

MAKING INROADS: CHINA'S NEW SILK ROAD INITIATIVE

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China's New Silk Road initiative is a multistate commercial project as grandiose as it is ambitious. Comprised of an overland economic "belt" and a maritime transit component, it envisages the development of a trade network traversing numerous countries and continents. Major investments in infrastructure are to establish new commercial hubs along the route, linking regions together via railroads, ports, energy transit systems, and technology. A relatively novel concept introduced by China's President Xi Jinping in 2013, several projects related to the New Silk Road initiative—also called "One Belt, One Road" (OBOR, or B&R)—are being planned, are under construction, or have been recently completed. The New Silk Road is a fluid concept in its formative stages: it encompasses a variety of projects and is all-inclusive in terms of countries welcomed to participate. For these reasons, it has been labeled an abstract or visionary project. However, those in the region can attest that the New Silk Road is a reality, backed by Chinese hard currency. Thus, while Washington continues to deliberate on an overarching policy toward Asia, Beijing is making inroads—literally and figuratively—across the region and beyond.

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An Ancient Trade Network Modernized

The New Silk Road is a modern-day revival of the ancient Silk Road initiated under the Western Han dynasty. The original network opened up various regions to trade by land and by sea, until advancements in maritime transport ultimately rendered land routes economically uncompetitive.

The Silk Road route traversed lands called *xi yu*, or “western regions.” These lay to the west of the Yumen Pass and include today’s Xinjiang region as well as Central Asia, both considered strategically significant from at least the 3rd century BC. In its broadest sense, *xi yu* encompassed areas further to the west and as far reaching as the Indian subcontinent, Europe, the Middle East, and Africa.

As is the case with most revivals, China’s New Silk Road takes certain notions from the original while adapting to the present-day circumstances. Most notably, the New Silk Road initiative places emphasis on “hard” infrastructure projects (i.e., construction of roads, railways, and energy pipelines) as well as “soft” (or “smart-iron”) projects such as e-commerce platforms. Trucks, trains, and pipelines carrying cargo and crude are thus to replace caravans of camels laden with silk and amber.

Another modern aspect of the New Silk Road initiative is the institutionalization of its funding mechanism. Namely, Beijing established a purpose-built \$40 billion Silk Road Fund in December 2014 to support investments as part of the New Silk Road, pooling together resources from the State Administration of Foreign Exchange, the China Investment Corporation, the Export-Import Bank of China, and the China Development Bank. Beijing has also initiated a multinational funding body: the \$100 billion China-initiated Asian Infrastructure Investment Bank (AIIB)—boasting 57 members including Germany, the United Kingdom, France, and Russia, but not the United States—is a development bank allocating funds for infrastructure construction projects as part of the New Silk Road. However, even China’s state coffers are insufficient to meet the over \$1 trillion cost associated with the New Silk Road. To bridge the gap, international and regional development banks (such as the European Bank for Reconstruction and Development, the Asian Development Bank, and the World Bank), host governments, and private-sector actors are also providing financing.

Assessing “Win-Win”

China is marketing its New Silk Road initiative as a “win-win” (*shuang ying*) scenario for all partners involved. For Beijing, benefits come in the form of a boost to the domestic economy by offsetting industrial overcapacity and opening up new markets abroad for China’s new consumer-driven growth model. This is of particular importance as China adjusts to a “new normal” of single-digit growth following decades of double-digit growth. The project will also deliver greater energy security for China by providing alternate hydrocarbon transport routes aside from those it traditionally depends upon, such as the Strait of Malacca and the South China Sea. Additionally, a core aim of the New Silk Road initiative is to close the investment gap between the east and west of China in an attempt to equalize regional disparities in economic development. Economic growth is also seen as a remedy to counteract ethnic separatism in certain regions, namely Xinjiang province. All of these factors allude to a strong domestic imperative behind the New Silk Road initiative. At a time when China is undergoing a massive reform program, the New Silk Road initiative is therefore heralded as a vital component of China’s evolving economic and foreign policy. In fact, it is a project mainly under the purview of the National Development and Reform Commission (NDRC).

For host governments, the New Silk Road initiative is projected to foster development in otherwise economically marginalized regions or countries. For instance, Pakistan’s president has lauded the China–Pakistan Economic Corridor component of the New Silk Road as a “monument of the century” (Iftikhar 2016) benefiting billions of people in the region through the construction of new roads, an 1,800-kilometer railway line, oil pipelines, and a multi-billion dollar port at Gwadar. The New Silk Road also brands itself as an all-inclusive project, thereby benefiting emerging economies as well as established ones: a remote village on the outskirts of Kyrgyzstan could stand to gain economically as much as a European Union member-state. Germany and Poland are building key New Silk Road-related dry ports and corresponding industrial zones, for instance (Shepard 2016). Thus, on the one hand, for host governments, the New Silk Road represents an opportunity for job creation, infrastructural and economic development, and becoming a part of the global supply chain. On the other hand, the local content aspect

of New Silk Road projects are wanting: Chinese companies generally prefer using a Chinese workforce as opposed to local laborers, which may offset local job growth creation in host countries. Environmental and safety standards are also of sizable concern for host governments, as is the protection of intellectual property. Limited reciprocal market access for foreign business into China is another area of concern.

For the private sector, the New Silk Road offers new business opportunities. According to PricewaterhouseCoopers (2016), the private entities set to benefit most include businesses focused on building infrastructure, such as suppliers of technology, raw materials, equipment, and components—as well as foreign engineering, procurement, and construction companies that could partner with Chinese players in overseas markets. The preferred method for private-sector participation looks to be in the form of public-private partnerships (PPPs).¹ Indeed, Chinese companies are increasingly experimenting with public-private partnerships in infrastructure projects and bringing substantial Chinese public-sector financing to the table under the New Silk Road banner (PricewaterhouseCoopers 2016).

While China's New Silk Road project seems to promote a “win-win” scenario in terms of economic growth, infrastructure development, job creation, and interregional and international connectivity, participation in New Silk Road projects ultimately requires partnering with China's state-sponsored banks, companies, and other state actors. The potential ramifications of this will be covered in the next section.

Public- and Private-Sector Participation

As of late, private businesses in China—particularly small and medium-sized enterprises (SMEs)—have been making slow and

¹In fact, on September 23, 2014, China's Ministry of Finance issued a notice to promote public-private partnerships in order to encourage capital investment in infrastructure.

According to the World Bank, there is no one widely accepted definition of public-private partnerships. An increasing number of countries are enshrining a definition in their laws, each tailoring the definition to their institutional and legal particularities. The PPP Knowledge Lab defines a public-private partnership as “a long-term contract between a private party and a government entity, for providing a public asset or service, in which the private party bears significant risk and management responsibility, and remuneration is linked to performance.” Available at ppp.worldbank.org/public-private-partnership/overview/what-are-public-private-partnerships.

steady headway into traditionally state-dominated sectors. However, state-owned enterprises (SOEs) dominate Chinese outward foreign direct investment (FDI) (Backaler 2014). This trend will continue as the central government pushes for SOEs to play a prominent role within New Silk Road projects. In fact, the Chinese government's role in FDI has been gradually changing from that of regulator to facilitator (KPMG 2015), and SOEs are the state's commercial conduit of choice. As China's FDI increasingly channels into New Silk Road projects,² participation by SOEs will therefore be an inherent component of the initiative.

Within corporatist states,³ SOEs may offer the only pathway for conducting business—at least until private companies and/or free market principles gain further ground.⁴ Until then, government backing via SOEs could prove critical for investing within particular sectors, such as energy, telecommunications, or defense.⁵

²According to *The Economist* (2016), official estimates suggest that in 2015, China's FDI in New Silk Road countries rose twice as fast as the increase in total FDI. Forty-four percent of China's new engineering projects were signed with New Silk Road countries, and 52 percent in the first five months of 2016.

³The significant role played by SOEs within domestic and international commercial activities in China is comparable to the "state-corporatist" paradigm in Russia, where heavily state-backed national champions typically wield a privileged position within outward and inward FDI projects. Schmitter (1974) expounds on "state corporatism" as "a defining element of, if not structural necessity for, the antiliberal, delayed capitalist, authoritarian, neomercantilist state." Another theorist of corporatism, Mihail Manoilescu (Schmitter 1974), distinguishes between two subtypes of corporatism: *corporatism pur*, in which "the legitimacy and functioning of the state were primarily or exclusively dependent on the activity of singular, noncompetitive, hierarchically ordered representative corporations" and *corporatisme subordonne*, whereby corporations were "created by and kept as auxiliary and dependent organs of the state which founded its legitimacy and effective functioning."⁷

⁴On the possibility of small and medium-sized enterprises gaining further ground, according to Backaler (2014), the Third Plenum of the 18th Central Committee in November 2013 expressed the new administration's intention to build a more even playing field between state-owned and private enterprises.

⁵This is especially the case when it comes to conducting commercial activity in "transition" countries, where informal socioeconomic structures often vie with formal state institutions. In China, for instance, it is a long-standing presumption that social connections (*guanxi*), and particularly personal connections to political authorities, remain indispensable for a wide range of activities, including conducting business, using courts, obtaining bureaucratic protection, boosting a company's reputation, and securing bank loans (Wang and Zhang 2014).

A similar concept, *blat*, also exists in Russia. For a good comparative study of informal practices in China and in Russia, see Ledeneva (2008).

However, SOEs present their own challenges and often operate at a loss. In China, in particular, SOEs have “more debt and worse repayment ability than private-owned firms, although they can borrow longer term because of government support” (Bloomberg 2016).⁶ Nontransparency within SOEs is an additional obstacle, allowing for pervasive rent-seeking behavior, increased opportunities for corruption and bribery, and unreliable figures pertaining to costs, revenues, and operational performance. All of these factors significantly increase the risk profile of conducting business with SOEs as opposed to private-sector entities. The quality and cost of infrastructure projects could also be impacted. According to a recent study by Oxford University’s Saïd Business School (Ansar et al. 2016) sampling 95 large Chinese road and rail transport projects over the last three decades, project completion times were by-and-large on time or ahead of schedule; however, actual construction costs averaged 30.6 percent higher than estimated costs, with three-quarters of transport projects in China coming in over budget. The study surmises that incentives for Chinese cadres and contractors are such that building as quickly as possible is rewarded even if performance in other areas such as cost, quality, safety, environmental impact, or public consultation processes suffer.

Partnering with SOEs undoubtedly presents a unique set of challenges for host governments and private-sector actors. While overarching reforms to state corporatist structures in China would provide a more effective long-term solution, the reality is that China’s SOEs are considered of strategic importance to the state and are thus likely to retain their monopolistic positions within industry, both domestically and in FDI projects. Nevertheless, the New Silk Road presents opportunities along with challenges.

For instance, the ambitious New Silk Road initiative might incentivize SOEs to implement international best-practice standards within their commercial activities. For China, which is still acclimating to conducting business abroad, implementing best-practice standards may even become a necessary step when faced

⁶According to *The Economist* (2016), many SOEs even have a department established specifically for the New Silk Road initiative “if only in the hope of getting money for their projects.”

with new business environments in foreign countries. For instance, the OECD's "Guidelines on Corporate Governance of State-Owned Enterprises" introduced in 2005 addresses issues particular to SOEs and offers advice on governance aimed at increasing transparency and efficiency.⁷ Likewise, the UN's recently introduced Global Partnership for Sustainable Transport aims to assist in setting best-practice standards for environmental and safety issues particular to the transport sector—which will feature prominently in New Silk Road projects. Multilateral and bilateral treaties, joint venture contracts, and/or public-private partnership agreements also provide plausible methods for stipulating best-practice standards with regard to SOE involvement in commercial projects.⁸

For host countries, the same could hold true. The New Silk Road may motivate host governments not only to adopt international best-practice standards, but also to improve their overall investment climates in order to attract New Silk Road-oriented FDI. A good case study can be found in the Almaty Ring Road Concession Project (also known by its Russian acronym, BAKAD)—part of the "Western China–Western Europe" transnational highway and the first public-private partnership project of its type not only in Kazakhstan but in the whole of Central Asia. BAKAD was implemented as a pilot project for the New Silk Road and served as the first public-private partnership structured under a new regulatory framework, with substantial amendments to the existing legislation made in 2014 as part of a new reform program in Kazakhstan called "*Nurly Zhol*."⁹ Making the effort to enact legislation in favor of public-private

⁷Available at www.oecd.org/daf/ca/OECD-Guidelines-Corporate-Governance-SOEs-2015.pdf. Also see the 2015 "G20/OECD Principles of Corporate Governance" at www.oecd-ilibrary.org/docserver/download/2615021epdf?expires=1478208852&id=id&accname=guest&checksum=58BA07C3D057A719F3828ED51DEA76DE.

⁸For example, several countries participating in B&R are also signatories to the Energy Charter Treaty, which sets provisions on dispute resolution, nondiscriminatory conditions for trade in energy materials, the protection of foreign investments, and the promotion of energy efficiency.

⁹Kazakhstan's new economic policy, "*Nurly Zhol*," or "Bright Path," was announced by President Nursultan Nazarbayev in November 2014 to correspond with the development plans of the New Silk Road initiative.

partnerships created the conditions that enabled international investors—such as the European Bank for Reconstruction and Development—to invest in BAKAD. For instance, in May 2015,¹⁰ Kazakhstan’s “Law on Natural Monopolies” was amended to increase the transparency of tariff calculations and the activities of monopolies, streamline tariff procedures, ensure consumer protection, and facilitate the processing of bids and the elimination of unnecessary costs. In fact, BAKAD could serve as a blueprint for future public-private partnerships in sectors that need to attract funding as part of the New Silk Road initiative.

Thus, while the substantial role of public-sector actors in the New Silk Road brings challenges, the New Silk Road initiative could help pave the way for the adoption of more market-oriented corporate governance measures, which may be crucial for private-sector investors considering placing funds into the costly and long-term projects espoused by the New Silk Road.¹¹

International and U.S. Implications

“Economic diplomacy” is Beijing’s novel approach for engaging with the international community (Ewert, Poeter, and Fermont 2016), and the New Silk Road initiative is a key mechanism for doing so. Accordingly, Beijing and host governments consider the New Silk Road initiative and the AIIB as high-priority projects.

From Beijing’s perspective, there is more to gain by pushing for soft “economic diplomacy” than by exercising “hard power” abroad. Beijing views the costliness and unpredictability of military conflict as contrary to its policy preference for cultivating sustained domestic

¹⁰In May 2015, Kazakhstan’s President Nazarbayev also set out the “100 Concrete Steps” plan intended to implement five institutional reforms in accordance with “*Nurly Zhol*,” including: (1) the creation of a modern and professional civil service, (2) ensuring the rule of law, (3) industrialization, (4) economic growth, and (5) transparency and accountability of the state.

¹¹Additional steps that private-sector actors could take to ensure best-practice standards and/or to help mitigate risks include: conducting thorough due-diligence on all potential project partners, considering political risk insurance, establishing arbitration and/or dispute resolution mechanisms from the outset, and ensuring contracts and/or treaties clearly delineate between states’ rights and investors’ rights.

economic growth,¹² which, in turn, it sees as crucial for ensuring domestic stability and regime continuity.¹³

Hence, Beijing is keen to stress that the New Silk Road is not a foreign policy project, but an economically oriented one. This is especially important for Beijing to emphasize because of the strategically significant geographic areas through which the New Silk Road passes.

Just as in ancient Silk Road times, Xinjiang (particularly Ürümqi and Kashgar) and Central Asia are areas of central importance for the New Silk Road initiative. Indeed, a main impetus behind the New Silk Road is to develop and engage with the Xinjiang Autonomous Region and to quell separatist tendencies and religious radicalization. Much to Russia's chagrin, Central Asia is also of core importance for the New Silk Road project: this region, traditionally considered part of "Russia's backyard," may be increasingly vied over not only for its massive energy reserves but also for its strategic location as the "buckle" within the New Silk Road's "economic belt" connecting trade links between the east and west. Kazakhstan and Kyrgyzstan are also members of the Eurasian Economic Union (EEU) along with Russia.¹⁴ Therefore, unless mutual areas for cooperation are fostered, a geopolitical tug-of-war between Russia and China could

¹²Whether China's adherence to a state-corporatist model is an effective method for achieving sustainable economic growth is a separate topic for debate.

¹³For Beijing, economic growth trumps military confrontation, unless strategic economic interests or territorial issues are concerned. Shaojun Li, a professor at the Institute of World Economics and Politics at the Chinese Academy of Social Sciences (an institution directly under the State Council and noted as the highest academic research organization in China in the field of social sciences) states:

For China, if there is no order in its external relations, its economic construction will suffer. In order to ensure an orderly and peaceful environment, therefore, China needs to embark on peaceful means as the preferred route for it to resolve its territorial disputes. . . . Focusing on developmental goals rather than hegemony determines China's defensive and inward military policy. The purpose of China's military construction is to serve its development. Once the military buildup exceeds the limits of self-defense, however, it tends to have a negative impact on national development because it not only utilizes domestic resources needed for development, but also creates unnecessary tensions in foreign interactions. [Accordingly,] as China changes its mode of development and expands domestic demand, it will not transform its economic development achievements into military-based power [Li 2014: 66].

¹⁴Other member states of the EEU include Belarus and Armenia.

ensue.¹⁵ For its part, Central Asia's interest in trade and FDI is particularly high at present due to the global economic slowdown, lower energy exports, and economic sanctions placed upon Russia, negatively impacting Central Asian workers' remittances back to their home countries.¹⁶ Accordingly, Central Asian countries are looking at diversifying their economies, engaging in and implementing WTO guidelines in a more expedient manner, and improving their overall investment and trade environments¹⁷ to attract FDI, as the BAKAD project and recent legislative reform program in Kazakhstan demonstrate.

However, the participation of the Chinese state via SOEs and other state-backed entities could challenge the notion of the New Silk Road as a purely commercial, and not political, project. Should there be excessive state intervention by Beijing, or should military activity be exercised in relation to the New Silk Road, international perceptions of the New Silk Road could quickly shift from it being viewed as a trade and investment initiative to an alliance-building and/or geopolitical expansion project. Such a perception would contribute to, rather than assuage, the foreign policy debate regarding a "rising China" and its perceived threat to the international order.¹⁸ The international community will therefore look beyond the "win-win" rhetoric driving the New Silk Road initiative and focus on the facts.

As for the United States, a substantive foreign policy toward Beijing is yet to crystallize. While Washington is still to form a collective approach toward China's New Silk Road initiative, the current outlook leans toward wholly ignoring, "countering," or "containing" China's New Silk Road initiative.¹⁹ Donald Trump's position toward

¹⁵Relations between the New Silk Road and the Eurasian Economic Union will be expounded upon by the author in a forthcoming Cato Institute Policy Analysis.

¹⁶According to the World Bank's 2016 Migration and Development Brief, within Europe and Central Asia, estimated declines in remittance receipts in 2015 were greatest among the Central Asian countries: 47 percent in both Turkmenistan and Uzbekistan, 25 percent in the Kyrgyz Republic, 24 percent in Tajikistan, and 23 percent in Kazakhstan. Available at pubdocs.worldbank.org/en/661301460400427908/MigrationandDevelopmentBrief26.pdf.

¹⁷Though these measures are not evenly applicable across all Central Asian states.

¹⁸The chief literature presenting this perspective include Mearsheimer (2006, 2010) and Allison (2015).

¹⁹The author will further analyze these approaches and offer policy recommendations in a forthcoming Cato Institute Policy Analysis.

China during his presidential campaign exhibited a strongly protectionist and economically isolationist rhetoric, and it is yet to be seen whether candidate Trump's views will be in line with President Trump's actual policies. A better approach would be to look for areas of cooperation where U.S. companies could potentially benefit from New Silk Road projects.

Conclusion

In conjunction with the New Silk Road initiative, Beijing is espousing a new "economic diplomacy" model to assist in spurring long-term, sustainable domestic economic growth. In addition, China's New Silk Road initiative is offering its partners job creation opportunities, FDI, infrastructure building, and bolstered commercial exchange. The end goal, according to China, is to establish a "win-win" scenario for all partners involved.

Yet, this ambitious multinational project comes with serious obstacles: unstable political regimes within host countries; subpar international business practice standards, including nontransparency and corruption; and the potential for Chinese state involvement to politicize commercial relations via SOEs. These could all thwart positive trade relations and investment environments. Such challenges could be mitigated if private- and public-sector participants take precautionary steps, such as exercising due diligence on projects and partners, establishing clear contractual or treaty terms on dispute and arbitration mechanisms, and insisting on the application of international best-practice standards. As for host countries, the New Silk Road initiative could incentivize governments to implement free market principles within their own economies in order to better attract FDI. This must include removing or reducing tariffs, simplifying tax codes, limiting bureaucracy, providing for the protection of private property, and strengthening the rule of law.

The New Silk Road is an imperfect project in its formative stages. It is a large-scale initiative projected to span several countries and continents and is backed by the world's second largest economy: if proven successful, it would be too large a project to ignore or to "contain." The United States should approach the New Silk Road initiative cautiously yet constructively and as a potentially positive opportunity for cultivating mutually beneficial trade and relationship-building ties with China and New Silk Road participant states.

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