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Great Leap Outward

Chinese ODI and the Belt & Road Initiative

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INTRODUCTION¹

Under the forceful and nationalistic leadership of Xi Jinping, Chinese outward investment is primarily a tool to project state power. Individual companies can and do pursue their own commercial interests, yet state support is reserved for investments that are deemed to further national industrial or strategic policies. State-backed investment is hardly a new phenomenon in China: Jiang Zemin's "Go Out" policy, launched back in 1999, encouraged state-owned enterprises (SOEs) to buy energy and mining assets overseas. But Xi's strategy is much more ambitious: to transform China into a global leader and reshape the world in Chinese interests.

Broadly, the strategy has two prongs. First, to acquire the foreign technology needed to upgrade the nation's manufacturing capabilities, so that China can compete at the top of the global value chain. This requires purchasing technology firms and intellectual property in developed economies, especially the United States and Europe. Second, to assert China's economic leadership across the developing world, bolstering its position as the only serious rival to the US. This is the strategic underpinning of Xi's signature foreign policy, the Belt and Road Initiative (BRI). Both prongs are designed to ensure that China realizes its long-term goal of becoming a fully developed superpower.

This paper will examine Chinese outward direct investment (ODI) and economic activity overseas, focusing on the progress of the BRI.

Outward Investment and the "Chinese Dream"

Xi Jinping's administration is harnessing the power of the state to realize one overriding goal: the "Chinese Dream" of national greatness.² Xi is not the first modern Chinese leader to promise "the great rejuvenation of the Chinese nation," but he is the first to set a target date: 2049, the centenary of the founding of the People's Republic of China. By mid-century, Xi says China must be "wealthy and strong," both at home and abroad.

¹ Much of this paper is based on my most recent book, which I do not reference elsewhere. See Miller, *China's Asian Dream: Empire Building Along the New Silk Road*, Zed Books, London (2017).

² Xi Jinping made his first public comments on the "Chinese Dream", also translated as "China Dream," when he visited the "The Road Toward Renewal" exhibition at the National Museum of China on November 29, 2012. See http://news.xinhuanet.com/english/china/2012-11/29/c_132008231.htm.

³ And as a great power, it must be an active participant in global affairs, helping to shape economic systems and make the international rules.⁴ The “Chinese Dream” is about more than national glory for its own sake: for China’s Communist leaders, international strength bolsters their political legitimacy at home.

The quest for “wealth and power” (*fuqiang*) has been a common refrain among China’s political leaders and intellectuals since the 19th century. It is shorthand for “enrich the state and strengthen its military power,” a phrase that dates back more than 2,000 years to the Warring States period, which laid the way to the unified Chinese empire. Today, the quest for wealth is intimately bound up with China’s place in the world: after years of preparing the ground economically, leaders believe China is on the cusp of taking its place as a global power. “China has stood up, grown rich and become strong,” Xinhua, the state news agency, declared at the conclusion of the 19th Party Congress in October 2017, after Xi Jinping had announced the beginning of a “New Era” of national development. “By 2050, two centuries after the Opium Wars, which plunged the ‘Middle Kingdom’ into a period of hurt and shame, China is set to regain its might and re-ascend to the top of the world.”⁵

The pursuit of national glory in this New Era requires a muscular foreign policy. This marks a fundamental shift in diplomatic strategy. Deng Xiaoping, China’s paramount leader from 1978 to 1992, advised that China should lie low in foreign affairs and concentrate on getting its own house in order—a dictum known as *taoguang yanghui*, usually translated as “hide our strength and bide our time.”⁶ For three decades, Beijing kept its nose out of other countries’ affairs, pursuing a foreign policy guided by the principle of non-intervention and non-alignment. Xi Jinping has abandoned the humble “hide and bide” approach, declaring that China must play a “proactive” international role.⁷ The diplomatic goal is to create a web of informal alliances lubricated by Chinese

³ For a useful roundup of Xi’s speeches on the “Chinese Dream” in which he talks about China becoming “wealthy and strong” (*fuqiang*), see “Xi Jinping zongshuji 15 pian jianghua xitong chanshu ‘zhongguo meng’”, *People’s Daily Online*, 19 June 2013, <http://theory.people.com.cn/n/2013/0619/c40531-21891787.html>.

⁴ See, eg, “China’s Xi demands accelerated FTA strategy”, Xinhua, December 6 2014, http://news.xinhuanet.com/english/china/2014-12/06/c_133837015.htm.

⁵ http://www.xinhuanet.com/english/2017-10/24/c_136702090.htm

⁶ Literally, “hide light, nurture obscurity.” Deng’s full dictum can be found here: “Deng Xiaoping’s ‘24-Character Strategy’”, <http://www.globalsecurity.org/military/world/china/24-character.htm>.

⁷ See “Xi Jinping: gengjia fenfa youwei de tuijin zhoubian waijiao”, 25 October 2013, <http://sc.people.com.cn/n/2013/1025/c345167-19776749.html>. Xi’s speech specifically referred to

cash. As other countries become ever more economically dependent on it, Beijing knows it will gain geopolitical clout.

China is the largest trading partner of most countries in Asia, including almost all of those in its immediate vicinity, and many countries beyond. This gives it enormous economic leverage. But it does not yet dominate investment and development finance to the same extent. In Southeast Asia, for example, Japan contributes more. In Central Asia, multilateral development banks such as the Asian Development Bank (ADB) and European Bank of Reconstruction and Development (EBRD) often play a bigger role. And in Central and Eastern Europe, where Chinese influence is growing rapidly, European funders are more significant.⁸ This is a failing that the BRI is designed to rectify.

At its simplest, the BRI describes two hugely ambitious projects to improve connectivity in Asia and beyond. On land, the “Silk Road Economic Belt” envisages the construction of new transport infrastructure and industrial corridors stretching across Central Asia to the Middle East and Europe, with additional economic corridors into sub-regions of Asia. On water, the “21st Century Maritime Silk Road” envisages new ports and trade routes across the South China Sea into the South Pacific, and through the Indian Ocean to the Mediterranean Sea. Beijing claims that 70 countries belong to the initiative, but the list continues to grow and there appear to be few geographical restraints on membership.⁹

The BRI has generated excitable headlines about how vast Chinese “investments” will reshape the Eurasian continent. Chinese enterprises are certainly funneling huge amounts of capital into projects, but most are not truly investments as they do not involve owning assets. Chinese acquisitions in Belt and Road countries are actually relatively small—only around 10% of annual ODI flows. In reality, the BRI is more

zhoubian waijiao—“neighborhood diplomacy.” But China’s “proactive” diplomacy now extends well beyond China’s neighborhood.

⁸ Hillman, “China’s Belt and Road Initiative: Five Years Later,” <https://www.csis.org/analysis/chinas-belt-and-road-initiative-five-years-later-0>.

⁹ A list of member countries is available on the official BRI portal: https://eng.yidaiyilu.gov.cn/info/iList.jsp?cat_id=10076&cur_page=1

often an opportunity for state construction enterprises to win contracts abroad, often funded by loans from Chinese state-owned banks to host governments.

By building vital public infrastructure—roads, bridges railways, ports, power lines, fiber-optic cables—the BRI is drawing participating countries ever tighter into China’s economic embrace. Beijing believes its financial muscle and engineering prowess will prove irresistible, especially in states that lack the capacity to finance and build their own infrastructure. For China, there is an economic logic at work: state engineering firms rake in billions of dollars from foreign contracts, even if many investments are not made for genuinely commercial reasons. But there is also a clear political motive: China expects its partners to respect its “core interests,” including its territorial claims in Taiwan, Tibet, Xinjiang and the South China Sea. Simply put, China is offering economic benefits in exchange for political support. This is a crucial aspect of what Beijing really means by “win-win” diplomacy.¹⁰

Above all, the BRI is a vehicle for China’s vaulting international ambitions under Xi Jinping’s leadership. As America’s commitment to Asia wavers under the presidency of Donald Trump, China is determined to replace it as the dominant regional power. Beijing’s propagandists are spinning the BRI as “Globalization 2.0,” a more inclusive and equitable version of international development driven by the East rather than the West.¹¹ Much of this is bluster, but Xi is playing a serious diplomatic game. Thirty heads of state attended the “Belt and Road Forum” held in Beijing in May 2017—not as many as had been hoped, but a sufficient showing to present Xi as an international statesman of substance. Picking up from his speech to global leaders at Davos earlier that year, Xi urged delegates to reject protectionism and embrace globalization, implicitly under China’s leadership.

China is still not trusted: the BRI is stirring up as much fear as hope, and few countries buy its diplomatic mantra of delivering “mutual benefits.” Yet China’s economic

¹⁰ One good example of the power of economic incentives came in October 2016, when China secured an unexpected diplomatic coup with the Philippines. Just three months after Manila won its international arbitration appeal against China’s maritime claims in the South China Sea, Philippines president Rodrigo Duterte returned home from Beijing with a trade and investment package worth US\$24bn. Since then, territorial tensions between the two countries have cooled considerably.

¹¹ See, eg, “China’s Belt and Road Initiative ushers in ‘Globalization 2.0’: Experts,” *China Daily*, http://www.chinadaily.com.cn/business/2017-04/13/content_28909176.htm.

diplomacy is bold, forward-looking and practical. Many states are more than happy to work with a partner that does not demand of them tiresome political or economic reforms. No doubt the BRI will deliver some costly boondoggles along the way: there are many reasons why projects can and will fail. But it will also bring useful infrastructure, new trade routes, and better connectivity across Asia and Europe. China's political leverage will inevitably grow as its economic grip strengthens—yet that might be an acceptable trade-off for countries anxiously seeking economic development.

OUTWARD INVESTMENT, CONSTRUCTION, LOANS AND AID

On the international stage, China's swift economic rise has come in two main phases. The first phase was founded on trade: after its WTO entry in 2001, China moved from the margins of the global trading system to become the world's largest exporter in 2009. The second phase, which began in earnest a decade ago, saw China's surge as an international investor. In 2008, China's annual outward investment breached US\$50bn for the first time, more than double the figure in 2007. By 2016, it had ballooned to US\$170bn. China now vies with Japan as the world's second-biggest source of outward investment, behind the US.

In the 2000s, China was known primarily for state acquisitions of natural resources in the developing world. Almost every deal involved energy or mining, and a large chunk of China's stock of ODI is still concentrated in oil and gas, high-grade coal mines, metal ores and hydropower. The direction of investment flows began to change, however, with the financial crisis of 2007-08. At first, the commodity-price crash gave mining and energy companies an added incentive to snaffle resource assets on the cheap. But Chinese firms also took the opportunity to diversify their investments into rich countries, acquiring newly available assets in non-resource sectors. They targeted technology, consumer goods and services, agriculture and real estate—seeking foreign brands and technologies for use at home, or access to new markets abroad.

By 2012, the investment tide seemed to have turned decisively away from emerging markets. As Chinese ODI became more driven by the private sector, capital naturally began to flow to economies with large markets, stable investment regimes, and strong technology assets. The trend suggested that Chinese ODI was becoming more “normal” and less frightening than it had previously seemed, when scaremongers suggested that unstoppable state firms, backed by a bottomless treasury, were embarked on a mad quest to “lock up” scarce natural resources.

The expanding footprint of private firms in developed economies continued for another three or four years. From 2014, Beijing made it easier for firms to make acquisitions overseas: pre-approval requirements were scrapped for most deals, and companies only required to register their planned transactions with local authorities. This released more pent-up demand from private firms looking to diversify abroad. As ODI values doubled

between 2012 and 2016, it seemed self-evident that China, long one of the world's biggest destinations for foreign investment, was on the road to becoming a big net exporter of capital.

In late 2016, however, the pendulum swung back.¹² Uneasy about the flood of capital pouring overseas into often dubious-looking investments in non-strategic industries, Chinese regulators became more stringent. With the strengthening US dollar placing huge downward pressure on the renminbi, the State Administration of Foreign Exchange (SAFE) acted to prevent capital leaving the country. Unofficially, it ordered banks to stop processing outward investments of more than US\$50mn without approval. Several government agencies announced they would closely monitor several specific types of outward investment, including purchases of real estate, hotels, cinemas and sports clubs.¹³ In January 2017, the State-owned Assets Supervision and Administrative Commission (SASAC) issued new rules on overseas investments, in principle banning large SOEs from venturing outside their core businesses.¹⁴

The then-central bank governor Zhou Xiaochuan also stepped into the fray. "Some investments do not meet our industrial policy requirements for outward investment," he said in March 2017. "Therefore we think a certain degree of policy guidance is necessary and effective."¹⁵ That summer, banks were ordered to examine their exposure to a group of acquisitive private firms, including property-to-entertainment giant Dalian Wanda, insurance and investment conglomerate Fosun International, travel group HNA, and insurer Anbang.¹⁶ Finally, regulators announced a new ODI regime based on lists of six types of encouraged investments, five types of restricted investments, and five types of prohibited investments.¹⁷

Guojin mintui: the state advances, the private sector retreats

¹² See Xie, "Rebooting China Inc.," Gavekal Dragonomics, 15 September 2017.

¹³ http://www.ndrc.gov.cn/xwzx/xwfb/201612/t20161206_829387.html.

¹⁴ <http://www.sasac.gov.cn/n2588035/n2588320/n2588335/c4258448/content.html>.

¹⁵ http://www.npc.gov.cn/npc/zhibo/zzzb23/node_29890.htm.

¹⁶ <https://www.ft.com/content/23c8ba54-5710-11e7-9fed-c19e2700005f>.

¹⁷ See Hanemann et al, "Chinese FDI in the US in 2017: A Double Policy Punch," Rhodium Group, 17 January 2018, <http://rhg.com/notes/chinese-fdi-in-the-us-in-2017-a-double-policy-punch>.

Measurement of China's ODI flows is imprecise: the Ministry of Commerce (Mofcom) and SAFE publish different figures that do not always line up. Mofcom's numbers are most widely quoted, but some critics believe they suffer from political manipulation.¹⁸ One way to crosscheck the official data is to use independent estimates of Chinese ODI built on counts of cross-border deals. The most comprehensive public data set is the China Global Investment Tracker (CGIT), maintained by the American Enterprise Institute, which lists every recorded transaction over US\$100mn from 2005 onwards.¹⁹ Another useful series is published by the Rhodium Group, a New York-based consultancy, although it only records transactions in the US.²⁰

Mofcom's data show that the crackdown which began in late 2016 worked: ODI fell to US\$120bn in 2017, down 29% on the year before. There is some disagreement over the extent of the investment slowdown, but ODI outflows would have been significantly higher without government restrictions.²¹ The most dramatic drop occurred in the US, where total investments halved to below US\$25bn, according to the CGIT. The Rhodium Group's China Investment Monitor recorded a similar decline: transactions slipped to US\$29bn, down 35% on the figure in 2016, with the biggest falls in entertainment, consumer products and services, real estate and hospitality. The actual decline was even more precipitous, as 60% of the transaction value made by Chinese firms in 2017 stemmed from the completion of deals announced in 2016.²²

In the US, much of the decline was directly attributable to Beijing's crackdown on "irrational" investments in non-strategic sectors: it is no coincidence that transaction values remained stable or even grew in strategic sectors such as biotech, ICT, transport and infrastructure. But higher regulatory hurdles in Washington were also an important factor. After broadening its definition of national security risks, the Committee on Foreign Investment in the United States (CFIUS) delayed or refused to approve many

¹⁸ See, eg, Derek Scissors: <http://www.aei.org/publication/private-data-not-private-firms-the-real-issues-in-chinese-investment/>.

¹⁹ <http://www.aei.org/china-global-investment-tracker/>.

²⁰ <http://rhg.com/interactive/china-investment-monitor>.

²¹ <http://fec.mofcom.gov.cn/article/fwtydy/tjsj/201801/20180102699450.shtml>. The CGIT's record of individual transactions shows that ODI actually rose by 9% to US\$181bn in 2017. Derek Scissors, who manages the CGIT, suggests that the bulk of ChemChina's record US\$43bn acquisition of Swiss agro-tech giant Syngenta does not seem to have been counted. Still, he concedes that the number of transactions fell, as did volume in many countries and sectors. See <http://www.aei.org/wp-content/uploads/2018/01/China-Tracker-Jan2018.pdf>.

²² Hanemann, *op cit*.

more deals than in previous years. The stricter approvals process targeted acquisitions of companies deemed to have strategic value, as well as those with access to sensitive US consumer data.

CFIUS's crackdown reflects deepening concern about Chinese state-led investments and unfair commercial practices. In both the US and Europe, Chinese firms regularly make cross-border acquisitions that foreign firms would never be permitted to make in China. The lack of "investment reciprocity" is particularly stark in Europe: Chinese foreign investment into the EU nearly doubled to US\$40bn in 2016, from US\$22bn in 2015, while European investment in China declined to a paltry US\$8bn.²³ According to the OECD's FDI Restrictiveness Index, China has by a wide margin the most stringent limits on foreign investors among major economies.²⁴ Many sectors are off-limits to foreign investors altogether, and others restricted to minority shareholdings or joint ventures. These restrictions are especially pervasive in China's fast-growing service sectors, which is also where developed countries tend to have the greatest comparative advantage.

Since the policy shift that began in late 2016, China's overseas investment regime has been tilted heavily in favor of SOEs and enterprises operating in strategic sectors. In 2017, the private share of ODI fell to 36% in 2017, down from 46% in 2016.²⁵ Restrictions on outward investment by private firms eased a little in the second half of 2017, but banks and companies now routinely consult regulators before making outbound deals, according to investment bankers and M&A lawyers.²⁶ Priority is given to investments that comply with national economic and strategic objectives, such as deals in high-tech sectors like semi-conductors. Acquisitions by state firms looking to advance national policy goals, notably the flagship "Made in China 2025" industrial policy and investments related to the BRI, are much more likely to gain official approval. That means that private firms risk losing out—with the possible exception of

²³ See Hanemann et al, *Record Flows and Growing Imbalances: Chinese Investment in Europe in 2016*, Merics Papers on China, January 2017, https://www.merics.org/sites/default/files/2017-09/MPOC_3_COFDI_2017.pdf.

²⁴ <https://data.oecd.org/fdi/fdi-restrictiveness.htm>.

²⁵ <http://www.aei.org/wp-content/uploads/2018/01/China-Tracker-Jan2018.pdf>.

²⁶ Xie, op cit.

politically canny tech companies like Tencent, Alibaba and Huawei, which are willing to pursue deals that benefit China Inc.

No doubt this state-driven investment model makes perfect sense within the confines of Zhongnanhai, but it is backfiring abroad. In both the US and Europe, opposition is hardening against Chinese acquisitions which threaten Western leadership in key technologies. In the US, private firms accounted for about 90% of Chinese transactions by value in 2017, as regulators blocked investments by SOEs on national security grounds. President Trump's administration is determined to protect strategic industries further, ordering an investigation of China's unfair commercial practices under Section 301 of the US Trade Act. In a detailed report published in March 2018, the Office of the US Trade Representative (USTR) accused the Chinese government of facilitating "the systematic investment in, and acquisition of, US companies and assets by Chinese entities, to obtain cutting-edge technologies and intellectual property and generate largescale technology transfer in industries deemed important by state industrial plans."²⁷ In response, the USTR said it would prepare to impose punitive tariffs on up to US\$60bn worth of Chinese exports, targeting strategic sectors included in the Made in China 2025 plan, such as advanced IT products, robotics, aerospace, high-speed rail equipment and electric vehicles. In addition, it proposed imposing investment restrictions independently of those made by CFIUS.

Europe is likely to follow suit. A shift in sentiment occurred in January 2017 with Chinese appliance maker Midea's US\$5.2bn acquisition of Kuka, a German advanced robotics firm. Two months later, the European Union Chamber of Commerce in China issued a report on Chinese industrial policy, concluding that there had been an "unprecedented wave of outbound investments" under the Made in China 2025 push.²⁸ And in February 2018, the Global Public Policy Institute and Mercator Institute for Chinese Studies in Berlin jointly published a hard-hitting report arguing that China was using investment as a tool for its "authoritarian advance" in Europe. "The EU and its members need to bolster a flexible set of investment screening tools," it concluded,

²⁷ *Findings of the Investigation into China's Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation Under Section 301 of the Trade Act of 1974*, Office of the United States Trade Representative, <https://ustr.gov/sites/default/files/Section%20301%20FINAL.PDF>.

²⁸ "China Manufacturing 2025: Putting Industrial Policy Ahead of Market Forces," <http://www.europeanchamber.com.cn/en/china-manufacturing-2025>.

adding that “Europe must be able to stop state-driven takeovers of companies that are of significant public interest.”²⁹ As the US and Europe erect higher regulatory barriers, China’s strategic investment push in the developed world is set to founder.

Investment and contacts along the Belt and Road

The story in emerging markets, where Chinese investments are increasingly channeled through the Belt and Road Initiative, is rather different. In the first place, the investment values are much smaller. Mofcom’s data show that Chinese firms invested US\$44bn in 60-odd countries along the Belt and Road in the three years from 2015 to 2017—almost exactly what China National Chemical Corporation paid for Swiss agro-tech giant Syngenta in 2017. That year, official BRI investments amounted to a little over US\$14bn; the biggest recipients were Singapore, Malaysia, Laos, Indonesia, Pakistan, Vietnam, Russia, the UAE and Cambodia.³⁰ In March 2017, the head of the National Development and Reform Commission said that “more than US\$50bn” had been invested since Xi Jinping launched the initiative in late 2013, without giving details. What is clear is that annual investment along the Belt and Road is only a fraction of total outward investment.

Exactly what constitutes an official BRI investment is a puzzle. Transaction values gathered by independent sources in Belt and Road countries are rather higher than Mofcom’s, which implies that not every investment is counted under the initiative. The CGIT data record that total investments in BRI countries amounted to US\$32bn in 2017, up from US\$30bn in 2016 but down from US\$38bn in 2015. Reuters counted acquisitions in 68 countries worth US\$31bn in 2016 and US\$33bn in the first eight months of 2017. Its analysis suggests that the smoother approval process enjoyed by companies making BRI deals explains why these investments rose even as the value of China’s global transactions fell.³¹

²⁹ See Benner et al, *Authoritarian Advance: Responding to China’s Growing Political Influence in Europe*, https://www.merics.org/sites/default/files/2018-02/GPPi_MERICS_Authoritarian_Advance_2018_1.pdf.

³⁰ <http://fec.mofcom.gov.cn/article/fwydy/tjsj/201801/20180102699450.shtml>.

³¹ <https://www.reuters.com/article/us-china-m-a/exclusive-chinas-belt-and-road-acquisitions-surge-despite-outbound-capital-crackdown-idUSKCN1AW00K>.

Since the definition of what constitutes a BRI investment is so fuzzy, there is no point worrying too much about the exact numbers. In any case, Chinese enterprises receive more income from construction and engineering contracts than they spend on foreign assets. This is a critical point: so-called Chinese “investments” are often no such thing. The value of overseas construction contracts and revenues has risen quickly, even as outward investment along the Belt and Road flat-lined in 2015-17. Mofcom reports that 61 Belt and Road countries generated new construction contracts worth US\$126bn and actual revenues of US\$76bn in 2016, accounting for about half of China’s total of both. In 2017, the value of contracts rose to US\$144bn for 7,217 projects in 61 countries, up 15%. Actual project revenues received amounted to US\$86bn, 51% of China’s global total.³²

These figures need to be treated with caution: there is a high probability that the contracted revenues are inflated to some degree by SOEs and officials looking to hit political targets. Moreover, not all of these projects are necessarily related to the Belt and Road’s core infrastructure push. Even so, the data are encouraging for engineering firms seeking new markets outside China, and do suggest the initiative has gained traction. The CGIT, which records construction projects in addition to investments, confirms that seven out of 10 of the biggest locations for construction projects by value are Belt and Road countries (the other three are in Africa).

The salient point is that, at its heart, the BRI is about the financing and building of transport and energy infrastructure for foreign investors. These projects can be worth billions of dollars, but they rarely involve Chinese ownership on foreign soil.

China’s state banks: loans and aid

Construction along the Belt and Road is dominated by large SOEs, which enjoy huge financial backing from state banks.³³ Bank of China, for example, has said it would lend

³² <http://fec.mofcom.gov.cn/article/fwtydl/tjsj/201801/20180102699450.shtml>.

³³ The “Belt and Road Big Data Report 2017,” published by the State Council Information Center, lists the top 10 Chinese enterprises taking part in BRI projects. Eight are state owned: State Grid Corporation of China, State Power Investment Corporation, China National Petroleum Corporation, Sinopec Corporation, Alibaba Group, China Railway Construction Corporation Limited, CRRC Corporation Limited, Huawei Technologies Co Ltd, Bank of China and China Mobile Communications Corporation. See <https://eng.yidaiyilu.gov.cn/jcsj/dsjkydl/40513.htm>.

US\$100bn in 2016-18 on BRI projects; CITIC Bank pledged total lending of US\$113bn over an unspecified time frame.³⁴ Not all of these loans will truly go to BRI projects, as any number of loans may be labeled under “Belt and Road” by savvy executives looking to impress their political masters. But there is no doubt that plenty of state-sponsored funding is available for enterprises engaged in projects that tick the requisite policy boxes.

By far the most significant financiers are China’s two policy banks: China Development Bank (CDB) and the Export-Import Bank of China (Exim). Xi Jinping announced at the Belt and Road Forum in May 2017 that an extra US\$55bn would be injected into China’s policy banks to help bankroll BRI projects. Some of this cash will go to supporting SOEs’ foreign operations; the bulk will probably be loaned to foreign governments who cannot afford to pay their Chinese constructors upfront. For several years, the CDB and Exim have lent more in Asia than the World Bank and ADB combined.

CDB’s original mandate was to support domestic infrastructure, but since 2008 it has also funded foreign resource acquisitions by state-owned firms. In addition to financing China’s push across Africa, it helped to grease big state-to-state oil deals with Venezuela, Russia and Brazil. Its portfolio of international loans rose from nearly zero in 2007 to US\$187bn in 2013, though its net lending fell back a little in 2014.³⁵ Its average annual net international lending exceeded any of the multilateral development banks in 2008-14. CDB claimed to have lent US\$180bn for BRI projects by the end of 2017.³⁶

For its part, China Exim Bank was traditionally a supplier of trade credits to facilitate exports and imports. But since 2010 it has become a major financier overseas: in 2014 alone, it disbursed US\$151bn, equivalent to the entire GDP of Bangladesh. Its accounts are rather opaque, but in 2014 its total non-trade related disbursements amounted to

³⁴ Kroeber, “Financing China’s global dreams,” *China Economic Quarterly*, Gavekal Dragonomics, November 2015.

³⁵ See Henry Sanderson and Michael Forsythe, *China’s Superbank: Debt, Oil and Influence—How China Development Bank is Rewriting the Rules of Finance*, Wiley, Singapore (2013).

³⁶ “Will China’s Belt and Road Initiative Outdo the Marshall Plan?” *The Economist*, 8 March 2017, <https://www.economist.com/news/finance-and-economics/21738370-how-chinas-infrastructure-projects-around-world-stack-up-against-americas-plan>.

US\$80bn—more than the combined lending of all the seven major multilateral development banks. Some of this was spent in China in the form of loans to engineering firms and materials companies selling goods and services abroad, but Exim Bank probably ranks as the world's single biggest financier of overseas development.³⁷ It claimed to have lent US\$110bn for BRI projects by the end of 2016.³⁸

Most loans by Chinese state banks are made on commercial terms. This is because China's interests come first: the BRI is not a giant handout. In this sense, the initiative is quite unlike the Marshall Plan, to which it is sometimes compared. According to economic historians, the US gifted 90% of the US\$13bn it plowed into Europe's war-ravaged economies between April 1948 and the summer of 1951. (That is equivalent to US\$130bn today, based on US consumer-price inflation.)³⁹ China is likely to provide far higher sums, but on much less generous terms. The caveat is that the Chinese government accepts that loans made for strategic rather than commercial reasons may never be repaid. Government officials privately admit they expect to lose 80% of their investment in Pakistan, 50% in Myanmar and 30% in Central Asia.⁴⁰ That is a price worth paying, Beijing believes, to secure geopolitical influence and/or greater border security.

Most Chinese financing comes in the form of export credits and loans made at market or close-to-market interest rates. In risky parts of the world where other investors and financiers fear to tread, Chinese banks can even afford to charge much higher rates. Most of this development finance generally comes with few (if any) strings attached, allowing rogue countries to pocket funds without making the kinds of economic or political reforms demanded by traditional aid donors. In Sri Lanka, to which China made a series of high-interest loans under the corrupt regime of the former president Mahinda Rajapaksa, a large chunk of these funds were paid as kickbacks to the leader's cronies.⁴¹

In Colombo, the extremely commercial terms charged by China became a bone of contention for the new government that took over in 2015. "The Chinese are not

³⁷ Kroeber, op cit.

³⁸ *The Economist*, op cit.

³⁹ Ibid.

⁴⁰ Author interview with Sun Yun in Washington, DC, 2 October 2015.

⁴¹ Author interviews with government ministers in Colombo, 13 March 2015.

providing gifts,” Ravi Karunanayake, Sri Lanka’s then finance minister told me that summer. “They’ve lent us US\$5bn on very, very commercial terms. Most of the loans are at about 6%, but the highest is 8.8%.”⁴² By comparison, multilateral development banks typically charge well under 2%. In 2016, a Sri Lankan minister informed reporters that a Chinese lender, presumably China Exim Bank, had agreed to issue a large loan at an interest rate of 2% to enable Sri Lanka to pay off previous loans taken out at 6.9%.⁴³

Beijing is sometimes willing to renegotiate loans, but it generally expects to get a return on its financing. In the right circumstances, though, it is willing to provide grants and aid loans at minimal interest rates. In addition to the US\$8bn lent to Sri Lanka at market rates, for example, China also made concessionary loans worth around US\$3bn.⁴⁴ China does not regularly release statistics on its foreign aid, but it provided approximately Rmb400bn (about US\$60bn) in development aid to 166 countries and international organizations between 1956 and 2016, according to a government white paper.⁴⁵ In 2013, it disbursed US\$7bn in aid globally, ranking sixth, according to the OECD.⁴⁶ It is certainly by far the largest aid donor among developing countries.

A database compiled at the College of William & Mary suggests that China’s aid program is actually more generous.⁴⁷ China committed to issuing US\$354bn of “official finance” between 2000 and 2014, the most recent year for which the researchers compiled data. Well over US\$200bn of this was loaned on generally non-concessional terms for commercially oriented projects; but China also provided at least US\$80bn of genuine development aid, in which at least 25% of the funds were given as grants. Since nearly US\$60bn of official finance flows were too opaque to be clearly

⁴² Author interview, 13 March 2015.

⁴³ See Seneviratne, “Sri Lanka Turning Anew Into a Geopolitical Battle Ground—Analysis”, *Eurasia Review*, 30 January 2016, <http://www.eurasiareview.com/30012016-sri-lanka-turning-anew-into-a-geopolitical-battle-ground-analysis/>. A smaller loan was granted by Exim Bank later that year: see “Cabinet approves fresh loan from China EXIM Bank”, 9 June 2016, <http://www.ft.lk/article/546991/Cabinet-approves-fresh-loan-from-China-EXIM-Bank>.

⁴⁴ <http://aiddata.org/china>

⁴⁵ http://www.xinhuanet.com/english/2016-12/01/c_135872798.htm

⁴⁶ See Kitano et al, *Estimating China’s Foreign Aid 2001-2013*, JICA Research Institute, June 2014, https://jica-ri.jica.go.jp/publication/assets/JICA-RI_WP_No.78_2014.pdf. Further information can be found in the *White Paper on China’s Foreign Aid (2014)*, http://news.xinhuanet.com/english/china/2014-07/10/c_133474011.htm. See also Miller, “Asia’s Infrastructure Arms Race”, *Gavekal Dragonomics*, 30 June 2015.

⁴⁷ See “China’s Global Development Footprint,” <http://aiddata.org/china>.

placed in either the non-concessional or development aid categories, China's actual aid disbursement could easily have topped US\$100bn. By comparison, the US donated US\$366bn of development aid during the same period.

Beijing's next task is to manage its aid programs more effectively. At 2018's annual meeting of the National People's Congress, it was announced that a new International Development Cooperation Agency would be established to utilize foreign aid as "an important instrument for great power diplomacy." The new agency merges offices under the ministries of commerce and foreign affairs, which have typically handed out funds on an often ad hoc basis to client states or friendly foreign leaders.⁴⁸ As China grows richer and more confident, it is set to behave more like other rich economies, doling out aid across a broader range of developing countries in an attempt to win good will.

The Asian Infrastructure Investment Bank

Xi Jinping first indicated that China would take a new approach to international development finance in October 2013. Speaking to the Indonesian parliament in Jakarta, he proposed that China set up its own multilateral development bank. Within just 18 months, it had gathered 57 founder members, including most Asian and many European countries. The rapid progress of the venture surprised everyone, not least Beijing. When the Asian Infrastructure Investment Bank's (AIIB) articles of agreement entered into force on Christmas Day 2015, the only two notable absentees were the US and Japan.⁴⁹

Much of the early resistance to AIIB came from the same two countries. Nervous officials at the ADB, which was founded by Japan in 1966 primarily to advance its own regional interests, worried that the "Chinese bank" would prove an unfair competitor.⁵⁰ They feared it would undercut the ADB's own high lending standards and threaten its role as "Asia's bank." Washington saw an even bigger threat. China, it suspected, was trying to create an alternative to the US-dominated system of global development

⁴⁸ See Xie, "A New Organization Chart," Gavekal Dragonomics, 14 March 2018.

⁴⁹ The full list of members can be found on the AIIB website:
<http://euweb.aiib.org/html/aboutus/introduction/Membership/?show=0>.

⁵⁰ This is how ADB officials referred to it on the side-lines of their annual meeting in May 2014, held in Astana, which I attended.

finance, enshrined at Bretton Woods. It viewed the AIIB as a potential competitor to the World Bank, and was concerned about its commitment to adhere to rules of good governance, responsible lending and environmental protection. Before the AIIB was officially established, it tried—and failed—to dissuade its allies from joining. This was short-sighted: shrewder policymakers would have sought to influence the evolution of the bank from the inside.⁵¹

But Washington was right about one thing: the founding of the AIIB was indeed motivated in part by Beijing's determination to redress the inequities in the Bretton Woods system. At the AIIB's signing ceremony in June 2015, China's then finance minister Lou Jiwei said the bank represented "an important move on the part of China to fulfil its growing international responsibilities, and to improve and complement the existing international order."⁵² Moreover, whatever its leaders say today, the AIIB was specifically conceived as an arm of China's economy diplomacy. The BRI's founding document clearly implies that the bank was established to support the initiative—even if the AIIB has since declared its operational independence from the Chinese state.⁵³

The founding of the AIIB—and its sister institution, the BRICS countries' New Development Bank—showed China's determination to play a global role commensurate with its economic might.⁵⁴ But this does not mean that it wants to demolish the existing global economic architecture. Far from building an alternative to the US-sponsored system of development finance, China is seeking to carve out its own space within it. Jin Liqun, the AIIB's urbane president and a fluent English speaker, is a former vice president of the ADB himself. He has worked hard to reassure skeptics that the AIIB will not seek to overturn the tenets of multilateral development finance. The bank, he says, will be "lean, clean and green": managerially efficient, intolerant of

⁵¹ See Miller, "A Petty and Short-Sighted Hissy Fit", Gavekal Research, 17 March 2015.

⁵² Ahead of the ceremony, *China Daily* printed a version of the speech Lou later gave at the ceremony: "Inclusive AIIB can make a difference", 25 June 2015, http://usa.chinadaily.com.cn/epaper/2015-06/25/content_21101260.htm.

⁵³ Here is the salient passage: "The Chinese government will integrate its domestic resources to provide stronger policy support for the Initiative. It will facilitate the establishment of the Asian Infrastructure Investment Bank." See "Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road," op cit.

⁵⁴ The New Development Bank (NDB) was founded by the five BRICS countries—Brazil, Russia, India, China and South Africa—a month after the AIIB. It aims to "mobilize resources for infrastructure and sustainable development projects" across all emerging economies. Headquartered in Shanghai, the NDB operates in a similar space as the ADB and World Bank.

corruption, and environmentally friendly.⁵⁵ From the very beginning, it busily recruited international consultants to help achieve these aims, including high-ranking Western diplomats and senior staff from the World Bank.

This multilateral approach has reassured foreign skeptics. By March 2018, the AIIB had 63 fully paid-in members—42 “regional” members from Asia, and 21 non-regional members—with a further 21 prospective members waiting to subscribe. Not only has the success in attracting so many shareholders given the bank international legitimacy, it also greatly limits Beijing’s control over it. China naturally exercises significant leadership and is the AIIB’s largest shareholder, based on its US\$29.8bn stake. In addition, its voting share of 26.9% gives it an effective veto, since a “super-majority” of 75% is needed to make significant decisions. But this share is set to fall as more members join. And with so many developed countries on board, the AIIB has to follow international best practice, especially on lending standards.

In any case, it is in Beijing’s interests to ensure the AIIB is well run. It knows that advancing China’s influence requires it to project a friendlier, more multilateral face. To this end, the AIIB’s operations are admirably transparent: its governance and shareholding structure, business plan, public consultation procedures, procurement policies, code of conduct, and financial statements are all publicly available online.⁵⁶ Moreover, it has forged alliances with other multilateral development banks, signing co-financing agreements with the ADB, World Bank, EBRD and European Investment Bank (EIB). Far from competing with existing institutions, it is cooperating with and learning from them.

This is not to say that some of the projects financed by the AIIB do not serve China’s interests: it has co-financed, for example, an expressway along the China-Pakistan Economic Corridor (CPEC). But the AIIB’s value to China is diplomatic rather than financial. It plans to lend no more than US\$2bn per year for its first five years of operation—significantly less than other multilateral development banks, and a puny amount compared with the vast loans routinely issued by China’s giant policy banks.

⁵⁵ “China-Led Development Bank AIIB Will be Lean, Clean and Green, Says its President”, *Wall Street Journal*, 22 January 2016, <http://www.wsj.com/articles/china-led-development-bank-will-be-lean-clean-and-green-says-head-1453479933?mg=id-wsj>.

⁵⁶ See <https://www.aiib.org/en/index.html>.

Although the AIIB has authorized capital of US\$100bn, its paid-in working capital is much smaller. By 2020, it will have roughly US\$20bn of usable equity, similar to the ADB.⁵⁷

In sum, the AIIB is a genuinely multilateral institution that does not represent a credible alternative to the Bretton Woods institutions. Under Xi Jinping's leadership, outward investment is increasingly designed to serve the interests of the state, but the AIIB does so only by boosting China's global prestige.⁵⁸ The truth is that China's financial power really resides in its policy banks. CDB and Exim Bank will happily support projects, such as coal-fired power stations, that the AIIB and other multilateral lenders would not touch. China's state-owned banks have more than enough cash to support Beijing's bold plans overseas. The bigger question is whether they will find enough bankable projects and willing recipients of Chinese investment to satisfy their leaders' global aspirations.

⁵⁷ See Kroeber, *op cit.*

⁵⁸ See Miller, "A Boring Infrastructure Bank," *Gavekal Dragonomics*, 30 June 2016.

BELT AND ROAD INITIATIVE

Stretching from the South China Sea across the Eurasian land mass, the Belt and Road Initiative is the most ambitious piece of China's outward investment policy.⁵⁹ Taking its inspiration from the ancient Silk Road that ran from China to Europe via central Asia, it envisages building roads, railways and industrial corridors across some of the wildest terrain on earth, and linking these to upgraded ports in Asia, Africa, the Middle East and Europe. Beijing says it will dismantle investment barriers, create new trade routes, improve international logistics, and deepen regional financial integration. It even claims that it will promote "world peace."⁶⁰

The initiative runs under a confusion of different monikers. Xi Jinping first proposed building a "Silk Road Economic Belt," a land route through Central Asia and the Middle East to Europe, at a speech in Kazakhstan in September 2013.⁶¹ A month later, in a speech to the Indonesian parliament, he proposed creating a "21st Century Maritime Silk Road," a web of sea lanes through the South China Sea and Indian Ocean.⁶² First called the New Silk Road, the scheme was later dubbed "One Belt, One Road" (*yidai yilu*), which sounds less clunky in Chinese than in English. After much internal debate, it was officially renamed the "Belt and Road Initiative" in 2015. Beijing is adamant that the BRI should not be called a "plan" or a "strategy," lest it be interpreted as a ruse to build a vast economic empire. China claims no ownership over the initiative, which it says is about "interconnected development" and "international coordination"—though, in reality, it is very much a Chinese project.

The BRI has enjoyed a huge propaganda push, but Beijing has done a poor job of explaining its intentions. Officially, the initiative targets five vague goals: policy coordination, facilities connectivity, unimpeded trade, financial integration, and people-to-people bonds.⁶³ Yet it is less a coherent plan involving a clear list of projects

⁵⁹ Just how ambitious is a subject of much debate. The BRI is often referred to as US\$1trn project; sometimes even higher figures are quoted. The truth is that there is no official number, and we can only guess how much capital will be plowed into BRI projects over the coming decade and beyond.

⁶⁰ "Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road", 28 March 2015, http://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1249618.shtml.

⁶¹ "President Xi Jinping Delivers Important Speech and Proposes to Build a Silk Road Economic Belt with Central Asian Countries", September 7 2013, http://www.fmprc.gov.cn/mfa_eng/topics_665678/xjpfwzysiesgjtfhshzzfh_665686/t1076334.shtml.

⁶² 2 October 2013, http://www.asean-china-center.org/english/2013-10/03/c_133062675.htm.

⁶³ "Vision and Actions," op cit.

than a series of wide-ranging policy aims. It is designed to bring a more strategic approach to overseas infrastructure construction than in the past, but many of the projects now included under its banner have been planned for years. With no clear definition, the BRI has become government shorthand for Chinese financing, investment and construction across much of the developing world.

Transport connectivity is at the heart of the initiative, which state media claim will run through 70 countries. Six distinct “economic corridors” are associated with it, but there are few clear transport routes.⁶⁴ In reality, Chinese firms will help to lay new roads and railway tracks, linking them to new or upgraded ports, wherever they find willing partners. Their success will rely on the vagaries of diplomatic negotiations, corporate deal-making, project management and economic demand. Some routes, such as the rail lines that lead from China to Europe via across Kazakhstan and Russia, already exist; others are on the drawing table and may never leave it. Much like the ancient Silk Road, the Belt and Road will form a network of trading routes influenced by the competing demands of geography, commerce and geopolitics.

The BRI is motivated by a number of sweeping goals. In the first place, it aims to protect national security. China wants to create a network of economic dependency that will consolidate its regional leadership and enable it to hedge against the United States’ alliance structure in Asia. Beijing has few genuine friends, but it is serious about buying influence. This is a departure from the past, when Beijing did not try to cultivate close diplomatic relations, other than with the rogue states of North Korea and Myanmar. It also wants to diversify energy supplies and create new import routes for oil and gas that do not rely on passing through the Strait of Malacca, which it views as a strategic chokepoint.

Equally important are economic motivations. At home, Beijing calculates that better connectivity will help its landlocked border regions become viable trade zones, bringing much-needed development. Abroad, Beijing hopes that state engineering firms, commodity producers and capital goods makers will find lucrative new markets. Envisaging a regional production chain centered on China’s own advanced

⁶⁴ The six corridors are: 1) New Eurasian Land Bridge from China to Europe; 2) China-Mongolia-Russia Corridor; 3) China-Central Asia-West Asia Corridor to Turkey; 4) China-Indochina Peninsula Corridor; 5) Bangladesh-China-Myanmar-India Economic Corridor; 6) China-Pakistan Economic Corridor.

manufacturing, it is subsidizing SOEs to export technology and industrial goods, which it hopes will lead to the widespread adoption of Chinese standards. Demand for Chinese construction services and capital goods will in turn be driven by state banks financing Chinese firms to build high-speed railways, pipelines, power grids and telecoms networks.

Finally, there are financial considerations. Beijing is pushing for greater financial cooperation and integration of cross-border markets, including an increased use of the renminbi for trade settlement. This would serve the long-term ambition of making the renminbi an international currency, taking its place alongside the dollar and the euro. In addition, it wants to nurture an alternative investment channel for China's more than US\$3trn of foreign exchange reserves.

Mixed progress along the Belt and the Road

Given that building infrastructure and fostering new trade flows takes years, it is too early to assess whether the initiative is a success. Much of the construction along the Belt and Road was planned or already underway on an ad hoc basis before President Xi repackaged it under the BRI banner, and it is impossible to unravel many recent developments from pre-existing projects and trends. Yet it is fair to say that the vastly increased political support offered since the initiative was announced has added considerable financial and diplomatic momentum to China's economic activity overseas.

The impact of the BRI is most obvious in Pakistan, where the China-Pakistan Economic Corridor—a US\$62bn package of infrastructure and agricultural projects that includes a planned highway, railway and pipeline linking landlocked western China to the Arabian Sea—has taken off since 2015. Gwadar Port, the gateway to the corridor, opened in 2016 after upgrades worth US\$1.6bn. China began work there as far back as 2002, completing the first phase of a deep-water port in 2007; the BRI has provided extra cash and linked the project to the more ambitious economic corridor. China Overseas Port Holding Co plans to spend US\$4.5bn on roads, power, hotels and other infrastructure in Gwadar's industrial zone. Inland, several coal and wind power projects

have been completed ahead of schedule, meaning that Pakistan is on course to eliminate its power shortage by 2019.⁶⁵

To the north, the New Eurasian Land Bridge—a series of roads and railway lines from China to Europe—has also made progress. Kazakhstan began building a railway linking China to Russia back in 2004, and the first rail services to Duisburg in Germany launched in 2012, a full year before President Xi first spoke of building a new Silk Road. But freight traffic only really began to take off in 2015 and is accelerating rapidly. More than 2,000 direct freight trains ran between China and Europe in 2017, nearly three times the total in 2015, connecting roughly 35 Chinese cities with 12 European countries, in as little as 10-14 days.⁶⁶ Sinotrans, the largest state-owned logistics firm, forecasts the number of trains will rise to 5,000 in 2020.⁶⁷

Projects to improve connectivity across Southeast Asia are also developing. One example is an alliance between 10 Chinese ports and six Malaysian ports, which are working together to reduce bottlenecks and boost trade; China is investing US\$10bn in a deep-sea port and commercial marina in Malacca. Up the coast, China Communications Construction Company is working on a 620-km rail line from Kuala Lumpur to the Thai border, financed by a US\$12bn loan from China Exim Bank. In late 2017, construction began in northeast Thailand on a section of line that will link to a US\$7.2bn railway across Laos, which Chinese engineers are busy carving through the jungle.⁶⁸ These sections will eventually join up to form a 3,900 km railway from Kunming to Singapore.

Beyond Asia, Chinese engineers have upgraded the railway line from Nairobi to the port of Mombasa on Africa's east coast. A new Chinese-built and operated railway also runs from Ethiopia to Djibouti, where China opened its first overseas military base in 2017. In the Mediterranean, China Ocean Shipping Company (Cosco) has invested at least €4.3bn in Greece's Piraeus port, which it acquired in 2016. Container throughput nearly quadrupled under its management between 2010 and 2015, with Huawei, ZTE,

⁶⁵ Rafiq, "The China-Pakistan Economic Corridor: Three Years Later," February 12, 2018: <https://reconnectingasia.csis.org/analysis/entries/cpec-at-three/>.

⁶⁶ <https://www.csis.org/analysis/rise-china-europe-railways>.

⁶⁷ https://fiata.com/fileadmin/user_upload/documents/recent_views/Working_Group_OSJD_FIATA/O_SJD-FIATA_Odessa_2_June_2017_-_Presentation_Zhao_Ning.pdf.

⁶⁸ <https://thediplomat.com/2017/12/construction-of-thailand-china-railway-finally-gets-underway/>.

Samsung, HP and Sony using Piraeus as their gateway to Europe. Cosco has committed to investing a further €700mn over the coming decade as it aims to make Piraeus the biggest commercial container port in the Mediterranean, eventually competing with the northern European hubs of Hamburg, Rotterdam and Antwerp.⁶⁹

Despite these successes, doubts hang over the viability of many Belt and Road projects, for a variety of reasons. One issue is security in politically volatile states. Pakistan has reportedly deployed 14,500 security personnel to ensure the safety of some 7,000 Chinese nationals working on the economic corridor. The danger was evident in May 2017, when two Chinese language teachers were kidnapped by armed men in Quetta, a remote but important section of the corridor. One of Beijing's motives in Pakistan is to prevent violent extremism seeping over the border into Xinjiang. Far from being a commercial venture, "this massive investment is actually a form of bribe" to persuade Islamabad to get a grip on terrorism, says one Beijing-based expert.⁷⁰ But further trouble is almost inevitable.

Another issue is financial viability. In public, few Pakistanis feel able to criticize the vast debts their country must bear to pay for CPEC; but the project is no longer viewed as an unalloyed good. The fiscal pressure is clear: Pakistan had to float Eurobonds worth US\$3.5bn in late 2017 and early 2018, partly to pay for machinery imports associated with CPEC. As the costs stack up, it may be forced to seek an IMF bailout to plug its ballooning current account deficit.⁷¹ Meanwhile, critics fear that new railways in Southeast Asia will not deliver the economic benefits Beijing promises. The Laos section of the Kunming to Singapore line alone is projected to cost the equivalent of half the country's annual economic output. Meanwhile, a much-hyped high-speed rail line between Bandung and Jakarta in Indonesia has suffered from expensive delays, and may never be built.

Criticism of the BRI is deepening, stirred by the realization that Chinese loans-for-infrastructure can amount to an inescapable debt trap. Some skeptics even refer, snidely, to "One Belt, One Trap." In Sri Lanka the current government has tried in vain to

⁶⁹ <http://www.seatrade-maritime.com/news/europe/cosco-reveals-620m-piraeus-development-plan.html>.

⁷⁰ Author interview in Beijing, 19 June 2015.

⁷¹ Rafiq, *op cit*.

extricate itself from the high-interest loans negotiated under President Rajapaksa. Failing to find alternative sources of financing and investment, it has been forced to swap debt for equity in some Chinese-financed infrastructure projects. In December 2017, it handed over the southern port of Hambantota to China Merchants Port Holdings on a 99-year lease.⁷²

Meanwhile, on China's border in Central Asia, tiny Tajikistan and Kyrgyzstan are also excessively indebted to Chinese banks. Both rely on Chinese firms to construct national transport and power networks. China National Petroleum Corp, which built and operates a gas pipeline from Turkmenistan that supplies both countries' power stations, literally keeps the lights on. Planned Chinese investments will increase Tajikistan's national debt owed to China to an estimated 100% of GDP; Kyrgyzstan owes 50% of its external debt to China Exim Bank alone.⁷³ Large chunks of these debts are unlikely to be paid back, leading executives in some Chinese banks and construction firms to complain in private that they, too, are being "trapped" into delivering projects that will never make a decent return.

Probably China's most vociferous critic is India, which sees the BRI primarily as a strategic ploy. Its suspicions were first aroused when a People's Liberation Army Navy submarine docked at a Chinese-owned container port in Colombo in 2014, seeming to confirm its fears about China's ambitions to wrest control of the Indian Ocean. India has only grown more agitated by the progress of the China-Pakistan Economic Corridor, which not only runs through disputed territory in Kashmir and Gilgit-Baltistan, but also gives China a potential naval base at Gwadar in the Arabian Sea. Military chiefs view China's port building in the Indian Ocean as a "string of pearls" threatening to choke Mother India. Scaremongering about China's strategic military ambitions is certainly a useful ruse to squeeze extra funding out of the national budget—but there is no doubt that China's financial muscle-flexing is weakening India's traditional grip in South Asia.

One example is the Himalayan kingdom of Nepal, where a pro-China, communist government took power in March 2018. India has long and deep roots in its much

⁷² <https://www.ft.com/content/e150ef0c-de37-11e7-a8a4-0a1e63a52f9c>.

⁷³ I am quoting information conveyed by regional experts at a conference at Chatham House, 16 October 2017.

smaller neighbor, but China has exploited Nepali resentment of India to its advantage. With Beijing pledging US\$8.3bn to build roads and hydropower plants as part of the BRI, Nepal's new leaders have vowed to break away from New Delhi's "micromanagement." Beijing is even talking of building a US\$8bn railway linking Kathmandu and Lhasa, the capital of Tibet.⁷⁴

It is a similar story 3,000 km south in the Maldives, where China Communications Construction Company is building a 1.3km "friendship bridge" linking the airport island to Male, the capital. It is expanding the airport, building roads and erecting a 25-story hospital to boot.⁷⁵ In November 2017 the Maldivian president rushed a controversial free-trade deal with China through parliament in just one hour. After strongly backing the Maritime Silk Road, there is much speculation in New Delhi that he may allow China to set up a naval base on the palm-covered island of Gaadhoo in the heart of the Indian Ocean. Whether this is all in the Maldives best interests is questionable: it is one of eight Belt and Road countries identified by the Centre for Global Development in Washington, DC, as at "particular risk of debt distress."⁷⁶

Discontent with the BRI has even spread to Europe, where critics accuse China of strategically building stocks of influence.⁷⁷ Its sway is strongest in Central and Eastern Europe, where the "16+1" framework has sown division within the European Union. In June 2017, not long after Cosco took control of Piraeus Port, Athens shot down a joint EU resolution condemning China's human rights abuses.⁷⁸ And in Hungary, where China Railway International Corp is building a €3.2bn high-speed railway from Budapest to Belgrade, Prime Minister Victor Orban has played the China card to put pressure on his EU partners. "Central Europe needs capital to build new roads and pipelines," Mr Orban said in Berlin in early 2018. "If the EU is unable to provide

⁷⁴ See, eg, Chowdhury, "Driven by India into China's Arms, is Nepal the New Sri Lanka?", *South China Morning Post*, 25 February 2018, <http://www.scmp.com/week-asia/geopolitics/article/2134532/driven-india-chinas-arms-nepal-new-sri-lanka>.

⁷⁵ See, eg, "In South Asia, Chinese infrastructure brings debt and antagonism," *The Economist*, 18 March 2018, <https://www.economist.com/news/asia/21738408-indian-hawks-see-unserviceable-chinese-loans-ploy-win-control-strategic-assets-south>.

⁷⁶ See <https://www.cgdev.org/article/chinas-belt-and-road-initiative-heightens-debt-risks-eight-countries-points-need-better>.

⁷⁷ Benner et al, op cit.

⁷⁸ Emmott et al, "Greece blocks EU statement on China human rights at U.N.," Reuters, June 18, 2017, <https://www.reuters.com/article/us-eu-un-rights/greece-blocks-eu-statement-onchina-human-rights-at-u-n-idUSKBN1990FP>.

enough capital, we will just collect it in China.” To help matters along, Hungary’s authoritarian leader has worked to prevent a strong EU stance against China’s territorial advances in the South China Sea.⁷⁹

In one respect, China’s economic influence in Greece and Hungary shows the efficacy of its strategy to use loans and investment to buy diplomatic leverage. But Beijing needs to beware negative political repercussions: if it is seen to be interfering in Europe, then the momentum for greater investment protections and other retaliatory measures will only strengthen. It does not help that Chinese-sponsored investments bring so few opportunities for local firms. Foreign firms are struggling to benefit commercially from the BRI, despite Beijing’s protestations that it is open to all. According to a report by CSIS, a full 89% of contractors on BRI projects tracked by its database were Chinese, while just 3% of contracts were won by third parties.⁸⁰ If the initiative brings strife without opportunity, international support will wane.

The risk of blowback is even stronger in Asia, where fear of China and resentment of its influence runs deep. Populist resistance to Chinese investments is a hazard for Chinese firms, especially in fragile states run by authoritarian governments, where regime change can see dramatic shifts in the political winds. China has bitter experience of this in Myanmar, where it rapidly lost its grip after spending more than two decades cultivating close ties there with the ex-ruling military junta. When the regime crumbled in 2011, political liberalization gave ordinary people a voice to protest against China’s presence, forcing the government to postpone or cancel Chinese investments worth many billions of dollars.⁸¹ Bilateral relations have improved since 2016, mainly thanks to China’s support of Aung San Suu Kyi’s government during the Rohingya refugee crisis. But the events in Myanmar could be echoed in other countries where China’s presence breeds ill will.

The Belt and Road Initiative has the potential to bring huge benefits in countries lacking good infrastructure, especially in Asia. The investment and construction is real, even if

⁷⁹ Benner et al, “Europe needs to step up vigilance on China’s influence,” *Financial Times*, 16 February 2018, <https://www.ft.com/content/a58b0a0c-127b-11e8-940e-08320fc2a277>.

⁸⁰ Hillman, op cit.

⁸¹ See Miller, “Myanmar: Going Solo” and “Chinese immigration: On the Road to Mandalay,” *China Economic Quarterly*, June 2013.

much of it was planned before the initiative was officially announced. Yet few of China's potential partners wholeheartedly believe that the BRI is really designed to deliver "win-win" development: more often, it is presumed to mean "double-win" for the Chinese. The success of the initiative will depend on Beijing's ability to persuade its partner countries that working closely with China—Party cadres, government officials, state diplomats, banks, enterprises, entrepreneurs, et al—is really in their best interests.

CONCLUSION

Only a decade ago, China was largely a passive player in the game of global investment flows: it received ever-growing investments at home, but its own investments abroad were both small and limited to the acquisition of natural resources. Today, China is one of the world's biggest investors, with an ODI stock approaching US\$1.5trn.⁸² At least 20 countries have received Chinese investment or construction worth US\$20bn or more.⁸³ Yet China's investments and economic activity overseas are under scrutiny as never before. In the rich world, the state-backed acquisition of foreign technology is stoking protectionism. In the developing world, where the Belt and Road Initiative promises to bring much-needed infrastructure, the greater fear is one of economic vassalage.

China will not retreat from high-profile industrial policies that cause particular concern, such as the Made in China 2025 plan or its strategy to develop a world-class semiconductor industry. These are central to Xi's vision of an economically powerful China and are not open for negotiation. But the onus may have to switch to developing these industries domestically if the US and Europe block purchases of high technology on national security grounds. In 2015 alone, Chinese companies announced takeovers of foreign semiconductor firms worth US\$35bn. Since then, several other proposed acquisitions of semiconductor firms have been derailed by CFIUS. The Trump administration looks set to toughen scrutiny on all Chinese technology investments, while political support for restrictions on Chinese investment is also calcifying in Europe.

Meanwhile, the Belt and Road Initiative will continue to elicit both hope and fear. The challenge for China's partner countries is how to extract as much economic benefit from it as they can without losing economic or political sovereignty. This is a precarious balancing act. Almost all states in China's immediate vicinity are putting in place hedging strategies to ensure they do not become appendages of the Chinese giant next door. Vietnam, for example, has moved markedly closer to the US in recent years. Nevertheless, the weakest countries will struggle to remain truly independent—and China's geopolitical leverage will continue to strengthen.

⁸² See <http://images.mofcom.gov.cn/fec/201711/20171114083528539.pdf>.

⁸³ Scissors, *op cit*.

China's greatest weakness is that it is not trusted. This means that its overseas push will continue to face headwinds. The Chinese Global Investment Tracker records well over 200 failed foreign acquisitions by Chinese investors since 2005, amounting to nearly US\$350bn of lost investments. If Chinese firms were not seen as agents of an opaque and potentially hostile state, they would have an even bigger presence around the world. The Belt and Road Forum in May 2017 aimed to address some of these fears, but no one was fooled: the BRI is, whatever Beijing claims, designed to promote China's own interests first. There are also valid doubts over the economic benefits that some Chinese-led projects will bring. China's leaders can talk about building a "community of common destiny" until they are blue in the face, but their determined pursuit of national glory is more likely to arouse anxiety than win friends.

Nevertheless, for all its faults the Belt and Road Initiative is a concrete and useful attempt by China to boost economic integration across a vast swath of the globe. No other country has come close to articulating such an ambitious plan, and no other country could finance one. As the US withdraws from its international obligations and closes its doors to the world, an alternative power is needed to promote international trade and provide global public goods. China's outward investment will continue to serve the demands of the state, but its economic impact will reach well beyond its shores.