CHINA'S "ONE BELT, ONE ROAD" INITIATIVE: ECONOMIC DIPLOMACY WITH CHINESE CHARACTERISTICS

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Synopsis

For years, China has been pushinghard on its central foreign policy message of "peaceful rise", but with limited effect. This is partly due to China's lack of soft power. Given so many inherent obstacles, Chinese policy makers naturally see economics as a potentially more effective instrument to advance its overall foreign policy interests.

For regional economic diplomacy, China seemed to have taken reference from post-war Japan, given its lack of a voice and strong political and institutional influence in the region. Thus, China had to first concentrate on expanding its markets and later acquiring the region's natural resources and raw materials.Subsequently, China started toconduct its economic diplomacy with strong financial muscles. With its vast foreign reserves ofreachingUS$4 trillion (2014), relatively low government debt, persistent "twin surpluses" (both trade surplus and capita account surplus) and a healthy fiscal balance, the Chinese government has been "cash rich".

With ASEAN, Premier Zhu Rongji's China-ASEAN Free Trade Area enjoyed two-way trade of close to US$500 billion in 2014. China also put up a US$10 billion China-ASEAN Investment Fund to deepen economic cooperation with individual ASEAN countries. Furthermore, China has expanded its Official Development Assistance programme. During 2010-12, China dispensed US$14 billion largely in grants and interest-free loans to developing countries in Africa and the Asia-Pacific. With its total overseas direct investment amounting to US$140 billion, China has now become the world's third largest source of FDI.

By far, the most significant new initiative has been the setting up of a US$40 billion Silk Road Fund for its "One Belt, One Road" scheme, which launched by President Xi Jinping at the APEC Summit in Beijing in October 2014. This was quickly followed up by the establishment of the Asian Infrastructure Investment Bank, with China providing half of its US$50 billion start-up capital. Fifty-seven countries

had signed up as its founding members, including some of America's close European allies like UK and Germany.Overall, China's initiatives could be viewed by some developing countries as its efforts to promote South-South cooperation, which in turn could contribute to the growth and spread of the so-called "Beijing Consensus" as a potential counter-weight to the "Washington Consensus".

Furthermore, China's new Silk Road initiatives are likely to be China's landmark economic diplomacy feat with profound long-term implications for both China and its neigbhouring countries. The One Belt, One Road scheme is inherently win-win programme for all the countries concerned. In launching this, China is leveraging on its inherent comparative in its capital surplus and infrastructure building experiences, particularly for high-speed rail.

In providing the needed connectivity, thescheme will also carry the potentialof ultimately integrating the different parts of Asia as one gigantic economic entity, which will then further extend to Europe afar.In this sense, China's One Belt, One Road scheme can be a game change in terms of re-shaping both regional and globalfuture geo-political as well as geo-economic patterns.

Economics Taking the Lead

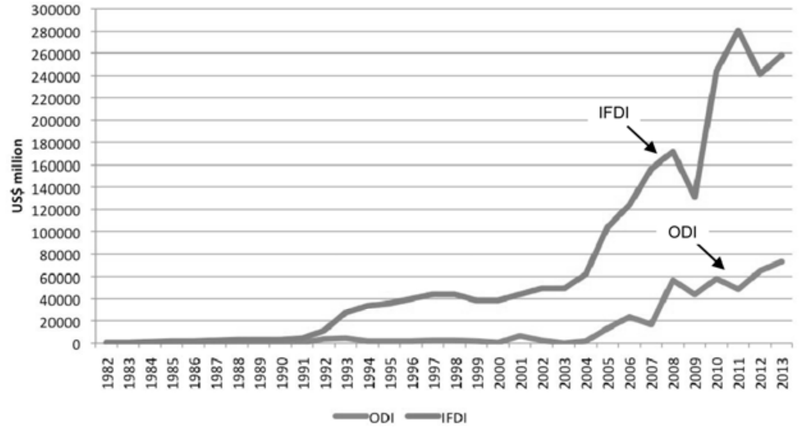
Although Chinese President Xi Jinping formally took over China's presidency as its supreme leader barely two years ago, he has already consolidated his power as China's real "strongman" after Deng Xiaoping. Confident and secure in general public perceptions, Xi has promised to transform China through national rejuvenation to realizehis vision of the "Chinese dream".Externally, Xi has sought to pursue an active foreign policy in order to elevate China's international standing. The main thrust of his foreign policy is to cultivate "good-neighbourly relations" with countries on its periphery and closer political and economic ties with countries afar. At the global level, China is promoting a "new type of major-country relationship" with the world's sole superpower (or hegemon to its competitors), the United States. This was much evidenced in Xi Jinping's recent visit to Washington.

The pomp and ceremony that accompanied China's hosting of the 22nd APEC Summit in Beijing in November 2014 hadsentan unmistaken message to the rest of the world that China is a fast rising power, and that it deserves a "rightful" regional and global role.Shortly before this meeting, the International Monetary Fund (IMF) confirmed that China had become the world's largest economy in 2014 in terms of PPP (purchasing power parity) gross domestic product (GDP). On account of its size, China's present levels of economic production, consumption, trade, capital movements and tourism have already made a huge impact on the global economy.

China's growing economic diplomatic muscles are reflected in the following few charts... For example, according to China Daily in 2014, China's overseas direct investments(ODIs) were higher than incoming foreign direct investments (FDIs) for the first time[①].Figure1shows a possible trend for China to be a net outward investor in the near future.Figure 2indicates the current major destinations of Chinese outward investments, mainly to Asia (especially Hong Kong). Figure 3shows a clear trend that Chinese foreign aid (Official Development Assistance equivalent) is also on an uptrend. Recent trends indicate Chinese foreign aid directed at the African continent(Figure 4).

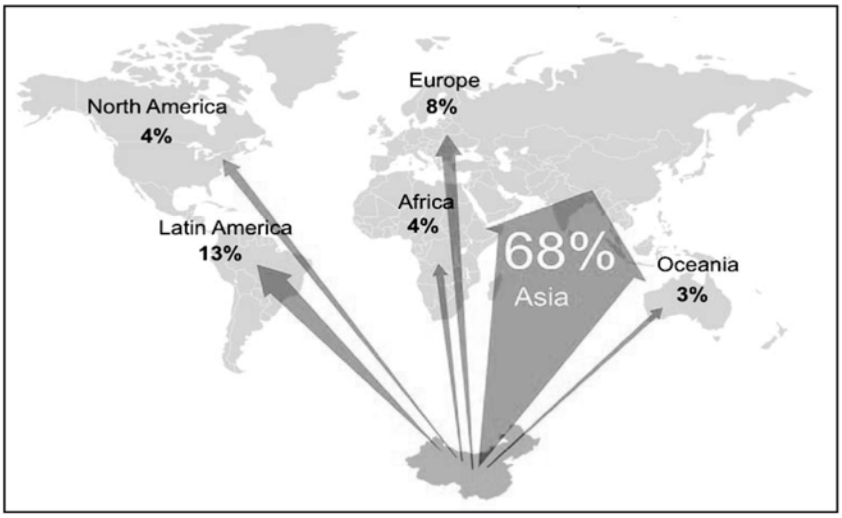
① Chang, Lyu, "Landmark year as ODI set to exceed FDI" dated 30 October 2014 in China Daily [downloaded on 27 January 2015], available at http://www.chinadaily.com.cn.

FIGURE 1 CHINA'S BALANCE OF PAYMENT, INWARD AND OUTWARD INVESTMENT FLOWS, 1982-2013



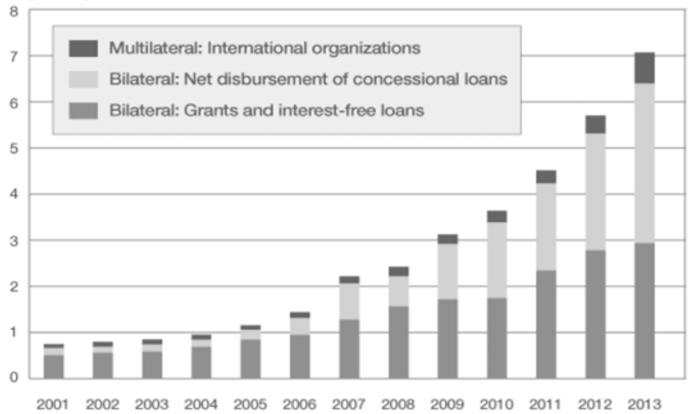
Source: SAFE, "Will China Be a Net Outward Investor in 2015?" undated on the Freeman Blogactiv EU website [downloaded on 2 April 2015], available at freeman.blogactiv.eu.

FIGURE 2 CONTINENTAL DISTRIBUTION OF CHINA'S OFDI STOCK, 2013



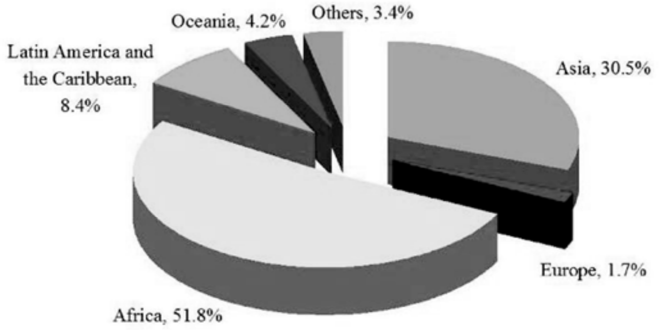
Source: Zhou, Lihuan and Denise Leung, "China's Overseas Investments, Explained in 10 Graphics" dated 28 January 2015 on the World Resources Institute website [downloaded on 2 April 2015], available at http://www.wri.org/blog/2015/01/china%E2%80%99s-overseas-investments-explained-10-graphics.

FIGURE 3 CHINA'S ESTIMATED FOREIGN AID (ODA EQUIVALENT), 2001-2013



Note: Figures for 2013 are provisional. Figures for Chinese foreign aid are estimated by approximation to the definition of ODA.
Source: OECD International Development Statistics, Kitano Naohiro and Harada, "Figure 2 China's Estimated Foreign Aid (ODA equivalent), 2001-2013" on the Nippon.com website [downloaded on 2 April 2015], available at http://www.nippon.com/en/files/a03404en_fig02.gif.

FIGURE 4 GEOGRAPHICAL DISTRIBUTION OF CHINA'S FOREIGN ASSISTANCE FUNDS, 2010-2012



Source: Xinhuanet, "Figure 2: Geographical Distribution of China's Foreign Assistance Funds, 2010-2012" on the Xinhuanet website [downloaded on 2 April 2015], available at http://news.xinhuanet.com/english/china/2014-07/10/133474011_14049749104241n.jpg.

China became the world's third biggest source of ODIsfrom 2012 to 2013 for the first time in its economic history[2]. The primary reasons for Chinese acquisition of overseas companies and firms are probably economic ones such as acquiring the needed technologies for the next phase of economic development[3] but it can also increase Chinese footprints in overseas companies.

Foreign Policy Goals

Although China has been relentlessly pushingfor its central foreign policy message of "peaceful rise", the concepthas not been wholeheartedly embraced by all its neighbours. This is partly due to China's lack of soft power, both in terms of cultural influence as well as Joseph Nye's original idea of exemplary leadership and governance.The situation has been further complicated by China's outstanding bilateral issues with certain Asian states over territorial disputes. Chinese diplomatic postures are sometimes seen as too assertive by its rivals and some anxious neighbours.

Given the many inherent obstacles, Chinese policy makers would naturally see economics as a potentially more effective instrument to advance its overall foreign policy interests. China obviously possesses a stronger comparative advantage in economic diplomacy than in other options. It thus hopes that its stronger economic strength can make up for its inherently weaker geopolitical posture.Moreover, economic diplomacy is often seen as a no-detriment or low-detriment initiative since all developing economies require funding for infrastructure construction.

Promises and Challenges of Economic Diplomacy

② Xinhua, "China 2013 outbound investment hits record high" dated 10 September 2015 on the China Daily US website [downloaded on 16 March 2015], available at http://usa.chinadaily.com.cn.

③ Chen, Cong, "Challenges Facing China's ODI" dated 10 January 2014 on the CRI (China Radio International) website [downloaded on 16 March 2015], available at http://english.cri.cn/7146/2014/01/09/3361s807333.htm.

“Economic diplomacy” is basically a strategy of using more “carrots” than “sticks”. It has always been an integral part of a state’s overall foreign policy pursuits. At the height of mercantilism around the 16th century, some European states openly used economic diplomacy as both a means and an end. Thus, trade was to follow the flag or gunboat diplomacy and colonization was closely connected with the acquisition of bullion and raw materials.

Traditionally, “economic diplomacy” was also defined as official state-sanctioned activities to increase exports, attract more foreign investments and maximizeone’s own interest in international economic organizations, i.e. increasing one’s own economic benefits.In an interdependent world, however, it also meant that countries have to influence economic outcomes in other countries in order to maximizeand realizeone’s own benefits. In a globalizedmodern economy today, the economic instruments available for diplomatic uses,ranging from trade to economic aid and loans, FDI and technology transfer, have greatly increased. Their application is now at a much higher level of sophistication.

China has thus developed capabilities to conduct economic diplomacy along traditional lines, playing constructive and functional roles in economic mutualism while, in other situations, adopting proactive, and interventionist or realist measure when it feels its interests are better served that way.

Historically, the Chinese practice of foreign policy was rooted in its traditional concept of a world order which was not based on equality, but arranged in hierarchical terms, with the Imperial court establishing tributary relations with the “barbarian states” on its periphery.In managing such a Sino-centric regional order, Imperial China was, as noted by Henry Kissinger, “remarkably pragmatic about the means it employed”, which included open coercion and outright bribery. Harvard historian John K Fairbank had also argued that tribute-bearing missions were themselves a convenient “cloak for trade”. Suffice it to say that economic diplomacy was already widely used in Imperial China.

In Maoist China, politics and ideology took command. Trade, sports and cultural exchanges had to be subservient to the state’s overall foreign policy goals. This was at play during the Cold War era in Southeast Asia as well. Thus, when its relations with Malaya (Malaysia) turned sour in the 1960s, Beijing promptly switched its purchases of rubber from Kuala Lumpur to the more expensive but lower-quality variety from Ceylon (Sri Lanka).In the 1980s, to reward President Marcos’ initiative in normalizingrelations with China, Beijing supplied petroleum to the Philippines at “friendship prices” (well below world market price). China did the same to Thailand.

The most controversial case of Mao’s economic diplomacy was the building of a 1,860 km-long Tanzania-Zambia Railway in the early 1970s at the cost of US$500 million to China, which was then truly “poor and blank”. The project had yielded China little concrete political and commercial benefits except perhaps facilitating China to regain its UN seat in 1971 with a few additional African votes. This project has since remained a negative example of China’s excessive use of economic diplomacy with almost zero returns.

Deng started economic reforms in 1978, and his overall foreign policy line was extremely pragmatic when he concentrated on the goals of gaining or regaining China’s seat at various international organizations, first the World Bank (April 1980), then the IMF (1980) and eventually the WTO (2001). China has benefited immensely from its participation in these international organization sand subsequently from becoming one of their active participants. For regional economic diplomacy, China studied and learnt from postwar Japan. Much like Japan, lacking a voice and strong political and institutional influence in the region, China initially had to concentrate on expanding its markets and later acquiring the Asian region’s natural resources and raw materials.

Thus, in 2000, Premier Zhu Rongji proposed the China-ASEAN Free Trade Area (CAFTA), the first largest “ASEAN Plus One” regional trade scheme. In 2010, CAFTA came into effect, with two-way trade reaching US$500 billion in 2014. China also put up the US$10 billion China-ASEAN

Investment Fund to deepen economic cooperation with individual ASEAN countries. More recently, China is focusing on the larger, 16-member Regional Comprehensive Economic Partnership, which is ASEAN-centric but mainly China-driven.

As China's economy has grown and its external balances rapidly expanded, China is becoming an increasingly important capital-surplus economy, particularly for 2014 when China's ODI exceeded its inbound FDI. With its total ODI amounting to US$140 billion, China had become the world's third largest source of FDI.China has also openly touted its strong financial and technological capability in developing infrastructure (e.g. its high-speed rail) for the emerging economies. In recent years, China has also significantly expanded its Official Development Assistance (ODA) programme. During 2010-12, China doled out a total of US$14 billion (largely grants and interest-free loans) to developing countries in Africa and the Asia-Pacific.

As China's economy has grown and its external balances rapidly expanded, China is becoming an increasingly important capital-exporting economy, particularly for 2014 when China's outbound ODI exceeded its inbound FDI. With its total ODI amounting to US$140 billion, China had become the world's third largest source of FDI, with the footprints of Chinese corporations expanding to 156 countries.

However, China's present ODA commitment is still small, compared with traditional OECD donors. China has the potential to catch up, particularly since many OECD countries today have run into serious fiscal deficits. All in all, China is clearly in the thick of deploying all the major conventional economic diplomatic tools that Western powers and Japan had formerly used.

Despite its long tradition of utilizingeconomic diplomacy, China is admittedly still pretty much a novice in this kind of economic game, especially when it comes to operating in the market environment or in a country with a more open political and social system.

On the one hand, China has gained considerable political mileage by featuring itself as a member of the South and a champion of the developing world, operating without such ideological conditionality as demanding commitment to liberal democracy or improvement of human rights, and displaying no territorial ambitions or seeking any military alliances. On the other, China as being seen as an authoritarian state ruled by a Communist Party is also suffering from "image problems" in its economic diplomacy overseas. China's investment acquisitions in developed countries have often been viewed with political suspicion or even blocked for "national security" reasons.

China's generous aid and loans to certain developing countries "with no strings attached" were derogatively viewed as "buying friendship", an accusation that Japan endured in the past at the height of its ODA dispensing. Beijing has also come to recognize that some of its overseas economic ventures have not been financially productive. Spearheaded largely by state-owned enterprises (SOEs) and administered by bureaucrats or diplomats with no business or financial background, many of its overseas projects were often over-priced or short-changed, full of corruption and kick-backs.

"One Belt One Road" as the "Game Changer"

Flush with China's capital surplus (resulting from surplus in both current and capital accounts), President Xi Jinping at the 22nd Asia-Pacific Economic Cooperation (APEC) Summit in Beijing in November 2014 proposed to put up China's own kind of "Marshall Plan" (this term was officially avoided by Beijing because of its Cold War connotation) by pledging US$40 billion to assist countries in its proposed Silk Road zone for infrastructure development under the "One Belt for One Road" scheme. The first Silk Road Fund project has already started with China assisting Pakistan in

developing its Karot hydropower project on the Jhelum River[④].

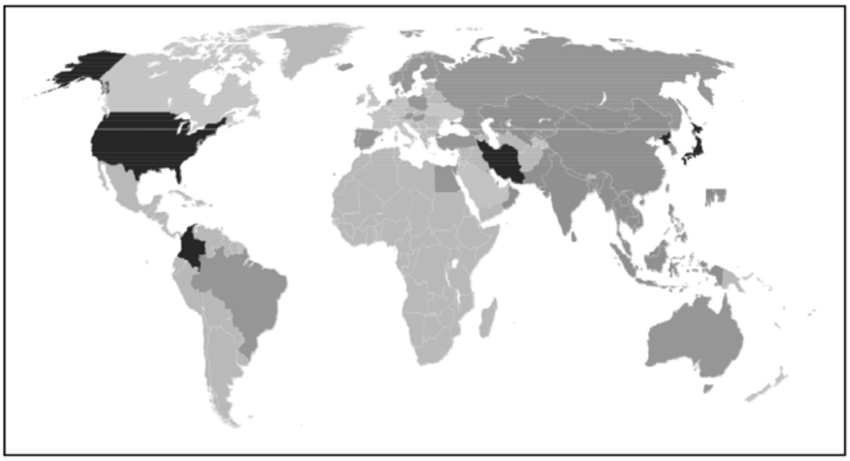
More concretely, China had quickly proceeded to set up the Asian Infrastructure Investment Bank (AIIB) to assist in the funding of capital construction projects in the region by providing US$50 billion or half of its start-up capital. The United States initially opposed this China-sponsored project for fear of adversely affecting institutions like the World Bank that have been under the US influence. By the end of April 2015, 57 countries had signed up as AIIB’s Founding Members, including America’s close allies such as UK, Germany, Franc and Italy, Australia, New Zealand and South Korea. As a result of such overwhelming popular support, the US had softened its opposition to this project.

The World Bank President Jim Yong Kim had openly welcomed the AIIB as a “potentially strong ally” of his own institution. Addressing the opening of the Afro-Asia Summit in Jakarta on April 22, 2015, Indonesian President Joko Widodo gave a strong endorsement to this China-led AIIB by saying: “those who still insisted that the global economic problems could only be solved through the World Bank, International MonetaryFund and Asian Development Bank were clinging to obsolete ideas”[⑤].

China on its part had also assured that the operation of the AIIB would stick to the multilateral framework and basic market rules, and to operate in a transparent manner, much along the line of the World Bank’s IFC (International Financial Corporation). China had also pledged that the AIIB would work closely with other existing financial institutions. This new financial institution, which is expected to fill the crucial infrastructure funding gaps in the developing world, will be officially launched in June 2015. Suffice it to say that China has scored a significant diplomatic breakthrough by having attracted so many of America’s allies to support its project.

It seems clear that China has scored a significant diplomatic coup from the AIIB episode. All of China’s economic diplomatic initiatives, as discussed earlier, would in the long run contribute to the growth and spread of the so-called “Beijing Consensus” as a potential counter-weight to the existing “Washington Consensus”.

FIGURE 5 AIIB MEMBERSHIP



Key PFM signed the memorandum to build AIIB Approved as PFM of AIIB Applying to become PFM of AIIB Have the intention to apply Application under consideration No intention to participate Uncommitted

Source: Jowl Semhur, "Prospective Founding Members (PFMs) of AIIB (2015-04-06 UTC+8 08:00:00)" dated 30 march 2015 and updated on 6 April 2015 in the BlankMap World, EmberEdison and edisonabcd websites [downloaded on 6 April 2015], available at https://commons.wikimedia.org/wiki/File:Hong_Kong_Location.svg?uselang=zh-cn; http://commons.wikimedia.org/wiki/File:BlankMap-Macau%26HongKong.svg (a creative commons file).

It should furtherbe stressed that all theSilk Roadinitiatives, old and new, are basically about “connectivity”. In this sense, the role of China is most crucial as China possesses the key technology

④ “Silk Road Fund makes its first investment”, China Daily (April 22, 1015).

⑤ “Asian, African nations challenge “obsolete” world order”, Reuter (Jakarta, April 22, 2015).

and engineering skills of building the required transportation networks, particularly for the high-speed rail. China also has strong financial capability to help fund infrastructure building.

Ultimately, the end objective of any Silk Road connectivity is not just for the relevant states or economies to take advantage of China's economic growth and its vast domestic markets by becoming more closely integrated with the Chinese economy. The long-term implications of the One Belt, One Road schemeare the emerging of several mega "continental bridges" that will finally link up different parts of Asia: The integration of the manufacturing-based East Asia with theresource-rich Southeast Asia and Central Asia, and then South and West Asia into one gigantic economic entity. The future is admittedly full of promises and challenges.

Just a little over a century ago, the noted British geographer Sir Halford Mackinder, in his "Geographical Pivot of History", came up with his "Heartland Theory" for the Eurasian landmass comprising Central Asia and other states along the Eurasian edges. This Eurasian heartland was to Mackinder the "World-island", and "Who rules the World-island commands the World'!

The Heartland theory had turned out to be not really crucial for the ocean-going Anglo-Saxon powers, which had sought to dominate the world with their superior navies. This theory is understandably even less relevant today for the 21th century geopolitical landscape.

Whereas politics has since shifted, geography remains. Geographically, China (also Russia) is still pivot to the Eurasian heartland. Strategically, this heartland has become even more crucial for China, for security reasons (anti-terrorism) as well as for economic reasons (with its oil and gas). China's overriding priority for its One Belt, One Road scheme is likely to focus more on building the economic bridges between Asia and Europe, and this will also rekindle the development promises of the Eurasian heartland.