells in Table 14.4 (see Appendix 2) represent those product groups where both Balassa and Vollrath indices show comparative advantages: crustaceans and mollusks, fish and aquatic invertebrates, vegetable roots and tubers, tea, and preserved fruit.

Applying the Lafay index to China's export portfolio, the authors concluded that the country has a competitive advantage in labor intensive vegetable roots and tubers, tea, preserved fruit, fish, crustaceans, and

mollusks (see Appendix 3, Table 14.5). Labor intensive crops are better suited for Chinese agriculture (Fang and Beghin 2000). Among the grains, japonica rice is the only crop that exhibits a comparative advantage because it has a higher labor/land ratio than wheat and maize. However, due to high domestic demand, China's rice production should be targeted to maintain the balance between domestic supply and demand (Cheng 2007).

As only four out of 32 commodity groups demonstrated comparative advantages on all three indices, they are considered as positively competitive commodities in China's export portfolio. Other items in China's agricultural export portfolio are either conditionally competitive or conditionally non-competitive. Bearing in mind that most products from the CC and CNC groups are those on which China bases its current self-sufficiency policy, the authors concluded that with such a policy China is going against its comparative advantages.

5 BRI and Differentiation of Policy Measures in Agricultural Exports

China wants its agriculture to stand out in the world. Such an ambitious goal requires a global strategy that coordinates domestic and foreign markets and resources. The BRI is an attempt to increase China's agricultural production and exports, enhance overseas investment, and even reshape international rules on agriculture. In the framework of the BRI, China is interested in promoting its economic influence in the world and exploring new markets for its agricultural commodities and food products. To increase benefits from international trade, both China and its neighbors have to transform economic growth drivers, seize current opportunities, reduce dependence on factors of production (investment and labor), increase reliance on innovation and quality, modernize, and diversify. The major challenge for the sustainable development of trade between China and the countries of Eurasia would be the development and implementation of trade policies that take into account evolving technologies, new financing mechanisms, multistakeholder contributions/partnerships, and cross-border cooperation.

A promising form of collaboration between China and countries involved in the BRI is an international agricultural demonstration zone (ADZ). Approved to be established in ten countries of Southeast Asia and Africa, ADZs will be based on existing projects set up by Chinese firms, which will be given government backing to serve as platforms for other Chinese companies, thus expanding infrastructure and trade links between Chinese agricultural sectors and the world (Asiaone 2017). In addition to ADZs, China should encourage agricultural exports and support companies to set up overseas production bases.

In terms of agricultural exports, policy measures have to be differentiated to support the competitiveness of PC and CC commodity groups and to establish competitive advantages for CNC and NC commodity groups (see Table 14.2). Policy measures for the CC group should be focused on the promotion of domestic products abroad and creating demand for them in the markets of foreign countries. Export-oriented agricultural producers should also benefit from subsidized loans and export insurance programs. Currently, subsidies on agricultural products are provided so as to meet domestic consumption needs, not to promote exports, as the policy does not involve export products in which China has a comparative advantage (Ni 2013).

Indirect economic measures focused on increasing competitiveness and establishing competitive advantage are needed for those products that are conditionally non-competitive, for example, income support or reduction of production costs. Measures to prevent and offset the impact of increases in agricultural imports should be introduced, including anti-dumping measures, countervailing and safeguard measures, and a mechanism to cope with agricultural subsidies in other countries.

Non-competitive products have to be targeted at the domestic market to ensure food security and improve farmers' incomes through a system of agricultural support policies, including direct payments for grain production, subsidies for agricultural inputs, subsidies for farm machinery purchases and improved crop varieties, minimum purchasing prices for wheat and other crops, and temporary storage options. Such measures aimed at supporting CNC and NC products will increase the economic performance of agricultural producers, drive them to expand their production facilities, and thus create conditions for the development of their competitive advantages.

Table 14.2 Grouping of China's export products by competitiveness and differentiation of policy measures

Groups	Export products	Policy measures
PC	1. Fish and aquatic invertebrates 2. Crustaceans, mollusks, and aquatic invertebrates 3. Vegetables, roots, tubers 4. Tea, mate	1. Diminishing of administrative barriers to export 2. Development of production and logistic infrastructure, including access to foreign markets
CC	1. Fruit, preserved 2. Vegetables 3. Fish, fresh, chilled, frozen 4. Fish, dried, salted, smoked 5. Eggs, yolks, albumin 6. Meat, edible meat offal 7. Flour (wheat and meslin) 8. Cereal preparations 9. Fruit and vegetable juices 10. Sugar confectionery 11. Spices	1. PR and promotion of domestic products on foreign markets 2. Support of "niche" export-oriented productions 3. Subsidized loans for the development of export production 4. Subsidized insurance of export-oriented productions
CNC	1. Live animals 2. Meat of bovine animals, fresh, chilled, frozen 3. Rice 4. Maize 5. Cereals, unmilled 6. Fruits and nuts 7. Coffee, coffee substitutes 8. Cocoa 9. Chocolate 10. Margarine 11. Edible products and preparations 12. Other meat and edible meat offal 13. Animal feedstuffs 14. Sugar, molasses, honey	1. Income support of agricultural and food producers 2. Reduction of production costs 3. Programs for sustainable development and diversification of the rural economy 4. Measures to prevent and offset the impact of sharp increases in agricultural imports 5. Investments in agricultural research and infrastructure
NC	1. Milk and dairy products 2. Wheat and meslin 3. Barley	1. Direct payments for grain production 2. Comprehensive subsidies for agricultural inputs 3. Subsidies for farm machinery purchases 4. Subsidies for improved crop varieties 5. Minimum grain purchasing prices 6. Temporary storage options

Source: Authors' development

Table 14.3 Balassa index values for selected agricultural commodity groups in China, 1995–2015

Commodities	1995	2000	2005	2010	2011	2012	2013	2014	2015	RCA_{av}
Live animals	**1.600**	**1.066**	0.325	0.230	0.258	0.233	0.210	0.196	0.206	0.480
Meat of bovine animals	0.072	0.042	0.026	0.031	0.029	0.018	0.009	0.010	0.007	0.027
Other meat and edible meat offal	**1.367**	0.800	0.243	0.144	0.128	0.111	0.107	0.116	0.111	0.347
Meat, edible meat offal	**1.848**	**2.275**	**1.500**	0.855	0.923	0.956	0.830	0.775	0.658	**1.180**
Milk and dairy products	0.059	0.091	0.057	0.015	0.021	0.022	0.014	0.012	0.010	0.033
Eggs, yolks, albumin	0.774	0.576	0.441	0.281	0.325	0.275	0.252	0.247	0.246	0.380
Fish, fresh, chilled, frozen	**1.550**	**1.545**	**1.198**	**1.079**	**1.158**	**1.097**	**1.025**	0.983	0.902	**1.171**
Fish, dried, salted, smoked	**1.625**	**1.017**	0.750	0.675	0.646	0.711	0.693	0.652	0.601	0.819
Crustaceans, mollusks	**2.105**	**1.221**	0.751	**1.006**	**1.043**	**1.071**	**1.115**	**1.105**	**1.014**	**1.159**
Fish and aquatic invertebrates	**3.032**	**3.771**	**2.939**	**2.026**	**2.275**	**2.263**	**2.095**	**1.957**	**1.815**	**2.464**
Wheat and meslin	0.004	0.002	0.028	0.000	0.003	0.000	0.000	0.000	0.000	0.004
Rice	0.074	**2.223**	0.304	0.194	0.170	0.102	0.140	0.117	0.086	0.379
Barley	0.000	0.000	0.004	0.008	0.003	0.002	0.000	0.000	0.000	0.002
Maize	0.041	**3.055**	**1.319**	0.014	0.013	0.025	0.008	0.002	0.001	0.498
Cereals, unmilled	0.884	0.544	0.461	0.316	0.042	0.182	0.141	0.101	0.068	0.304
Flour	0.678	0.644	0.461	0.262	0.022	0.235	0.213	0.155	0.101	0.308
Cereal preparations	0.397	0.230	0.174	0.167	0.192	0.178	0.153	0.145	0.134	0.197
Vegetables	**2.099**	**1.628**	**1.033**	**1.028**	**1.021**	0.882	0.785	0.773	0.760	**1.112**
Vegetables, roots, tubers	**3.747**	**2.634**	**1.837**	**1.710**	**1.887**	**1.583**	**1.667**	**1.562**	**1.576**	**2.022**
Fruits and nuts	0.554	0.323	0.255	0.314	0.322	0.351	0.344	0.317	0.353	0.348
Fruit, preserved	**1.908**	**2.339**	**1.561**	**1.399**	**1.447**	**1.420**	**1.294**	**1.146**	0.973	**1.499**
Fruit and vegetable juices	0.200	4.516	0.786	0.607	0.684	0.684	0.525	0.387	0.338	0.970
Sugar, molasses, honey	0.605	0.444	0.210	0.188	0.184	0.171	0.196	0.209	0.227	0.271
Sugar confectionery	0.706	0.812	0.703	0.704	0.748	0.719	0.714	0.694	0.678	0.720

(*continued*)

Table 14.3 (continued)

Commodities	1995	2000	2005	2010	2011	2012	2013	2014	2015	RCA_{av}
Coffee, coffee substitutes	0.017	0.038	0.043	0.044	0.049	0.063	0.064	0.069	0.085	0.053
Cocoa	0.210	0.111	0.090	0.045	0.055	0.052	0.056	0.051	0.037	0.079
Chocolate	0.038	0.040	0.049	0.054	0.075	0.082	0.087	0.097	0.093	0.068
Tea, mate	**3.880**	**2.927**	**1.640**	**1.085**	**1.202**	**1.211**	**1.251**	**1.246**	**1.226**	**1.741**
Spices	**3.318**	**1.469**	**1.901**	**1.242**	0.998	0.765	0.823	0.785	0.597	**1.322**
Animal feedstuffs	0.577	0.377	0.220	0.323	0.291	0.349	0.280	0.306	0.259	0.331
Margarine	0.020	0.255	0.094	0.029	0.025	0.032	0.031	0.030	0.030	0.061
Edible products and preparations	0.557	0.867	0.473	0.392	0.419	0.408	0.378	0.353	0.359	0.467

Source: Authors' calculation

Table 14.4 Vollrath index values for selected agricultural commodity groups in China, 1995–2015

Commodities	1995	2000	2005	2010	2011	2012	2013	2014	2015	RTA_{av}
Live animals	***1.462***	***0.907***	**0.192**	**0.073**	**0.065**	0.000	**0.021**	−0.143	−0.056	**0.280**
Meat of bovine animals	**0.062**	**0.028**	**0.019**	**0.002**	**0.002**	−0.052	−0.298	−0.275	−0.543	−0.117
Other meat and edible meat offal	***1.221***	**0.029**	−0.002	−0.269	−0.370	−0.452	−0.521	−0.479	−0.582	−0.158
Meat, edible meat offal	***1.835***	***2.239***	***1.494***	**0.850**	**0.919**	**0.951**	**0.826**	**0.773**	**0.653**	***1.171***
Milk and dairy products	−0.077	−0.304	−0.229	−0.541	−0.539	−0.664	−0.923	−1.029	−0.660	−0.552
Eggs, yolks, albumin	**0.719**	**0.556**	**0.434**	**0.274**	**0.321**	**0.273**	**0.251**	**0.246**	**0.246**	**0.369**
Fish, fresh, chilled, frozen	***0.888***	***0.651***	***0.236***	***0.399***	***0.482***	***0.493***	***0.459***	**0.388**	**0.312**	***0.479***
Fish, dried, salted, smoked	***1.302***	***0.586***	**0.612**	**0.643**	**0.619**	**0.683**	**0.664**	**0.630**	**0.567**	**0.701**
Crustaceans, mollusks	***1.710***	***0.629***	**0.364**	***0.594***	***0.523***	***0.456***	***0.438***	***0.449***	***0.213***	***0.597***
Fish and aquatic invertebrates	***2.990***	***3.757***	***2.911***	***1.974***	***2.198***	***2.191***	***2.023***	***1.865***	***1.715***	***2.403***
Wheat and meslin	−4.334	−0.290	−0.602	−0.096	−0.083	−0.225	−0.356	−0.189	−0.212	−0.710
Rice	−2.344	***1.767***	**0.001**	**0.068**	**0.002**	−0.366	−0.303	−0.380	−0.573	−0.236
Barley	−2.817	−3.007	−1.738	−1.039	−0.839	−0.962	−0.821	−1.843	−3.385	−1.828
Maize	−2.567	***3.055***	***1.317***	−0.145	−0.154	−0.419	−0.231	−0.192	−0.351	0.035
Cereals, unmilled	−0.477	**0.544**	**0.416**	**0.181**	−0.015	0.035	−0.748	−3.170	−5.039	−0.919
Flour	**0.533**	**0.413**	**0.392**	**0.244**	**0.012**	**0.223**	**0.189**	**0.128**	**0.074**	**0.245**
Cereal preparations	**0.334**	**0.187**	**0.137**	**0.104**	**0.117**	**0.091**	**0.051**	**0.027**	−0.042	**0.112**
Vegetables	***1.962***	***1.505***	***0.786***	***0.725***	***0.700***	**0.470**	**0.407**	**0.384**	**0.350**	***0.810***
Vegetables, roots, tubers	***3.706***	***2.510***	***1.773***	***1.654***	***1.822***	***1.501***	***1.586***	***1.477***	***1.477***	***1.945***
Fruits and nuts	**0.450**	−0.017	**0.065**	**0.030**	−0.020	−0.053	−0.035	−0.133	−0.189	**0.011**
Fruit, preserved	***1.877***	***2.293***	***1.458***	***1.206***	***1.259***	***1.233***	***1.130***	***0.959***	**0.711**	***1.347***
Fruit and vegetable juices	**0.164**	**4.457**	**0.664**	**0.477**	**0.548**	**0.557**	**0.397**	**0.243**	**0.204**	**0.857**
Sugar, molasses, honey	−1.578	**0.093**	−0.117	−0.086	−0.253	−0.368	−0.314	−0.205	−0.355	−0.354
Sugar confectionery	**0.431**	**0.606**	**0.625**	**0.629**	**0.663**	**0.615**	**0.611**	**0.580**	**0.497**	**0.584**
Coffee, coffee substitutes	**0.004**	**0.021**	**0.017**	**0.006**	**0.007**	**0.005**	**0.004**	−0.019	−0.035	**0.001**
Cocoa	−0.122	−0.121	−0.092	−0.113	−0.123	−0.145	−0.142	−0.123	−0.139	−0.125

(*continued*)

Table 14.4 (continued)

Commodities	1995	2000	2005	2010	2011	2012	2013	2014	2015	RTA_{av}
Chocolate	−0.021	−0.106	−0.034	−0.035	−0.029	−0.036	−0.045	−0.064	−0.105	−0.053
Tea, mate	***3.852***	***2.886***	***1.605***	***0.995***	***1.112***	***1.116***	***1.158***	***1.131***	***1.073***	***1.659***
Spices	***3.169***	***1.347***	***1.845***	***1.183***	**0.942**	**0.678**	**0.777**	**0.722**	**0.536**	***1.244***
Animal feedstuffs	−0.149	−0.801	−0.404	−0.260	−0.180	−0.069	−0.165	−0.166	−0.365	−0.284
Margarine	−0.177	−1.717	−0.060	−0.144	−0.528	−0.622	−0.421	−0.553	−0.532	−0.528
Edible products and preparations	**0.382**	**0.556**	**0.251**	**0.064**	**0.089**	**0.035**	−0.036	−0.076	−0.261	**0.111**

Source: Authors' calculation

Table 14.5 Lafay index values for selected agricultural commodity groups in China, 1995–2015

Commodities	1995	2000	2005	2010	2011	2012	2013	2014	2015	LI_{av}
Live animals	***0.591***	***0.257***	**0.082**	**0.023**	**0.021**	**0.002**	**0.009**	−0.036	−0.011	**0.104**
Meat of bovine animals	**0.038**	**0.001**	**0.002**	**0.002**	**0.002**	−0.023	−0.137	−0.130	−0.236	−0.053
Other meat and edible meat offal	***1.137***	**0.005**	**0.002**	−0.246	−0.339	−0.382	−0.427	−0.378	−0.382	−0.112
Meat, edible meat offal	***0.416***	***0.722***	***0.894***	**0.227**	**0.240**	**0.238**	**0.203**	**0.182**	**0.133**	***0.362***
Milk and dairy products	−0.046	−0.266	−0.283	−0.308	−0.314	−0.348	−0.526	−0.595	−0.267	−0.328
Eggs, yolks, albumin	**0.041**	**0.005**	**0.016**	**0.022**	**0.022**	**0.020**	**0.018**	**0.017**	**0.015**	**0.020**
Fish, fresh, chilled, frozen	***0.599***	***0.676***	***0.281***	***0.311***	***0.362***	***0.343***	***0.323***	**0.274**	**0.200**	***0.374***
Fish, dried, salted, smoked	***0.136***	***0.097***	**0.129**	**0.052**	**0.049**	**0.048**	**0.045**	**0.042**	**0.034**	**0.070**
Crustaceans, mollusks	***1.046***	***0.608***	**0.379**	***0.249***	***0.221***	***0.179***	***0.197***	***0.226***	***0.126***	***0.359***
Fish and aquatic invertebrates	***0.995***	***2.052***	***2.375***	***0.672***	***0.746***	***0.733***	***0.659***	***0.568***	***0.452***	***1.028***
Wheat and meslin	−2.920	−0.242	−0.637	−0.055	−0.056	−0.138	−0.208	−0.100	−0.091	−0.494
Rice	−0.606	***0.650***	−0.001	**0.020**	**0.001**	−0.111	−0.076	−0.095	−0.132	−0.039
Barley	−0.348	−0.515	−0.373	−0.094	−0.085	−0.097	−0.089	−0.164	−0.295	−0.229
Maize	−1.161	***1.566***	***0.828***	−0.060	−0.075	−0.200	−0.101	−0.075	−0.114	**0.067**
Cereals, unmilled	−0.036	**0.045**	**0.036**	**0.007**	−0.001	0.001	−0.039	−0.170	−0.308	−0.052
Flour	**0.056**	**0.042**	**0.055**	**0.017**	**0.001**	**0.016**	**0.013**	**0.008**	**0.004**	**0.024**
Cereal preparations	**0.159**	**0.151**	**0.193**	**0.065**	**0.070**	**0.052**	**0.029**	**0.016**	−0.021	**0.079**
Vegetables	***1.579***	***1.726***	***1.469***	***0.668***	***0.577***	**0.326**	**0.299**	**0.273**	**0.238**	***0.795***
Vegetables, roots, tubers	***1.522***	***1.447***	***1.592***	***0.679***	***0.714***	***0.518***	***0.576***	***0.527***	***0.477***	***0.895***
Fruits and nuts	**0.449**	−0.086	**0.137**	**0.013**	−0.045	−0.081	−0.067	−0.174	−0.230	−0.010
Fruit, preserved	***0.427***	***0.768***	***0.812***	***0.299***	***0.317***	***0.298***	***0.269***	***0.223***	**0.164**	***0.397***
Fruit and vegetable juices	**0.036**	**1.681**	**0.333**	**0.106**	**0.126**	**0.118**	**0.077**	**0.041**	**0.031**	**0.283**
Sugar, molasses, honey	−0.943	**0.020**	−0.158	−0.060	−0.177	−0.216	−0.162	−0.096	−0.127	−0.213
Sugar confectionery	**0.077**	**0.159**	**0.231**	**0.096**	**0.094**	**0.083**	**0.085**	**0.081**	**0.062**	**0.108**

(*continued*)

Table 14.5 (continued)

Commodities	1995	2000	2005	2010	2011	2012	2013	2014	2015	LI_{av}
Coffee, coffee substitutes	**0.002**	**0.014**	**0.014**	**0.003**	**0.004**	**0.003**	**0.002**	−0.007	−0.013	**0.002**
Cocoa	−0.027	−0.034	−0.051	−0.034	−0.036	−0.031	−0.029	−0.028	−0.029	−0.033
Chocolate	−0.004	−0.039	−0.021	−0.010	−0.008	−0.010	−0.013	−0.019	−0.028	−0.017
Tea, mate	***0.354***	***0.516***	***0.371***	***0.119***	***0.122***	***0.115***	***0.123***	***0.110***	***0.101***	***0.214***
Spices	***0.229***	***0.207***	***0.306***	***0.115***	**0.107**	**0.066**	**0.073**	**0.077**	**0.064**	***0.138***
Animal feedstuffs	−0.158	−1.046	−0.763	−0.274	−0.181	−0.075	−0.170	−0.170	−0.309	−0.350
Margarine	−0.009	−0.159	−0.007	−0.011	−0.043	−0.046	−0.028	−0.035	−0.028	−0.041
Edible products and preparations	**0.263**	**0.565**	**0.446**	**0.044**	**0.050**	**0.020**	−0.037	−0.057	−0.197	**0.122**

Source: Authors' calculation

6 Conclusions

The aim of the study was to develop an approach to the identification of competitive and non-competitive products in China's export portfolio to differentiate BRI policy measures aimed at the support, promotion, development, or establishment of a competitive advantage. The authors employed a five-step process of analysis to: (1) reveal comparative advantages of a country in exports; (2) discover competitive advantages in both exports and imports; (3) weight each product's contribution to an export portfolio; (4) divide products into groups depending on their competitiveness; and (5) differentiate policy measures aimed at developing domestic agricultural production and diversifying exports as a comparative advantage of China in terms of the expansion of the BRI.

In the case of China's agricultural exports, the above-described methodology identified comparative advantages of the country in the export of labor intensive agricultural products. Further comparison between the revealed comparative advantages and competitive advantages with the implementation of Vollrath and Lafay indices showed that China did not have comparative advantages in those agricultural commodities on which the country bases its current self-sufficiency policy.

A set of policy measures have been constructed in such a way that competitive and conditionally competitive export products have to be supported to implement or develop competitive advantage and thus expand exports; while conditionally non-competitive and non-competitive products should be reoriented to the domestic market. Implementation of those measures may expand the export of China's labor intensive agricultural products in the PC group, facilitate the concentration of resources toward potentially competitive products that are CC, promote the competitive advantage of CNC and NC products, and thus increase the overall productivity of China's agriculture and ensure the sustainable export growth of China's agricultural products to the BRI countries.

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Appendix 1

Appendix 2

Appendix 3

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Part IV

Financial, Legal, and Cultural Perspectives on BRI

15

The Role of China's Sovereign Wealth Funds in President Xi Jinping's Ambitious Belt and Road Initiative

Stephen Thomas and Ji Chen

This chapter begins with a brief review of the development and pre-2013 roles of China's Going Global programs for China's two sovereign wealth funds (SWFs): the China Investment Corporation (CIC); and the State Administration of Foreign Exchange Investment Company (SAFEIC). It then shows how Xi Jinping, since he became President in 2013, enlisted the financial resources and the leadership of CIC and SAFEIC in support of his Belt and Road Initiative (BRI). Next, it shows how CIC and SAFEIC helped to make possible BRI's financial programs, including the Silk Road Fund and the Asian Infrastructure Investment Bank (AIIB). BRI has also changed the personnel, business practices, investment goals, and investment returns of China's SWFs, particularly the CIC, which has become more of a policy SWF. Finally, it examines whether CIC and SAFEIC will be able to continue to support BRI projects despite a series of recent financial challenges.

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1 2007–2013: The Development of CIC and SAFEIC, China's Two Largest SWFs

In January 2007 China's government-owned foreign exchange reserves had reached US$1 trillion, the largest official reserves of any country in world history at the time, surpassing even the official foreign exchange reserves of Japan. Drawing on these huge reserves in 2007, the Chinese Ministry of Finance (MOF) initiated a SWF that was structured to be commercial, market-oriented, and transparent: the CIC. That same year another important Chinese financial administrative body, the Chinese State Administration of Foreign Exchange (SAFE), increased the funding and expanded the activities of its own SWF, one that was more secretive and policy-oriented, the SAFEIC. As with most SWFs, both CIC and SAFEIC shared the goal of enabling countries with foreign exchange reserves, earned from the export of natural resources such as oil, or from foreign trade surpluses, to receive a higher rate of return on investments from their foreign exchange reserves than from simply holding foreign currency or gold, or purchasing low-interest sovereign bonds, such as US Treasury Bonds.

The CIC was funded by the Chinese MOF through a one-time bond issue and allocation of the US$200 billion proceeds to fund the CIC in 2007 (Thomas and Chen 2011). SAFEIC was initiated in 1997 at China's SAFE branch in Hong Kong with only US$20 billion from China's foreign exchange reserves. In 2007 SAFEIC also received an unreported infusion of US$200 billion from its owner, SAFE. Annually since 2007, except during the 2015–2016 Chinese stock market crash, CIC has grown its assets under management, mostly from returns on its international and domestic investments, from US$200 billion in 2007 to US$814 billion in 2017 (SWFI 2017). CIC has also had several government capital infusions, US$30 billion in 2012, after several years of requests, and a second infusion in 2015—when the MOF provided CIC with an additional US$100 billion through a domestic bond issue—that was used to fund President Xi's new global initiatives: the BRI, the Silk Road Fund, and the AIIB (caixin.com 2017). The US$100 billion infusion was allocated to the BRI through CIC Capital, an investment platform set up by CIC in 2015.

SAFEIC does not publicly disclose the details of most of its capital infusions, the use of its funds, nor the returns on its investments. From media reports and outside analysis, we can offer some estimates (SWFI 2017). There appears to have been a major infusion of US$200 billion in 2007. Since then, because of SAFEIC's status as a "policy" SWF wholly owned by SAFE, there have probably been additional infusions as China's foreign exchange reserves have grown from US$1 trillion in 2007 to US$3 trillion in 2017, the largest government-held foreign exchange reserves of any country in world history. Some of the reasons for SAFE to set up SAFEIC and move away from simply purchasing US treasury securities, were the same as for the CIC. Through SAFEIC, SAFE could make alternative overseas investments with higher returns, such as real estate or natural resources. SAFE could also make "policy" investments through SAFEIC, such as Eurobonds in 2012 (Bloomberg News 2012). To make its investments, SAFE also set up "investment platforms." One example was the SAFE Buttonwood Fund, established in 2014 to allocate SAFE capital to China's new Silk Road Fund (Reuters 2016). (Interestingly the New York Stock Exchange was founded on May17, 1792, when 24 stockbrokers signed the "Buttonwood Agreement" on Wall Street in New York City under a Buttonwood Tree).

The CIC has increased its asset values an average of 15% annually since 2007. CIC assets under management reached a level of US$814 billion by December 2015; they did not increase during 2016 due to CIC's involvement in helping rescue the Chinese stock market in 2015 and 2016 as part of President Xi's "National Team." SAFEIC assets have also grown, but at a slower pace of about 10% annually until 2015, when they fell from an estimated US$542 billion in June 2015 to US$474 billion by June 2016. The decrease was probably also due to losses from participation in President Xi's National Team purchase of Chinese stocks to help stabilize China's stock markets in 2015. (Xi's National Team purchases stopped China's stock market collapse in about six months, compared with the ten years it took to recover from the 1929 Great Depression). Despite SAFEIC losses, by 2015 China's two SWFs still had accumulated assets of over US$1 trillion, the largest pool of investable SWF assets in the world (SWFI 2017). President Xi has mobilized some of these assets to capitalize his BRI projects, BRI-related funds, and banks.

From 2007 to 2013, CIC and SAFEIC followed different business models. In 2007 CIC became a registered company established under China's Company Law. Until 2013 CIC operated mostly as a commercial enterprise, following generally accepted international governance standards, making investments for commercial goals and being relatively transparent about its investments and financial returns, CIC achieved a transparency level on the Linaburg-Maduell Transparency Index of 8 out of 10, among the highest in the world for a SWF (SWFI 2017). From 2007 to 2013 the CIC also followed SWF principles and practices endorsed by the International Forum of Sovereign Wealth Funds when operating in the global economy. In 2008,Chinese CIC officials helped write the Forum's 24 SWF best practices, the Santiago Principles. Until 2013 CIC generally followed the Santiago Principles in its investment practices (SWFI 2017).

From 2007 to 2013 CIC's investment objectives were, first, to invest in a diversified portfolio of overseas financial instruments designed to maximize long-term returns on CIC's investable capital. CIC's second objective was to recapitalize Chinese state-owned commercial banks to maintain and increase the value of CIC's domestic bank shares held by Central Huijin, a wholly owned financial subsidiary CIC had purchased for US$67 billion when CIC was first established in 2007. CIC's bank stock shares as part of the Central Huijin purchase included controlling stock interest in China's four largest state commercial banks: the Industrial and Commercial Bank of China (ICBC); the China Construction Bank (CCB); the Agricultural Bank of China (ABC); and the Bank of China (BOC).

Since 2007 CIC's assets have greatly increased, in large part because Central Huijin bank shares have increased in value as China's four state-owned banks have rapidly grown along with China's economy. The four banks have had very successful initial public offerings on the Hong Kong and Shanghai stock exchanges, despite dire predictions in 2000 of upcoming Chinese bank failures (Chang 2001). The ICBC was the world's largest in terms of assets in 2016, and the other three CIC commercial banks are the world's next three largest banks (*Forbes* 2017). In addition, CIC has 35% ownership of the China Development Bank (CDB), one of the world's largest policy development banks. CDB loans and grants are another of President Xi's major capital sources for funding BRI projects.

SAFEIC has always been a policy SWF, and is a subsidiary of SAFE, itself a department of the People's Bank of China, China's central bank. SAFEIC operates as a state administrative unit of the People's Bank of China rather than as a Chinese company, it is not registered under Chinese Company Law, is managed only by government officials, and has no foreign directors or advisors. SAFEIC has not joined the International Forum of Sovereign Wealth Funds, has never agreed to abide by the SWF Santiago Principles, and does not publicly report on most of its investment activities or investment results. SAFEIC has a transparency index level of 4 out of 10 on the Linaburg-Maduell Transparency Index, lower than any other major SWF, except for that of Saudi Arabia (SWFI 2017).

SAFEIC's investment goals are similar to those of CIC, that is, to find safe and prudent investments for some of China's vast foreign exchange reserves. SAFEIC, however, has always been a policy SWF and has helped to carry out Chinese government foreign policy goals since its inception. For example, SAFEIC invested in European bonds in 2012 at a time when CIC leaders were publicly adamant about not doing so due to CIC's belief that European bonds lacked commercial promise, even though then Prime Minister Wen Jiabao and People's Bank of China Governor Zhou Xiaochuan publicly committed China to purchasing European bonds (Bloomberg News 2012).

2 CIC's and SAFEIC's New Roles in President Xi's Post-2013 Global Initiatives

Since 2013 both CIC and SAFEIC have been mobilized to support President Xi's new BRI global programs. By March 2013 China's foreign exchange reserves had increased to US$3.5 trillion, a world record for government-held foreign exchange reserves. Given the enormity of China's official foreign exchange holdings, President Xi could feel comfortable expanding China's government-sponsored Going Global development programs both in size and in scope as part of his global China Dream objective. Also, President Xi needed government financial institutions to carry out intermediation between China's huge official foreign

exchange reserves and his Going Global initiatives, the BRI, the AIIB, and the Silk Road Fund.

CIC and SAFEIC, and their various investment platforms and largely-owned financial institutions, have provided much of the capital, as well as the financial intermediation tools and financial management to move funds from China's foreign exchange reserves to President Xi's BRI projects and to help oversee the use of the funds. These new roles for CIC and SAFEIC under President Xi since 2013 have required more of a policy orientation for China's SWFs, particularly for the CIC, as well as for CIC-controlled Chinese commercial banks and the CDB, a policy bank with a CIC controlling interest. CIC also had significant changes in personnel, business practices, and investment goals, as it became more involved in supporting President Xi's new BRI projects and policies.

Much of the investment capital for China's BRI regional development programs has come directly or indirectly from CIC and SAFE, through one of their investment platforms, or through loans for BRI development projects made by China's two groups of financial institutions: state-owned commercial banks, composed of China's four largest state-owned commercial banks—ICBC, CCB, ABC, and BOC—in which the CIC has a controlling share interest; and state-owned policy banks, the major sources being China's two largest policy development banks, CDB and the Exim Bank of China. CIC owned 48% of the stock of the CDB until 2015, when its ownership share was reduced to 35% to permit SAFEIC to become another major shareholder, at 27%. The Exim Bank of China is the only major investor in BRI that does not include CIC or SAFEIC funding. Instead the major funder is the People's Bank of China, although the President, Ms. Hu Xiaolian, is the former head of SAFE.

In 2014, in support of the BRI, President Xi set up an entirely new SWF, the Silk Road Fund, with a planned capital of US$40 billion. The first US$10 billion of funding includes: US$6.5 billion that has come from the above-mentioned SAFE Buttonwood Investment Holding Company, Ltd. (an investment platform set up in 2014 by SAFE); US$1.5 billion from CIC through its investment platform, the SERES Investment Company; US$1.5 billion from the Exim Bank of China; and US$0.5 billion from the CDB (35% CIC and 27% SAFE owned).

In 2015, President Xi announced another major financial initiative, the 65-country multilateral AIIB, with plans to invest at least US$200 billion in infrastructure development in Asia. China promised to contribute US$100 billion, to be provided by the MOF, with the CIC serving as the conduit. AIIB will have the equivalent of two-thirds of the capital of the Asian Development Bank and about half of World Bank assets. During the first year of the AIIB, from January 2016 to January 2017, there have been nine major development projects. AIIB President Jin Liqun (formerly an official with CIC) stated that the bank aimed to lend $1.2 billion in 2016, and it has more than met that target, extending over $1.7 billion of loans (aiib.org 2017).

President Xi's BRI programs from 2013 to the present have been made possible by: China's success in accumulating foreign exchange reserves; by the establishment of China's two, now huge, SWFs to invest some of those reserves in Chinese financial institutions that support foreign investment and development loans; by the training Chinese experts in global investment through their participation in CIC, SAFEIC, and foreign investment firms; and the ability of President Xi's leadership team to develop and to carry out proactive, Chinese-led, global economic development initiatives.

3 Consequences for CIC and SAFEIC of Participating in President Xi's BRI Programs

Lou Jiwei served as CIC's first CEO for six years, from its inception in 2007 to 2013, just after Xi Jinping began his first term as President. Lou Jiwei had been one of the earliest architects of China's reform policies, having participated in a 1992 high-level planning meeting in which the concept of a "socialist market economy" had been approved by then President Jiang Zemin (Caixin 2013). In 2013 Lou Jiwei was replaced by Ding Xuedong, a government cadre with considerable experience in the MOF but almost no international investment experience. Lou Jiwei then became China's Minister of Finance from 2013 to 2016, one of the top

government financial positions in China. Under Ding's leadership as the new CEO, CIC has been more focused on supporting President Xi's new BRI policy-driven investments than in seeking high investment returns, as had been the case under Lou Jiwei's management.

From 2013 to 2017, the major cost to the CIC of becoming less independent and more policy-oriented was to be mobilized into President Xi's National Team to save China's stock markets in 2015. CIC was asked to buy US$115 billion of the US$230 billion total of Chinese stocks purchased by Chinese financial institutions on the National Team before the stock markets stabilized in early 2016 (Riley 2015). Because of the success of President Xi's stock market rescue, the market value of CIC's large shareholder stake in China's state commercial banks did not collapse. Instead, CIC's bank shares experienced their first year of merely stable value since 2007 (CIC Annual Reports, 2008–2016).

CIC's enterprise culture has also changed. Perhaps because of the intense campaign against corruption waged by President Xi, CEO Ding asked CIC personnel to write personal statements of 12,000 or more words examining their past and current behavior. To the credit of Lou Jiwei and Ding, no CIC staff member has yet been caught up in a financial corruption investigation, although the long-serving president of the (largely CIC-owned) China Agricultural Bank, Zhang Yun, has been fired and is serving two years of probation for corruption. CIC company culture has probably been changed to a more serious and watchful one, due to the intense new anti-corruption policies of the Xi administration.

The CIC's extensive experiences with rule-based domestic and international financial regimes from 2007 to 2013 appear to have contributed to President Xi's choice of BRI policies and personnel. For example, CIC had been structured according to China's Company Law, formulated "in order to meet the needs of establishing a modern enterprise system, to standardize the organization and activities of commercial companies rather than government bureaucracies" (Company Law of China 2013). These rule-based practices appear to have been carried over to President Xi's BRI, AIIB, and the Silk Road Fund.

Lou Jiwei became China's Minister of Finance in 2013 and served until 2016, when he became Chair of the National Council of the Social Security Fund. Jin Liqun had been Chairman of the Supervisory

Board of the CIC from 2009 to 2012. In October 2014, based partly on Jin Liqun's successful global leadership role at the CIC, he became Secretary-General of the Multilateral Interim Secretariat established to create the AIIB. Jin Liqun then became President-designate and was elected President of the AIIB by the international board of the AIIB in January 2016.

CIC has continued to have an active role in international SWF investment organizations. At the 2015 annual meeting of the International Forum of Sovereign Wealth Funds held in Milan, Italy, the CIC delegation participated in decision-making on key issues related to Forum governance and development and played an active role in its organization. During the meeting, Forum Vice Chairman Li Keping (President and Chief Investment Officer of CIC), was elected a member of the new Board of Directors by the Forum. CIC also carried out a self-evaluation on the implementation of the 24 generally accepted principles and practices, the Santiago Principles. The evaluation results as reported by China were that CIC was characterized by openness and transparency and has honored its commitment to the Santiago Principles.

Since 2013 the Xi administration has altered the CIC's investing goals. The most important change being President Xi's direction to the CIC to support his ambitious global initiatives, with less regard for possible negative financial return outcomes. Another change has been to direct the CIC to include a long-term perspective, to actively support the China Dream, and specifically to support China's post-2013 global initiatives: BRI, AIIB, and the Silk Road Fund,

We find it difficult to evaluate the influence of President Xi's leadership on SAFEIC, beyond the observation that SAFEIC has made significant international investments in the BRI, through its investment platform *Wutongshu* (Buttonwood Tree). SAFE is the only stockholder in the Exim Bank of China, China's second largest policy development bank. SAFEIC appears not to have had any serious corruption investigations of its leadership.

Perhaps the major example of President Xi's influence on China's SWFs is that he directed both CIC and SAFE to join his National Team to help China's stock markets survive a disastrous July 2015 stock market meltdown. Despite great initial losses, CIC and SAFEIC helped restore

Chinese popular confidence in the Shanghai and Shenzhen equity markets. Since February 2016, market indexes have stabilized at modestly higher levels than before the market boom and collapse in 2015, and China's stock markets were saved from a potentially disastrous long-term collapse.

4 Can China Continue to Finance BRI Through CIC- and SAFEIC-Owned and Controlled Financial Institutions?

Will CIC and SAFEIC-owned and controlled Chinese commercial and policy banks be able to continue to finance President Xi's BRI projects and development funds, given recent Chinese financial challenges? There are some foreign and Chinese analysts who feel that despite the political and diplomatic support of President Xi, BRI projects cannot continue to be financially supported by CIC and SAFEIC because of four main challenges that have emerged since 2014: first, there is the falling level of China's still vast foreign exchange reserves, from about US$4 trillion in 2014 to US$3 trillion in 2017, the first major decrease since 2001; second, Moody's Investors Service (and the other major rating agencies) downgraded China's sovereign debt in 2017, the first downgrade since 1989 (Macfarlane 2017); third, there has been an asset value decrease of China's two SWFs, CIC and SAFEIC, for the first time since 2007; and fourth, there are the warnings by international and Chinese economists and analysts that some companies receiving BRI project loans and investments may not be profitable enough to make payments on their loans or to reward investors.

We cannot know definitively whether China will overcome these four major challenges, and our analysis is made difficult by the opaque nature of China's economic data and decision-making processes. We conclude, however, that there is enough information to offer some tentative answers even though we realize that collection of BRI project economic performance data during the coming years will be needed to make a definitive evaluation.

Our tentative conclusion at this time is that the same Chinese government policies and problem-solving capabilities that brought about China's impressive post-1978 economic growth (making China the world's second largest economic state) and that created China's massive official foreign exchange reserves (even after the decrease from 2014 to 2017, China's reserves were still two and a half times larger than Japan's, the next biggest) will be used to successfully overcome these four major challenge areas. The Chinese government has already analyzed the challenges and developed new and revised policies that have addressed some of them (Bloomberg News 2017).

China's new 2017 policies appear, so far, to be generally successful. We therefore agree with the analysis of Brad Setser (a senior fellow at the Council on Foreign Relations) that China can afford to continue to finance BRI projects without jeopardizing its own financial stability (Setser 2017). Why do we believe that China already has begun to address these four challenges in ways that will contribute to continued successful Chinese financing of President Xi's BRI projects through CIC and SAFEIC and the funds and banks they oversee?

The first challenge is the decreasing level of China's foreign exchange reserves that fell from almost US$4 trillion in June 2014 to about US$3 trillion in early 2017—the first major decrease since 2001. China's foreign exchange reserves are the main source of financial support for President Xi's BRI projects, largely through CIC and SAFEIC investments, and from loans from CIC- and SAFE-owned commercial and policy banks and Chinese development funds. If the 2014–2017 rate of contraction (an annual average decrease of US$330 billion) were to continue, China might lose the capacity to continue to support BRI. But, as of 2017, China's ruling State Council has instituted policies to stop its foreign reserves shrinking by increasing limits on public and private outward foreign direct investment (OFDI) not in support of BRI projects (Bloomberg News 2017).

The second challenge was Moody's downgrade of China's sovereign debt rating, in line with Fitch's and Standard & Poor's. Although China's debt rating is still high, the decrease was a warning that China's level of outstanding loans was becoming financially troubling. The Chinese State Council's 2017 financial reform policies also aimed to meet this second

challenge. Moody's reported that they did not think China's financial situation was in great danger. After the downgrade, Moody's said it did not plan to move China's rating lower than the new "A1" level, which is still investment grade: "The erosion in China's credit profile will be gradual and, we expect, eventually contained as reforms deepen" (Macfarlane 2017).

Third, since 2015, both CIC and SAFEIC have had decreasing asset levels. CIC's assets fell from US$813.762 billion in 2015 to US$813.513 billion in 2016, a loss of US$250 million and the first year since CIC was established in 2007 that assets did not increase (SWFI 2017). SAFEIC's assets also decreased but much more substantially, from US$542 billion in June 2015 down to US$474 billion in June 2016, a loss of US$68 billion, again for the first time since 2007. An explanation for SAFEIC's much greater loss is that one of its investment arms, *Wutongshu* (Buttonwood Tree), invested US$48 billion in the CDB and US$45 billion in the Exim Bank of China. These negative asset outcomes for both SWFs may also have been the result of CIC's and SAFEIC's costly participation in President Xi's National Team rescue of China's stock market. These are probably temporary setbacks based on one-off events rather than the start of a long-term trend of CIC or SAFEIC assets shrinking based on problems with BRI policies or projects. CIC and SAFEIC support for BRI should therefore be able to continue.

Fourth, there is recognition among analysts that there will be problems with some of the many investments and loans being made as part of the BRI (Balding 2017). For example, there are reports that some Chinese officials expect to lose up to 80% of their Economic Corridor project loans in Pakistan, 50% in projects in Myanmar, and 30% in Central Asia (Kynge 2016).

While these are understandable concerns, particularly when investing in over 65 poorer countries with different cultures and many financial challenges, we believe that due to CIC's substantial ownership of China's four large commercial banks, and CIC and SAFEIC financial oversight of the new BRI funds (such as the Silk Road Fund), and of the policy banks—AIIB, CDB, and Exim Bank of China—there will probably not be a high enough level of failed investments and loans to curtail continued Chinese investment in BRI projects. As Setser points out, the actual

level of Chinese financial institution investments and loans in BRI projects is so far only about US$10–20 billion per year (Setser 2017). Most CIC and SAFEIC OFDI is in wealthier countries, in Europe and in the USA, rather than in the mostly less-developed countries of the BRI. Investment and lending in support of BRI is still a small percentage of Chinese OFDI by CIC and SAFEIC. Thus, even if policy investments and loans fail at a higher rate in BRI projects than those in wealthier countries, China's economy will probably not be damaged in any major way. Also, AIIB officials, such as AIIB President Jin Liqun (formerly of CIC), are reporting that AIIB has only a small and decreasing level of non-performing loans (aiib.org 2017).

Thus, even though the long-term goal of President Xi's BRI is to make nearly US$1 trillion in investments and loans over the next five to ten years, and even though many of these financial support activities for BRI are largely "policy" investments and loans, the new Chinese government economic policies designed to support BRI while protecting the wider Chinese economy will probably be successful. If so, there will continue to be investment and loan funds to support BRI projects, despite the challenges facing BRI-driven investments and loans. We agree with Brad Setser that China has enough financial resources in the form of foreign exchange reserves and policy experience based on over ten years of operating CIC and SAFEIC in the global economy to be able to overcome the very real challenges of BRI activities in the four problem areas discussed above (Setser 2017).

5 Summary and Conclusion

Since President Xi took office in 2013, he has enlisted China's two largest SWFs, CIC and SAFEIC, in a wide variety of supportive roles that have permitted Xi's Going Global programs—particularly the BRI, AIIB, and the Silk Road Fund—to develop at a very ambitious speed and scope. CIC and SAFEIC have been among the main financial institutions that have moved large amounts of capital from China's foreign exchange reserves to BRI, AIIB, and Silk Road projects. CIC especially has provided valuable global business experience and talented leaders who have

been able to oversee the intermediation from China's foreign exchange reserves in SAFE to BRI, AIIB, and Silk Road Fund capitalization.

There will be many future challenges in the 65 countries where BRI programs are being funded and developed, but if they are generally successful, the initiatives could produce mutually beneficial results, both for China and for BRI recipients. BRI projects can also absorb some of China's domestic excess manufacturing capacity. The outcomes can both build infrastructure and promote economic development in the many poor countries on the Silk Road Belt and the Maritime Road and can also earn China increased "soft power" as part of President Xi's China Dream.

We believe that the CIC will be able to tolerate both short- and long-term risks associated with BRI projects and to use its ten years of successful international experience to help China overcome the immense challenges of President Xi's BRI projects. We also believe that the CIC will, in the process, become an even more policy-driven SWF than the mostly commercial SWF that it had been previously. Finally, we believe the CIC and SAFEIC will continue to contribute to the success of President Xi's BRI programs.

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(State Commission for Restructuring the Economy) to…make a proposal to the central committee. Chen Jinhua immediately asked the commission's macro-economic control bureau chief, Lou Jiwei, now chairman and CEO of the sovereign wealth fund China Investment Corp., to organize a conference… Discussions were to focus on finding the best way to describe and spell out goals for Chinese economic reform"… "(E)stablishing a socialist market economy" (was proposed and approved).

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16

The Changing Rules of International Dispute Resolution in China's Belt and Road Initiative

Jingzhou Tao and Mariana Zhong

1 Background to China's Belt and Road Initiative

1.1 Political and Policy Background

As China explored new driving forces in foreign trade and outbound investments for its economic growth, President Xi Jinping announced the One Belt One Road, or the Belt and Road Initiative (BRI) in 2013, as a national and regional, strategic, and long-term development plan. The concept of a Belt and Road was based on China's ancient land and maritime silk road routes—one connecting China to Europe through Central Asia and the Middle East by land, and the other linking China to Southeast Asia and East Africa by sea. These two routes encompass around 65 countries in modern times.

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Under the BRI and along these ancient routes, China is seeking to build major infrastructure, such as ports, oil and gas pipelines, power plants, airports, expressways, roads, railways, and so on, thereby, on one hand, making it easier for China to trade with countries in those regions, and on the other, creating a win-win solution for those countries by improving their domestic infrastructure status, driving local economic growth, and enhancing the people's quality of living by bringing more goods, jobs, and development opportunities to those regions.

1.2 Chinese Government Support in Implementing the BRI

Since the inception of the BRI in 2013, China has demonstrated to the world its resolution and serious commitment to this initiative, as can be seen from, for instance, the enormous amount of special funds devoted to it, the favorable outbound investment policies, the national and international special events, forums, research projects, and the newly-established institutions organized for the purpose of ensuring the smooth implementation of the BRI.

According to media reports, China has planned costs of close to US$1 trillion for building infrastructure in Belt and Road countries. The Asian Infrastructure Investment Bank based in Beijing is among the many multilateral development banks involved in assisting and providing funds for the implementation of the initiative. Other major state banks are playing active roles in financing infrastructure, resources, and industrial and financial cooperation projects under the BRI.

On June 16, 2015, China's Supreme People's Court issued an opinion on the People's Courts providing judicial services and safeguards for the construction of the Belt and Road (FaFa [2015] No.9, the SPC's BRI Opinion), which explicitly encourages the use of international arbitration in resolving BRI disputes, and requires the People's Courts to efficiently recognize and enforce BRI awards, and to improve the mutual recognition and enforcement of arbitral awards with BRI countries that are not member states of the New York Convention.

1.3 Surge of Outbound Investments

The BRI provides great opportunities for—and has already caused a surge among—both Chinese and foreign investors to invest in a plethora of infrastructure projects in BRI countries. (see for example, *NY Times*, "U.S. Firms Want In on China's Global 'One Belt, One Road' Spending", at: https://www.nytimes.com/2017/05/14/business/china-one-belt-one-road-us-companies.html).

For Chinese companies, in particular the state-owned enterprises, the BRI has afforded solid national support in outbound investment policies, including favorable policies in financing and foreign exchange. Chinese private companies are also encouraged to explore foreign investment opportunities, although in reality it is often more difficult for private companies to secure financing (particularly from commercial banks) for their overseas projects, compared with SOEs. It is said that the BRI may be the largest scale of outbound investments initiated by a single state in history. (Hancock, Tom. 2017. "China Encircles the World with One Belt, One Road Strategy." *Financial Times*, May 9. Accessed August 31, 2017. Chinese version available at: http://www.ftchinese.com/story/001072495).

Foreign investors are also benefiting from the BRI. For example: General Electric is said to be targeting orders of billions of dollars for BRI projects; Citibank won a contract from the Bank of China to handle a US$3 billion bond offering to raise money for opening branches across Asia, Eastern Europe, and East Africa; and the US multinational conglomerate Honeywell International is selling equipment to Central Asia for processing natural gas.

2 Legal Risks and Challenges

Dealing with and investing in over 60 countries is an enormous and complicated task, associated with a wide range of potential risks and challenges arising from the diversified and complex legal, political, economic, cultural, and religious systems across these regions.

This chapter only deals with potential legal risks and challenges arising from foreign investment activities in BRI countries. Each country has

their own and independent legal system, and some countries are familiar with international dispute resolution mechanisms, such as international commercial/investment arbitration, while to others these notions are completely strange. Out of all 65 BRI countries, about 41 are civil law countries—including Russia, Turkey, Iraq, Kuwait, Croatia, the Czech Republic, and China—about 11 are common law countries—such as Singapore, India, Nepal, Israel, Sri Lanka, Pakistan, and Philippines—about four are Islamic law countries, and about nine are mixed or hybrid law countries. The diversity and differences in their legal systems, history, and jurisprudences are potential obstacles for cross-country business cooperation and are likely to lead to legal risks and challenges in both contracting activities and the implementation of contracts.

Moreover, as many BRI countries are developing countries, it is also a justified concern that their legal systems are not sufficiently transparent or mature to deal fairly and efficiently with international disputes arising from large-scale international investment projects, not to mention that judicial corruption and/or local protectionism may come into play during attempted local resolutions of international disputes.

Therefore, to be well equipped and prepared for these potential legal risks and challenges, it is vitally important to understand and familiarize oneself with the mechanisms of international dispute resolution that are available to foreign investors investing in BRI counties.

3 Available International Dispute Resolution Mechanisms

Under the BRI many types of disputes may emerge, which could be categorized broadly by the following (non-exhaustive) list:

Investment disputes arising between a foreign investor and a host country, for violation of an international treaty, bilateral or multilateral agreement, and most typically, a bilateral investment treaty (BIT);

Commercial disputes arising between foreign investors, or between a foreign investor and a local business partner, for breach of commercial contract(s);

Sovereign disputes arising between states, for matters relating to bilateral trade, anti-dumping, anti-trust, and so on that fall under the governance scope of WTO; and

Other international disputes concerning human rights, diplomatic protection, and so on that are governed by international or regional treaties/agreements.

This chapter only discuss international resolution mechanisms for *investment disputes* and *commercial disputes*.

In the activities of outbound investments, sophisticated business parties often prefer a multi-tiered dispute resolution clause in their contracts. These clauses often require a cooling-off period before formal initiation of legal proceedings. During such periods, the parties are often capable of/entitled to conduct amicable negotiation/conciliation/settlement talks, with escalation methods leading to top management in-person conversations. If the dispute cannot be resolved during such cooling-off periods, the parties are then entitled to commence, depending on the choice(s) made in their clause, local court litigation or international investment/commercial arbitration.

Litigation in the domestic court(s) of a host country, that is, local litigation, is not a prerequisite for international commercial arbitration. However, it is often utilized in practice as a parallel proceeding by one party as a strategy to disrupt an on-going international arbitration already initiated by the other party.

Local litigation is, sometimes, required before initiation of international investment arbitration, if exhaustion of local remedies is required in the applicable investment treaty/agreement. Modern trends have largely abandoned such a requirement. Furthermore, the existence of an "umbrella clause" in a given BIT could escalate a contractual claim to an investment claim, hence allowing an investor to directly initiate investment arbitration against the host state without going through local court proceedings.

This section briefly examines and highlights some of the important factors and rules in international commercial and investment arbitration, and the key considerations in drafting a dispute resolution clause in commercial contracts under the BRI.

3.1 International Commercial Arbitration

Foreign investors are often unfamiliar with—and not used to—litigation in domestic court(s) of a host country, as they do not know the local bodies of law, the applicable judicial procedures, the prevailing legal practices, and so on. By contrast, international commercial arbitration, which has gained wide popularity among the international business community due to its flexibility and detachment from local judicial environments, is apparently a much more appealing dispute resolution mechanism to foreign investors, because, among other things, it offers better clarity and certainty in its procedure.

It is therefore reasonable to expect that a large proportion—if not all—of international commercial contracts signed under the BRI would have adopted an arbitration clause.

To garner the benefits of international commercial arbitration, it is vitally important that the parties have properly drafted and installed an arbitration clause in the contract. How to properly draft the arbitration clause is a key factor that should be considered by the parties at the outset of contracting, in order to avoid an arbitration clause being rendered invalid, unenforceable, or otherwise detrimental to a party's rights and entitlement to fair remedies. Generally speaking, the following factors are some important considerations in negotiating and drafting an arbitration clause.

3.1.1 The Seat of Arbitration

If the seat of arbitration is to be located in a BRI country, the parties need to consider whether the country is a member state of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention). As China is a member state of the New York Convention, any foreign award rendered in another member state is enforceable in China pursuant to the provisions of the Convention and the relevant Chinese national law, and vice versa.

If, however, the award is rendered in a BRI country that is not a member of the New York Convention, such as Maldives, Sudan, East Timor (Timor-Leste), Turkmenistan, Iraq, and Yemen, and the enforcement is sought in China, the Chinese court will then decide whether to recognize

and enforce the award based on an applicable treaty, if any, absent of which, on the principle of reciprocity.

There is very little record of Chinese courts enforcing a foreign award based on the principle of reciprocity. Noticeably, this trend seems to be reversed by a recent recognition and enforcement of a US court judgment by a Chinese court in Wuhan, Hubei Province. (see: Liu Li v. Tao Li, Tong Wu. 30 June 2017. Civil Verdict No. (2015), the Intermediate People's Court of Wuhan Municipality, Hubei Province) But it remains to be seen whether such enforcement will become common judicial practice in China.

Furthermore, the seat of arbitration has profound impacts upon the conduct of international arbitration. It not only affects the enforceability of the award, but also decides the applicable law governing the arbitration procedure, the appointing authority of arbitrators absent the parties' agreement/choice, and the judicial authority overseeing the arbitration process, lending judicial support—including interim measures to the arbitration—and setting aside the final award if required. Therefore, when choosing the seat, the parties need to be confident that it has a mature legal system, a pro-arbitration and experienced judiciary, an advanced pool of sophisticated international arbitrators, and a national arbitration law that allows timely and effective judicial support to the activities of international arbitration.

In disputes involving Chinese parties, Singapore and Hong Kong are often the popular seats of arbitration for their proper satisfaction of the factors mentioned.

3.1.2 Ad Hoc Versus Institutional Arbitration

International commercial arbitration can be conducted ad hoc, that is, without an administering institution, or by an institution such as the International Chamber of Commerce (ICC), Hong Kong International Arbitration Centre (HKIAC), Singapore International Arbitration Centre (SIAC), China International Economic and Trade Arbitration Commission (CIETAC), and so on. Whether to choose ad hoc or institutional arbitration depends on the parties' assessment of the comparative advantages and disadvantages of these two forms of arbitration.

1. Ad hoc arbitration in China and recent developments

For a long time, ad hoc arbitration was not allowed in China because, according to PRC arbitration law, a valid arbitration agreement must contain the designation of an arbitration commission. The rationale behind such a prohibition of ad hoc arbitration is multifold. Many believe that the central government simply does not trust—and is not willing to confer such power on—adjudication of commercial disputes by one or three individuals without supervision or management by an organization. It should be noted, however, that China does recognize ad hoc arbitral awards rendered by other contracting members of the New York Convention, as well as in Hong Kong and Taiwan as per the bilateral enforcement arrangements.

In late 2016, the Supreme People's Court of China (SPC) issued an opinion on providing judicial safeguards for the construction of China's pilot free trade zones (the SPC Opinion), in which it appears that China's historic position *against* ad hoc arbitration was, to a certain extent, softened. Article 9 of the SPC Opinion states,

> where one or both parties registered in the pilot free trade zone have agreed to arbitrate relevant disputes at a specific place in the mainland, according to specific arbitration rules, and by specific arbitrator(s), the arbitration agreement may be held valid. Where the People's Court considers the arbitration agreement to be invalid, it shall report its opinion for review by the court of a higher level. Where the court of a higher level concurs with the lower court, the opinion shall be reported to the Supreme People's Court for review, and decided after the Supreme People's Court renders a reply.

This provision makes it possible for companies registered in the pilot free trade zones to opt for ad hoc arbitration seated in mainland China, provided that the agreement specifies the chosen arbitration rules and the chosen arbitrators. In the meantime, the long-established prior-reporting system, which applies in Chinese judicial review of enforcement of foreign and foreign-related arbitral awards, has been extended to China's judicial review of ad hoc arbitration agreements. Despite the above

"breakthrough", the ambiguity and uncertainty in the legality of ad hoc arbitration seated in China remains unresolved. Therefore, it is still not advisable for foreign parties to include an ad hoc arbitration clause with Chinese parties if the arbitration is seated in the mainland.

It is, of course, a different story if the seat is located in another jurisdiction where ad hoc arbitration is not as controversial.

2. Institutional arbitration and recent developments

Advantages of institutional arbitration include: the availability of pre-established arbitration rules that ensure the arbitration proceeding be conducted in a timely and organized manner; parties to arbitration could receive administrative assistance from the institution, including a panel list of arbitrators to choose from and sometimes a scrutiny of the final awards. Also, according to some commentators, "a perceived advantage of institutional arbitration is the reputation and prestige of the institution. It is widely perceived that an arbitral award issued under the name of a well-known institution for example, ICC, is helpful in terms of enforcement." (Rajoo, Sundra. 2010. Institutional and Ad hoc Arbitrations: Advantages and Disadvantages. The Law Review, 554.).

However, institutional arbitration is believed by many to be a cause of increases in both time and costs, which has gradually become the focus of discussion in improving institutional arbitration services.

International/foreign and Chinese arbitration institutions have responded to the BRI in many ways, such as amending their arbitration rules or establishing special arbitration centers. For instance, in October 2016, the Wuhan Arbitration Commission in China took the initiative to establish the first Belt and Road Court of Arbitration to adjudicate BRI disputes in accordance with a special set of rules; on December 1, 2016, the Shenzhen Court of International Arbitration in China issued updated arbitration rules to include administration services for investor-state disputes, which makes it the first Chinese arbitration institution to be equipped to administer such disputes. In May 2017, CIETAC announced the establishment of the CIETAC PPP Arbitration Center to adjudicate disputes arising from PPP (public-private partnership) projects in BRI.

In addition, SIAC, HKIAC, KLRCA (Kuala Lumpur Regional Centre for Arbitration) and CRCICA (Cairo Regional Centre for International Commercial Arbitration) have all demonstrated their enthusiasm to provide qualified dispute resolutions services to adjudicate BRI disputes and attract BRI users. Specifically, the SIAC launched its investment arbitration rules, effective as of January 1, 2017; the HKIAC announced that it looks to capitalize on the advantages of Hong Kong and provide a full range of dispute resolution services to parties with BRI disputes, including both contract- and treaty-based disputes; the KLRCA has liaised with other institutions around the world to prepare for disputes that may arise from China's BRI, and it intends to create an arbitration alliance with institutions ranging from Asia to Africa and Europe to welcome and better resolve any and all disputes; furthermore, the CRCICA signed the "B&R Arbitration Initiative Cooperation Agreement" with the Beijing Arbitration Commission and KLRCA on May 9, 2017, which aims to provide high quality dispute resolution services to BRI users.

3. Ad hoc versus institutional arbitration

As mentioned above, whether to choose ad hoc or institutional arbitration largely depends on the parties' assessment of their comparative advantages and disadvantages. In comparison with the advantages of institutional arbitration analyzed above, ad hoc arbitration does not have a readily-applicable set of arbitration rules, which leaves the parties with choices of either UNCITRAL (United Nations Commission on International Trade Law) arbitration rules or other rules that could be applied in ad hoc proceedings. Furthermore, there is no administrative service from an institution, and the award will not be scrutinized.

It is natural and reasonable to expect that ad hoc arbitration could afford the parties more autonomy and flexibility, although some worry that it also affords plenty of room for guerilla tactics and unsupervised delays in conducting the proceedings.

In terms of costs and time, a perceived advantage of ad hoc arbitration is that there are no administrative costs charged by an institution,

or intervention by a secretariat in transmitting the files or managing the proceeding. However, this is not necessarily the reality. In ad hoc arbitration, costs and time could considerably increase if the tribunal has little experience in managing such proceedings or controlling the counsel/parties in their use of guerilla tactics or other improper conducts.

3.1.3 Other Factors to Consider in Drafting an Arbitration Clause

In drafting an arbitration clause, in addition to the seat and the form of arbitration, parties also need to consider important factors such as the applicable laws, the formation of tribunal and required credentials of the arbitrators, the language of the arbitration, specially tailored procedures, appeal mechanisms, if any (and often there are none), and the legal effect and enforceability of the final award.

Applicable law includes the law governing the contract, the arbitration agreement, and the arbitration procedure. There is often no need to designate three different laws and it is common understanding and practice that *lex arbitri* will govern the arbitration procedure, unless otherwise agreed by the parties. It is important though, to carefully consider whether the arbitration agreement should be subject to a law different from the law governing the contract, if the latter would risk rendering the arbitration agreement invalid or unenforceable.

A party often needs to consider if they want their arbitrator to be an expert in the relevant industry or a lawyer familiar with the governing law of the contract, and if their chair-arbitrator should have a nationality neutral from both parties.

The language of arbitration includes language of the hearing, written submissions, and evidence. Note that the parties are free to agree on different languages for different aspects but that may increase the costs of arbitration.

Lastly, the parties are often allowed to amend a chosen set of arbitration rules and tailor the procedure to their needs. Therefore, if, for

instance, the parties wish to agree on a longer timeline (as compared with the default rule in a chosen set of arbitration rules) for making their submissions, they could explicitly say so in their arbitration clause.

3.2 International Investment Arbitration

3.2.1 Bilateral Investment Treaties

Generally speaking, BITs are intended to encourage foreign investments in a host state and provide protection to foreign investors with respect to their investments in that state. Before making an investment in a BRI project, investors should always first determine whether a BIT exists between their country of origin and the country where the investment is to be made. This is critically important as a valid BIT could afford a foreign investor the right to initiate investment claims against the host country if his/her investments suffered harms that are protected against in the BIT. In practice, investment claims often arise where the host government has (directly or indirectly) expropriated the investment, unfairly or unequally treated the investor, and/or otherwise imposed harm upon the investment.

Notably, China has one of the most extensive BIT networks in the world. It has concluded BITs with over 150 countries, covering most continents, including Asia, Europe, Africa, Latin America, and Oceania. As for BRI countries, China has by now concluded 54 BITs. Historically speaking, despite the many BITs signed by the Chinese government for the initial purpose of attracting foreign investments to China, there have been very few arbitral awards rendered against China, mainly because the Chinese government tends to settle most investment claims before they lead to arbitration.

If there is an existing BIT, investors should carefully scrutinize the provisions and look for important protections, including dispute resolution clauses, protections against expropriation, and fair and equitable treatment clauses.

Nearly every BIT contains a dispute resolution clause that indicates how the parties will handle disputes either arising out of and/or relating

to investments made under the BIT. Investors should carefully consider the parameters and scope of dispute resolution clauses. China's early BITs in the 1980s or 1990s often had a quite narrow scope for disputes to be submitted for investment arbitration, and when acceding to the ICSID (International Centre for Settlement of Investment Disputes) Convention in 1993, China declared that it would only consider submitting to the jurisdiction of ICSID disputes over compensation resulting from expropriation and nationalization. However, such a declaration was only indicative of China's position when joining the Convention and cannot override any more expansive jurisdiction agreed in its BITs. As a matter of fact, China's modern BITs have mostly enlarged such scope and included other disputes, such as liability issues arising from breach of the BITs. Therefore, if a modern Chinese BIT allows the parties to submit more expansive issues (often termed as "all disputes arising out of or in connection to") to ICSID arbitration, the investor could invoke such a provision and an ICSID tribunal will have the proper legal basis to assert its jurisdiction.

Unfortunately, for investments in BRI countries that have no BIT with China, such as East Timor (Timor-Leste), Bhutan, Maldives, Nepal, Afghanistan, Iraq, Palestine, and Montenegro, there will be no protection for investment arbitration. A Chinese investor will need to rely on other means of dispute resolution if it suffered damage to its investments. For investors from these countries, it is a sensible option to consider channeling their investments through a country that has a valid BIT with China, in order to be entitled to the protection of investment arbitration.

3.2.2 Ad hoc or ICSID Investment Arbitrations

The majority of China's BITs allow ad hoc or ICSID arbitration. Ad hoc arbitration is the original and earliest form of arbitration, also the early form of investment arbitration preferred by China in its BITs prior to its accession to the ICSID Convention. Notably, ICSID could provide assistance to ad hoc arbitrations to the extent agreed by the parties. However, unlike the ICSID Convention, which requires enforcement commitment

by a member state, for ad hoc arbitrations, there is no enforcement mechanism of ad hoc awards.

This is particularly true with respect to China's second generation BITs, signed after 2000, which often provided for four kinds of investment arbitration, leaving it to a unilateral choice by the investor, which are: (1) ICSID arbitration pursuant to the ICSID Convention, if the investor's state of origin and the host country are both members of the ICSID Convention; (2) arbitration pursuant to the ICSID Additional Facility Rules, if one or both countries (involved) are not members; (3) ad hoc arbitration pursuant to the UNCITRAL Arbitration Rules; or (4) arbitration pursuant to other arbitration rules. While arbitral awards rendered under the first category may be enforced on the basis of the ICSID Convention, those rendered under all other three categories are not guaranteed any legal basis. Given the fact that China has only committed to enforcing commercial arbitral awards (institutional and/or ad hoc) under the New York Convention, there is no possibility for a foreign investor to seek enforcement of investment awards against China relying on the New York Convention. Nonetheless, as noted above, the SPC's BRI Opinion has encouraged the lower Chinese courts to improve the mutual recognition and enforcement of arbitral awards with BRI countries that are not member states of the New York Convention, this opinion is considered to have indicated that the Chinese highest judiciaries are considering expanding the application of the New York Convention (to investment cases).

Last, among all BRI countries there are 51 ICSID member states. For investments in BRI countries that are not members of the ICSID Convention, such as Vietnam, Myanmar, India, Maldives, Tajikistan, Iran, Djibouti, Poland, Laos, Bhutan, and Palestine, ICSID arbitration will not be available. However, the parties could designate ad hoc or other institutional investment arbitration (such as ICC, SCC, or a Chinese institution such as CIETAC, which has recently promulgated its investment arbitration rules effective as of October 1, 2017) in the applicable BIT(s), bearing in mind that enforcement may or may not be an issue, depending on the (positively) evolving court practice in China.

4 Conclusion

By considering the potential legal risks/challenges in the BRI, the likely types of disputes, and the available and evolving mechanisms of international dispute resolution, this chapter concludes with the following suggestions.

It is always advisable to install a dispute resolution clause in the contract; and such a clause had better be designed in a multi-tiered structure and should be carefully crafted and reviewed by an experienced lawyer in international dispute resolution to avoid loopholes and difficulties in its enforcement. When considering different dispute resolution mechanisms, arbitration is preferred over local litigation. Arbitration clauses should be carefully drafted, and should designate, among other things, a neutral seat, applicable law, formation method of tribunal, and requirements for arbitrator credentials.

Furthermore, before making an investment, the investor should first find out whether there is a governing BIT, and if yes, whether the BIT affords basic protections to investors, such as investment arbitration, protection against expropriation, fair and equitable treatment, and so on. When examining the dispute resolution clause in a BIT, investors should check the scope of disputes submitted to arbitration, and other relevant restrictions, if any. For investments made in BRI countries that are not members of the New York Convention, enforcement of a commercial arbitral award is not guaranteed. Investors may need to consider other or additional means of dispute resolution.

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17

Globalization 5.0 Led by China: Powered by Positive Frames for BRI

May Hongmei Gao

1 Introduction

The Belt and Road Initiative (BRI), also known as the One Belt One Road Initiative (一带一路), was proposed by Chinese President Xi Jinping in 2013, while visiting Kazakhstan and Indonesia. By linking over 100 countries along a land-based Silk Road Economic Belt (BRI by land), an oceangoing twenty-first Century Maritime Silk Road (BRI by sea), and an air-based connection with the Americas (BRI by air), the BRI creates a powerful new wave of globalization—Globalization 5.0. The Chinese government and the state-run media promote BRI to the global communities in the framework of "win-win," in contrast to the traditional Western framework of "winner takes all." President Xi views BRI as a massive infrastructure project to revive the Ancient Silk Road, to share the Chinese Dream, and to replicate Chinese economic miracles in the rest of the world.

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At the inaugural Belt and Road Forum on May 14, 2017, in Beijing with an audience of 1500, including many heads of state, President Xi said that in pursuing BRI, "we will not resort to outdated geopolitical maneuvering. What we hope to achieve is a new model of win-win cooperation." Xi promised free trade, openness, and shared prosperity (Cai 2017). He projected China as a willing driver of global trade and investment, a contrast to Washington's "America First" agenda, and the growing fractures in the European Union amid Brexit. Among voices of protectionism and isolationism in the West, China has emerged as a de facto new leader of globalization. President Xi affirmed China's commitment to preserving and advancing economic globalization. At the January 2017 World Economic Forum in Davos, Switzerland, President Xi said China had been a beneficiary and a contributor to globalization, which he praised as: "Economic globalization has powered global growth and facilitated movement of goods and capital, advances in science, technology and civilization, and interactions among peoples." However, President Xi stressed that globalization was a "double-edged sword," and that we needed to be tolerant of differences while maintaining economic openness (*South China Morning Post*, 2017).

This chapter claims that BRI pushes forward the new wave of Globalization 5.0, led by China and supported by a well-established ecosystem cultivated by China over the years, including the Asian Infrastructure Investment Bank, the Silk Road Fund, the Regional Comprehensive Economic Partnership, the South–South Dialogue, the New Development Bank, and the Confucius Institutes. Findings from this research show that the Chinese government and state-run media intentionally frame BRI with such positive concepts as "win-win", "peace", "development," "collaboration", "partnership," and "common destiny."

2 Research Method

This research adopts a multi-method approach of textual analyses, participant observation, and applying a framing analysis to Chinese government and state media rhetoric. First, the author synthesized over 3000 Chinese and English web pages, originating from the USA, China, Africa,

and Europe. Second, from 2014 to 2017, the author practiced systematic observation of BRI development, including organizing global conferences and participating in social media discussions with global business leaders and decision makers (WeChat, Twitter, Facebook Messenger, LinkedIn groups, etc.). The author is the Chair of a large Asian business conference in the USA, in which many top Chinese companies participate, such as Huawei, ZTE, Yingli, GD Copper, and China Telecom. Third, the author applies framing analysis to the rhetoric of the Chinese government and the English versions of three state-owned media websites: Xinhua News Agency, *China Daily*, and *People's Daily*.

2.1 Framing Analysis

Framing theory and the methodology of framing analysis suggest that how something is presented, or framed, influences the choices readers/audience make. The elements of a communication frame include *message*, *audience*, *messenger*, *medium*, *images*, *context*, and *moral*. The conception of framing analysis can be found in cognitive psychology (Bateson 1972), sociology (Goffman 1974), linguistics and discourse analysis (Tannen 1993), organizational sciences (Weick 1979), communication and media studies (Pan and Kosicki 1993).

Frames are chosen with an audience in mind (Chong 1996). Chong and Druckman (2007) articulate a method for identifying frames in communication, and how such frames affect public opinion. The major premise of framing theory is that an issue can be viewed from a variety of perspectives and can be construed as having implications for multiple values. A more precise definition of framing starts with a conventional expectancy value model of an individual's attitude (Ajzen and Fishbein 1980; Fairhurst and Sarr 1996; Nelson et al. 1997). An attitude toward an object is the weighted sum of a series of evaluative beliefs about that object. Specifically, $Attitude = \sum vi \times wi$, where vi is the evaluation of the object on attribute i, and wi is the salience weight associated with that attribute. A frame in communication organizes everyday reality (Tuchman 1980) by providing "meaning to an unfolding strip of events" (Gamson and Modigliani 1987: 143). After all, the essence of a communication is

its meaning, not the words. When Chinese government and state-run media adopt proper frames for BRI, it helps international communities to understand and accept BRI projects.

3 Five Waves of Globalization Synthesized

Globalization (全球化) is the process of international integration arising from the interchange of peoples, worldviews, products, ideas, and cultures. Advances in infrastructure and technologies intensify globalization, and generate the further interdependence of peoples, economies, and nations. Although many scholars place the origin of globalization in modern times, others trace its history to long before the European Age of Discovery and modern times. By applying framing analysis to the leadership and causes of globalization in chronological order, the following five waves of globalization are synthesized.

3.1 Globalization 1.0: Ancient Silk Road (Third Century BC—1400s)

Scholars trace the origin of the ancient Silk Road to the third century BC. Chinese Han Dynasty Official Zhang Qian (164BC—114BC) and his followers traveled to Central Asia, and brought knowledge, culture, and seeds back to China. Venetian merchant Marco Polo (1254–1324) traveled from Venice, Italy, to Beijing, the capital of the Yuan Dynasty. His travel stories were recorded in *Book of the Marvels of the World*, also known as *The Travels of Marco Polo*, a book that described the wealth, size, and capital of China, and other cities and countries in Central and South Asia (Wikipedia Website 2017). Although Marco Polo was not the first European to reach China, his detailed chronicle inspired Christopher Columbus, and many other travelers, to search for the wealth of China and India. Zheng He (1371–1433), a Ming Dynasty Chinese mariner, explorer, and diplomat, commanded seven voyages to Southeast, South, and West Asia, and East Africa along the South China Sea and the Indian Ocean. These were examples of the first wave of globalization. The leadership of this wave of globalization was *laissez-faire*, driven by trade,

curiosity, and restricted by human knowledge of world geography. The framework of this period was: trade, friendship, and win-win.

3.2 Globalization 2.0: European-Led Colonial Expansion (1450–1950)

Stuchtey (2011) synthesized that for 500 years from 1450 to 1950 (from the Early Modern Period to the end of World War II), the colonial or imperial encirclement of the world was an integral component of European history. It was not only global colonial powers—such as Spain and the United Kingdom—but also "latecomers"—such as France, Germany, Portugal, the Netherlands, Belgium, and Italy—who participated in the historical process of colonial expansion with which Europe decisively shaped world history. In their efforts to find a direct trade route to Asia, known from the Silk Road, European nations established colonies and semi-colonies in the Americas, Africa, India, the East Indies, West Indies, and even in coastal China. Mercantilists maintained that the colonies could serve as a source of wealth, while personal motives by rulers, statesmen, explorers, and missionaries supported the imperial belief in "Glory, God, and Gold." In the late nineteenth century, colonialism became less popular, due to the Napoleonic Wars, the independence of the USA, the struggle for nationalism and democracy in colonies, and the cost of industrialization. The guiding frame of the colonial, or imperial, era was the domination by one country or people (Europeans or Whites) over another group of people (Africans, Asians, Native Americans, or non-Whites). In other words, the frameworks of power imbalance, winner versus loser, or winner takes all dominated the theme of this wave of globalization.

3.3 Globalization 3.0: US-Led Modern Economic Growth (1945–1990s)

Large-scale globalization began in the late nineteenth century, paralleling the rise of the United States of America as a superpower, and the formation of modern states. When World War II ended in 1945, many nation states gained independence, and their educational systems and infrastructure improved. With the advancement of technologies and innovation,

the connectivity of the world's economies and cultures grew exponentially. In 2000, the International Monetary Fund identified four basic aspects of globalization in this era: trade and transactions; capital and investments; human migration; and dissemination of knowledge (IMF Website 2017). This wave of globalization created modern nation states, and organizations of global interaction, such as the United Nations, the World Trade Organization, the World Health Organization, and the World Bank.

3.4 Globalization 4.0: Internet-Based Global Integration (1990s–2013)

Thomas Friedman (2000) gave a succinct summary on globalization in the era of the Internet in *The Lexus and the Olive Tree: Understanding Globalization*. In the chapter "Buy Taiwan, Hold Italy, Sell France," Friedman writes that "plugging" your country into globalization is the equivalent to taking your company public. Friedman claims that the simple definition of globalization is the interweaving of markets, technology, information systems, and telecommunications systems in a way that is shrinking the world, which enables us to reach around the world farther, faster, deeper, and cheaper than ever before. Globalization in this era is characterized by "integration," and activated by the "Internet." The frame of this Internet-based globalization is "technology," "digital divide," and "economic dualism". Most people were "dragged" into Globalization 4.0, but their benefits from globalism were restricted by their access to the Internet and opportunities. In *The World is Flat*, Friedman (2005) highlighted globalization's opportunities for individual empowerment and poverty reduction, as well as the drawbacks in environmental, social, and political imbalances. Environmental challenges such as global warming, water and air pollution, and the depletion of ocean resources are the unfortunate outcomes of this era of globalization.

3.5 Globalization 5.0: China-Led Global Collaboration (2013–present)

Today, after four waves of globalization, the world is at a crossroads. While advancements in transportation and communication technologies

continues to drive the interconnectedness and interdependence of economies, peoples, and nations, such trends also create unprecedented economic dualism and challenges for global governance. Since 2013 the Chinese government and media claim that BRI seeks a common prosperity for all mankind by building infrastructure and reducing the rich–poor gap. The Chinese government and media frame BRI as a revitalization of Globalization 1.0, the ancient Silk Road that connected China with Central Asia, Europe, and Africa. While telling nostalgic stories about the ancient Silk Road, the Chinese government and media frame BRI as a vehicle to replicate the Chinese economic miracle by building infrastructure for third world countries and beyond in Globalization 5.0.

4 BRI Drives Globalization 5.0

Since its inauguration in 2013, over 100 countries and international organizations have signed up to the BRI, covering 63% of the world's population, three-quarters of global energy resources, and 40% of world GDP. HSBC states that BRI will generate roughly 300 billion to 500 billion yuan in railway investment, financing over 15,000 kilometers of high-speed rail (Sito 2017). Bert Hofman, the World Bank's chief in Beijing, adds that less-developed countries along the new Silk Road stand to be among the big winners. The top recipients of investment dollars from China are expected to be India, Russia, Indonesia, Iran, and Egypt (*South China Morning Post* 2017). Credit Suisse estimates that China could invest between US$52 billion and US$79 billion in 13 African countries. "Africa is rich in resources, and an important destination for Chinese investment over the past decade" (Sito 2017). The Asian Development Bank published a report in 2010, which said that the region requires US$8 trillion to be invested from 2010 to 2020 in infrastructure. "The unbalanced economic development and different political systems of countries along the BRI is the main challenge," says Xu Fengxian, a researcher with the Chinese Academy of Social Sciences (Cai 2017). Compounding matters, these once freely navigable trade routes, are now slashed by festering conflicts—most notably in Afghanistan, Pakistan, Myanmar, Ukraine, and most of the Middle East. China's own westernmost region of Xinjiang is also prone to outbreaks of radical Islamic terrorism.

BRI matters for the new wave of globalization for three major reasons. First, the projects are vast. China says it will invest a cumulative US$4 trillion in BRI countries. BRI is dramatically larger than the post-World War II Marshall Plan, which amounts to US$130 billion in current dollars, initiated by US President Harry Truman (Cai 2017). Although Chinese officials reject the idea of comparing BRI to the Marshall Plan, it may provide people with the perspective that China can use such massive infrastructure projects to win geopolitical influence, and thus make China the center of the new globalization. Second, BRI underscores a benign global environment for China. President Xi has made BRI the most important feature of his foreign policy. His chief foreign adviser, Yang Jiechi, has tied BRI to China's aim of becoming a "moderately well-off society" by 2020. President Xi endorsed his predecessors' view that China faces a "period of strategic opportunity" up to 2020, meaning that China can take advantage of a mostly benign global environment to strengthen its global power without causing conflict (Campbell 2016). Third, the BRI positions China at the center of trading blocs and challenges the traditional Western view of world trade in which there are two main trading blocs—the trans-Atlantic bloc and the trans-Pacific bloc, with Europe in the first, Asia in the second, and the USA the focal point of both blocs. Two regional trade deals proposed during the Obama Era, the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership, embody this approach. But the BRI treats Asia and Europe as a single space, and China, not the United States, is its focal point. As a result, the Chinese government's support for BRI projects, China's foreign direct investment (FDI), is increasingly spreading along the Silk Road. In 2015, by official reckoning, Chinese FDI in BRI countries doubled (Sito 2017). BRI contracts are now more likely to involve Chinese firms managing the infrastructure they build, rather than (as in the past) building them and simply handing them over.

5 Frames Used to Promote BRI

Convincing other countries of the benefits of BRI can be difficult. At a time when China's growth is responsible for much of the world's economic dynamism, the Western media urge caution in the face of

expanding Chinese influence, Chinese dominance, and even a "China Threat." These reports have criticized BRI as examples of neo-colonialism initiatives. Beijing's overlapping disputes in the South China Seas may also galvanize suspicions that BRI is a Trojan horse for extending its geopolitical clout and dumping excess production capacity abroad. As such, peacefully resolving these territorial quarrels and building political capital will take on a new impetus for China. Despite challenges, China moves forward with BRI by presenting it in positive frames. This research synthesizes the following five major frames.

5.1 Frame 1: Development

Some countries involved in previous globalization waves have been left forgotten and far behind. Their desire for industrialization is a perfect fit with China's BRI for them to benefit from developing their infrastructure. Beijing says it expects the economic contact along the Silk Roads to boost productivity in each country. "In Africa, sometimes our policy makers think the Chinese are Santa Claus," says Ali Khan Satchu, a financial analyst in Nairobi. "No, they're there to make a return on their investment" (Sito 2017). African nations and, above all, their leaders, have come to see the relationship with China in a positive light, as an engine for economic growth. Development has been a popular bandwagon for third world countries to jump on. Many countries want to copy China's success in lifting millions out of poverty through development and industrialization and are eager to learn from China. The plan becomes even more attractive when there is funding available from China for large-scale infrastructure projects, from high-speed rail in Thailand, to a modern train system in Kenya, to an airport in Pakistan.

5.2 Frame 2: Mutual Respect and Mutual Trust

Through economic exchanges China hopes to gain closer cultural and political ties with each of the countries along the Silk Road—resulting in a new model of mutual respect and mutual trust. People in many African nations believe such respect for China includes elements of aspiring toward the developmental state. Although China is still a developing

nation, a strong (in fact, authoritarian) state has built an economy that guarantees the lives of its citizens, winning recognition for its success, and perhaps this has given people hope. Nigerians believe that the Chinese respect the sovereignty of the Nigerian nation, unlike the West, whom they feel is trying to infringe on the country's autonomy. Therefore, Nigeria welcomes Chinese investments and consequently, in Lagos there are more than 17,000 legal Chinese residents. Even when there were rumors that China sought to dominate the African continent, it was labeled as Western propaganda by the Ministry of Foreign Affairs in Nigeria. Mutual respect and mutual trust, not power domination, attract more interest among countries to participate in the BRI.

5.3 Frame 3: Seeking the Power of Narrative in the Ancient Silk Road Story

Chinese President Xi often looks back on the Ancient Silk Road as a golden age, a time of *Pax Sinica*, when Chinese luxuries were coveted across the globe, while the Silk Road served as a conduit for diplomacy and economic expansion (Curren and Arnold 2017). Mr. Xi often speaks of such an ancient story of trade, merchants, travelers, camels, and exchanges of ancient peoples. The strategy tapping into the narrative power of story is very effective, as people of all cultures can easily relate to history and storytelling. "[It] would not form a small group to undermine stability but would instead create a harmonious family," Xi said ancient travelers along the routes brought prosperity and civilization because "they didn't use warhorses or long spears but camel teams and goodwill. They didn't rely on gunboats but cargo ships and friendship" (Cai 2017).

5.4 Frame 4: Actions Speak Louder than Words

Chinese companies participating in BRI move forward quickly, encouraged by policy and financial incentives from the Chinese government. In April 2017, Chinese shipping company COSCO took a 67% stake in Greece's second-largest port, Piraeus, from which Chinese firms are

building a high-speed rail network, linking the city to Hungary and Germany. In July 2017 work started on the third stage of a Chinese-designed nuclear reactor in Pakistan. In the first five months of 2017, more than half of China's overseas contracts were signed with nations along the Silk Road. China wants to use the completion of real projects to show the world that they are there to assist with local economics, not to hinder. Actions speak louder than words.

5.5 Frame 5: China is a Partner, Not a Colonialist

The image of Chinese people in third-world nations in Africa, Asia, and Latin America is mostly positive, as compared to that of White people. For example, as a result of the Western colonization of Nigeria and the concerns about Western imperialism, Nigerian officials view partnership with the Chinese as more beneficial than with the West. Anyu and Ifedi (2008) posit that African nations still bear memories of the exploitation of its natural and human resources by Western powers. Hence, countries such as China are viewed as better alternatives for the establishment of trade relations (Brookes and Shin 2006). Neuliep (2015) states that the host country's perception of foreign investors affects its acceptance of the business involved. China was reported as being more influential in Nigeria than the USA, with China having US$200 billion in trade per year versus US$85 billion from the USA (Penney 2014). In Kenya, respect and confidence in China is also solid (Kitaba 2017). On May 26, 2017, Kenyan and Chinese workers completed the biggest infrastructure project in Kenya—a US$3.8 billion, 472 kilometer (293 mile) railway that runs from the port city of Mombasa to the capital Nairobi, part of a larger Chinese-built rail network linking several countries. The new railroad is expected to handle 50% of freight from Mombasa to the border with Uganda, compared to just 4% taken by the old British colonial-built railway. The company behind the Kenyan railway project, Chinese state-backed China Road and Bridge Corporation, employed 25,000 Kenyan workers. In the ten-year period between 2004 and 2014, African countries borrowed nearly US$10 billion for railway projects from China. At the railroad's first stop out of

Nairobi, locals like security guard Joseph have little criticism for the project. "I think it's a great idea," he said. "Things are going to change around here … These people are going to start businesses, the community will get developed … My kids may even be employed here". Developing nations see China as a true partner for development, instead of a colonial power.

The framing analysis shows that win-win is the ultimate frame used by the Chinese government and media to promote the BRI. No longer winner takes all, no longer zero sum game, the new idea in town is win-win and mutual benefit. Throughout the world people want to be winners, not losers. The fact that more and more countries and international organizations are joining in the BRI shows that the new frame of win-win really works.

6 Conclusions

The BRI, an ambitious massive infrastructure and geopolitical project, has created a new wave of globalization. BRI is implemented on a large scale quickly because it has been Chinese President Xi's priority. After all, as the CEO of China, he has the authority to complete the tasks of BRI effectively. The Chinese government and state-run media promote the BRI to global communities in the framework of win-win, in contrast with a traditional Western framework of winner takes all, in other words, the other parties involved are guaranteed to be losers. President Xi presents the BRI as a massive infrastructure project to revive the ancient Silk Road, to share the Chinese Dream, and to expand Chinese economic miracles to the rest of the world.

In 2014, China emerged as the world's second-largest economy (Goh 2014). By 2020 Chinese global outward direct investment will amount to more than US$1 trillion. Going Global is not only a Chinese government directed policy, but also a practical business decision by Chinese companies facing intense competition at home and abroad. The BRI provides a unique bandwagon for Chinese companies to go global. The Chinese government and state-owned media adopt positive frames to persuade countries in Asia, Europe, Africa, and the Americas

to partner in massive scale, multicountry, BRI infrastructure construction projects. As stated in this chapter, frames in communication matter, because they affect the attitudes and behaviors of their audiences (Chong and Druckman 2007). Consequently, with a powerful framing effect, citizens in BRI countries are influenced to adopt such frames, and thus generate support from international communities for the BRI. This chapter synthesized the five positive frames used by the Chinese government and state media to influence the attitudes and decisions of other countries participating in the BRI.

The massive BRI projects create a new wave of globalization, one that is led by China: Globalization 5.0. This new wave of globalization is less imperialistic and more multilateral, less ideology driven and more pragmatic than those that came before. The Brexit and America First policies in the West make international communities think that somehow the UK and the USA are becoming more inward-thinking isolationists and protectionists, while the win-win approach makes China stand out as a new leader of globalization.

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18

Final Reflections

Christoph Lattemann, Ilan Alon, and Wenxian Zhang

China has emerged as a world economic and political power in the aftermath of the 2008 global financial crisis. At a time of Brexit, when the UK voted to pull out of the EU in protest at uncontrolled immigration, and at a time that America's Donald Trump is talking about building a wall on the Mexican border to make the USA "Great Again", China is building belts, roads, and new communications with the rest of the world, signaling a new era. The twenty-first century could be

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China's century, but that is not guaranteed and depends on how China responds to concerns from the rest of the world and its relation vis-à-vis its neighbors, trading partners, and perceived enemies. It also depends on how China responds to territorial, economic, military, and political disputes. China's period of political neutrality, peaceful economic and political rise, and non-interference may be coming to an end as it is expected to take sides or action on global and geopolitical issues (debt, economic cycles, armed conflict, environment, human rights, labor relations, disaster relief, development, etc.). The new Silk Road will challenge China in new and significant ways in years to come, as many of the chapters in this book have demonstrated.

We have been studying China's globalization since 2006 through a series of global academic conferences (see: www.chinagoesglobal.org). We have seen how Chinese companies have risen through acquisitions, knowledge and capabilities development, and changes in the institutional environment, both domestically and internationally. The BRI is the most recent policy framework that has galvanized many of China's actions abroad and that will guide its future development. It is worth noting that China's recent rise is seen by some Chinese as merely a return to normality, to an historical tributary Middle Kingdom system, which is at the center of Asia and, perhaps, the world. China will combine soft power, attracting people to study its language and culture, and hard power, building a massive and powerful army and navy capable of projecting itself around the world. A strong economy is fundamental to both.

The BRI comes with many names (One Belt One Road, Silk Road Economic Belt, Maritime Silk Road, etc.). Whatever name it takes, the basic idea of the BRI is to consolidate and upgrade a dense network of bilateral FTAs into a multilateral arrangement. There is no question that the BRI project will confer many advantages on China by absorbing some of its domestic excess manufacturing capacity, and by improving its institutional environment for OFDI. There will also be advantages for smaller economies; in many poor countries, infrastructure will be built and economic development promoted. But to increase benefits from international trade, both China and the participating developing countries have to transform economic growth drivers, seize current

opportunities, reduce dependence on factors of production (investment and labor), increase reliance on innovation and quality, modernize, and diversify. Neighboring countries need to offer favorable institutional environments to gain from the BRI and to attract Chinese OFDI.

1 Is BRI a Win-Win Framework?

The new multilateral arrangements around the BRI will come with new multilateral institutions to challenge and complement established institutions, rules, and practices. This will increase China's soft power as part of the China Dream, because, as Jake Lin states in Chap. 10, there is a tacit social contract behind the BRI. Granting access to China's massive market and capital investment is a "favor" that the host country will need to return sooner or later.

China's increased political influence has already caused many liberal countries to raise political questions (e.g., South China Sea disputes), social questions (e.g., criticism about human rights), and economic questions (e.g., steel dumping investigations). However, as May Hongmei Gao stated in Chap. 17, China's state-run media promote the BRI to global communities as a win-win solution in contrast to the (perceived) Western concept of winner takes all.

To assess if the BRI is a win-win endeavor, questions in three major fields have to be answered: (1) geopolitics and power relations; (2) economic development; and (3) legal and cultural aspects.

1. Geopolitical and power relations consequences

According to Indeo in Chap. 8, the Chinese official reading of the geopolitical aims of the BRI is to achieve the following strategic goals: (1) the implementation of an alternative continental route for trade and energy imports; (2) the reduction of the dependency on maritime routes crossing the Malacca Straits and the South China Sea; (3) securing peace and the enhancement of a security buffer zone between Xinjiang western province and Central Asia; and (4) preserving the Chinese western provinces from threats of instability linked to Islamist terrorism.

However, it is clear that the BRI is an ambitious global economic project that will modify the current geopolitical landscape—determined and designed by the USA—not only in Central Asia but in all countries involved.

Hence, the major *geopolitical* questions are: will China use the current void of a ruling global superpower to shape future global international trade and the economic landscape? Is the BRI a Trojan horse for extending its geopolitical clout? As a contested multilateralism policy, will China use the BRI to challenge established institutions, rules, practices, or missions? So far, we can state that success in China's BRI strategy may well contribute to important shifts in global power relations. As Thomas Lairson formulates it in Chap. 3, China will challenge the global position of the USA and the traditional Western view of world trade "but it is not likely to undermine global stability."

2. Economic development

The BRI can create positive economic effects in all involved countries. Within its framework China is interested in promoting its economic influence in the world and exploring new markets for its agricultural commodities and food products; and it wants to secure and diversify its access to energy and resource supplies.

Europe will gain a closer connection to a mass market. China's funds and expertise for the construction of infrastructure mega-projects can also be beneficial to developing ASEAN states. In return, ASEAN economies could offer better regional trade conditions to China. For Central Asian countries, BRI is an attractive idea and its success will ensure them economic benefits, in terms of access to new markets, transit fees, and modern infrastructures. Many developing countries seek FDI, including African countries (see Chap. 9 from Emmanuel Kodzi). Investment from China is generally welcomed in developing countries that are seeking FDI, along with the expectation of positive spillovers like job creation, technology transfer, and productivity increases. But these countries also need to offer favorable institutional environments to gain from the BRI and to attract Chinese OFDI.

The major economic question for Tomas Casas i Klett and Omar Serrano Oswald in Chap. 5 is: will China's FTAs promote both trade and

non-trade public welfare in their partnering countries? Furthermore, will those benefits be equally distributed?

For Vasilii Erokhin and Tianming Gao in Chap.14 the major challenge for the sustainable development of trade (between China and the countries involved) will be the development and implementation of trade policies that take into account evolving technologies, new financing mechanisms, multistakeholder contributions/partnerships, and cross-border cooperation.

As Lin mentioned in Chap. 10, another major economic question is around the debt and financial risks of the BRI project. China is providing the bulk of financing for the BRI at a time when its own debt to GDP approaches 300%. The financing of the BRI will come from some combination of the Asian Infrastructure Investment Bank (AIIB), the New Development Bank (BRICS-led), China's Export and Import Bank, China Development Bank, a special Silk Road Fund, and Chinese policy banks and commercial banks. Furthermore, China uses government financial institutions to carry out intermediation between China's huge official foreign exchange reserves and its Going Global initiatives, namely the BRI, the AIIB, and the Silk Road Fund. The China Investment Corporation, the State Administration of Foreign Exchange Investment Company, and their various investment platforms and largely state-owned financial institutions, have provided much of the capital, the financial intermediation tools, and the financial management to move funds from China's foreign exchange reserves to help oversee the use of the funds.

Other questions raised in this book are: will these new institutions question the role of established global institutions, such as the World Bank and the IMF? Are Chinese investment vehicles transparent, and will they follow established international standards of good governance? Or will these new institutions become an additional threat to the global financial stability? There will be many future challenges in the 65 countries affected by the BRI.

3. Legal Systems and FTAs

As many BRI countries are developing countries, it is a justified concern, as Stephen Thomas and Ji Chen stated in Chap. 15, that their legal

systems are not sufficiently transparent or mature enough to fairly and efficiently deal with international disputes arising from large-scale international investment projects; not to mention that judicial corruption and/or local protectionism may come into play during attempted local resolutions of international disputes.

Hence, the question is whether the diversity and differences in legal systems, history, and jurisprudences will become potential obstacles for cross-country business cooperation? Are these obstacles likely to lead to legal risks and challenges in both contractual activities and implementation?

2 Conclusion

BRI is among the largest and most important global institutions affecting the world in the twenty-first century. China's leadership will be tested through the BRI. The tacit social contract behind the FTAs, finance arrangements, and the BRI with China will be challenged. The BRI has already been challenged by many liberal countries, and public opinion is critical on issues relating to politics, society, and the economy.

We hope that China will be able to lead, create win-win conditions, liberalize both its own economy and those of other developing countries, increase the security of neighboring countries, provide economic assistance to those in need, and help achieve both the China Dream and a peaceful and harmonious growth for the entire world.

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[1] Note: Page numbers followed by 'n' refer to notes.

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