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THE GEOECONOMICS BEHIND THE BELT AND ROAD INITIATIVE

HOW THE BRI IS SHAPING A NEW GEOECONOMIC ORDER

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Abstract

In deze masterthesis wordt er onderzocht hoe het Belt and Road Initiative (BRI) bijdraagt aan de geoeconomische macht van China op het Euraziatische continent en de Indo-Pacifische ruimte. De ondersteunende deelvragen betreffen: (a) Wat zijn de voornaamste geopolitieke motivaties achter het BRI? (b) Hoe zullen de staatsgeleide banken en nieuw opgerichte multilaterale instituten de structurele, financiële en monetaire macht van China beïnvloeden? (c) Hoe kunnen handel en investeringen bijdragen tot het geoeconomische voordeel van China? Door een literatuuronderzoek is er op zoek gegaan naar een antwoord op voorgaande vragen. De conclusie luidt als volgt. Het BRI biedt een antwoord op de maritieme knelpunten en toenemende vraag naar energiereserves waar China mee te kampen heeft. Het BRI wordt voornamelijk gefinancierd met staatsgeleide nationale banken terwijl de nieuw opgestelde multilaterale instituten een relatief kleine rol spelen binnen het project. D.m.v. het BRI kan China een shift binnen de global supply chain forceren en zo China mogelijks uit de middeninkomensval hijsen.

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INTRODUCTION

"The Strategist
Defeats the enemy
Without doing battle
Captures the city
Without laying siege
Overthrows the enemy state
Without protracted war."
-Sun Tzu

Written in epigram – halfway between prose and poetry - The Art of War, thousands year after Sun Tzu's death, remains a central text in military strategy. In the excerpt above he makes clear what the Chinese strategy entails and where it differs from the Western – *clausewitzean* – aim of war. Where *vom Kriege* labels the conception of war as merely "a continuation of policy by other means", *The Art of War* looks at the concept of war as a process where you win without ever having to fight, because if you have to fight, you have made a strategic misjudgment. This is why the Chinese notion of war is more akin to our notion of geoeconomics than it is to geopolitics. Geopolitics is traditionally seen as a zero-sum game, as power is inherently limited. In this mindset confrontation is the only way of determining the absolute winner or loser. In geoeconomics, where the logic of geopolitics is combined with the tools of economics, there is still a zero-sum game at play but there is no need for a confrontational approach, as economic instruments have the capacity to produce the same outcome as a military conquest without the downsides of a military standoff.

Therefore, it should not be surprising that the biggest geoeconomic undertaking of our century is *made in China*: The Belt and Road Initiative (BRI). This project - also referred to as One Belt One Road (OBOR) – is an ambitious project put forward by the President of the People's Republic of China (PRC) with the aim of linking the Eurasian continent together in the spirit of the Ancient Silk Road. The Ancient Silk Road is used to hearken back to a time where world trade was defined by camel caravans traversing the Gobi desert and sailing ships navigating through the Strait of Malacca. If you exchange the camel caravans for freight trains and the *junks* for containerships, you can imagine how this modern Silk Road will look. The Belt and Road Initiative consists of two routes whereby the freight trains cross Eurasia among the Silk Road Economic Belt (SREB) and the containerships navigate along the 21st Century Maritime Silk Road (MSR).

In this thesis I aim to impart a deeper understanding of the geoeconomic reasoning behind the Belt and Road Initiative. My main research question in doing so is as follows: *How does the Belt and Road Initiative contribute to the enhancement of China's geoeconomic strength on the Eurasian continent and the Indopacific region?* This question will be supported by three side questions, being: (a) What are the main geopolitical motivations behind the pursuit of the BRI? (b) How will the state-owned banks and newly established China-led multilateral banks affect the structural, financial and monetary power of China? (c) How can trade and investments be used to the geoeconomic advantage of China?

I will try to provide an answer to these questions in the order as they are listed here with the aim of eventually coming to an answer to the main research question in the conclusion of this thesis. However, I will start by clarifying the ambiguity around what the Belt and Road Initiative contains and what the exact reported policy measures are that the Chinese government has put in place as a way to establish a modern version of the Ancient Silk Road.

1. The Belt and Road Initiative

The story of the Belt & Road Initiative begins in 2013. On a state visit of President Xi Jinping to Kazakhstan the President introduced the concept of a Silk Road Economic Belt in a speech delivered at the Nazarbayev University (Xi Jinping, 2013, September 7). Just one month later President Xi went to Indonesia to deliver a speech wherein he proposed building a close-knit China-ASEAN community and offered guidance on constructing a 21st Century Maritime Silk Road (Xi Jinping, 2013, October 2). November 2013 these two projects were coupled by the Third Plenary Session of the 18th Central Committee of the Communist Party of China that called for accelerating infrastructure links among China's neighboring countries. The Chinese government didn't miss a chance to promote the still inchoate project with the hefty title *The Silk Road Economic Belt and 21-century Maritime Silk Road* on several diplomatic occasions.

The idea gained further traction and over a couple of years the Chinese government developed the idea of a revival of the ancient Silk Road which would connect East with West into a comprehensive set of policies. In 2015 the National Development and Reform Commission, Ministry of Foreign Policy and Ministry of Commerce jointly put forward an action plan based on a few guiding principles and a series of policies in a report called *Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road* (hereafter: Visions and Actions document). This document stressed that the initiative "is a systematic project, which should be jointly built through consultation to meet the interests of all, and efforts should be made to integrate the development strategies of the countries along the Belt and Road" (NDRC, 2015).

On the 19th Communist Party of China national congress, the Belt and Road Initiative was officially written into the constitution of the PRC (Xinhua, 2017, October 24). This was the real starting point that made clear to the world that the BRI is here to stay.

A common mistake by commentators is to compare the BRI to the Marshall Plan. A comparison between the two is impossible to make as (1) the Marshall Plan was an aid program while the BRI is an infrastructure program (Eichengreen & De Long, 1993), (2) the Marshall Plan only lasted for three years, while the BRI is a project that will entail more than a decade (Eichengreen & De Long, 1993), and (3) the BRI is an undertaking of far greater scale. In order to illustrate the sheer magnitude of this project it is important to know that the Belt & Road Initiative will generate an additional $2,5 trillion worth of new trade a year and will encompass countries accounting for 29 % of global GDP (HSBC, 2017).

But what exactly is the BRI then? A lot of fog has been spread about the definition of what the Belt & Road Initiative actually is and which countries are involved in it[1]. According to the *Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road* document the aims of the BRI are five-fold. The first dimension of the BRI is the promotion of policy coordination on the

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[1] When asked during a press conference in April 18 2017 how many countries were included in the Belt and Road Initiative, Minister of Foreign Affairs Wang Yi said that he had 'no intention of designating clear geographic boundaries to the Belt and Road" (Caixin, 2017, May 9). However, media outlets and think tanks have been estimating the total amount of countries active within the BRI at between 65 and 80, depending on the definition.

basis of existing and new bi- and multilateral cooperation mechanisms. The second is to facilitate connectivity for overland and maritime transport, energy, and communication infrastructure. Thirdly, trade will be encouraged by simplifying customs-clearance systems and foreign investment procedures as this development goes hand in hand with the creation of more free trade zones. The fourth goal is the deepening of financial integration by involving China-supported multilateral financial institutions and promoting the use of the RMB in bilateral trade. The fifth and last dimension is the enhancement of people-to-people bonds by promoting extensive cultural and academic exchanges (NDRC, 2015).

To say the BRI is solely an infrastructural project is too narrow. Neither is the Initiative geographically limited to the countries along the old Silk Road. China has invited a host of countries from outside the Eurasian continent to take part in the Initiative. Eastern African countries are already actively involved in the project and earlier this year Chinese Foreign Minister Wang Yi called Latin America 'a natural fit for the initiative' (Reuters, 2018, 22 January). On the 26th of April Chinese Party Secretary of the Transport Ministry even went a few steps further by saying that China is 'willing to work with the US side, under the framework of China's Belt and Road Initiative and the US plan for rebuilding infrastructure' (SCMP, 2018, April 26).

The crux of the matter is that the BRI incorporates the framework for a win-win cooperative interpretation of globalization reflecting China's rise as a global power, industrial redeployment, increased outward investment and its need to diversify energy sources and routes (Lui & Dunford, 2016). Just as Mao called China's state ideology 'socialism with Chinese characteristics' the Belt and Road Initiative could be seen as 'globalization with Chinese characteristics'. The Visions and Actions document sees the Five Principles of Peaceful Coexistence as its core values: mutual respect, mutual non-aggression, mutual non-interference, mutual benefit, and peaceful coexistence (NDRC, 2015).

However, for now, the most tangible and important aspect of the BRI is the infrastructural. The terms One Belt One Road (OBOR) or the Belt and Road Initiative (BRI) are derived from the overland 'Silk Road Economic Belt' and the '21st Century Maritime Silk Road' concepts Xi Jinping introduced respectively in Kazakhstan and Indonesia. At the center of this initiative are a host of infrastructural projects with the purpose to interlink all the countries and cities of the Eurasian continent. The Silk Road Economic Belt involves the establishment of a continental economic and trade corridor extending from China's western provinces through resource rich Central Asia and finally to Europe. The Maritime Silk Road on the other hand puts forward the development of ports and trading hubs across from Shanghai in China to Piraeus in Greece.

1.1. THE SILK ROAD ECONOMIC BELT

(Map 1) While the Belt focuses on resource rich Central-Asia, the Middle East, and consumer driven Europe, the Road pinpoints the economically expanding Southeast Asia. For China, foreign policy is subordinate to the domestic goals of maintaining internal stability and economic growth. The SREB project has five pivotal infrastructure projects: the China-Pakistan Economic Corridor (CPEC), the China-Mongolia-Russia Economic Corridor (CMEC), the New Eurasian Land Bridge Economic Corridor (NELBEC), the China-Central Asia-Western Asia Economic Corridor (CCAWAEC), the China-Indochina Peninsula Corridor (CIPC) and the China-Bangladesh-India Economic Corridor (CBIEC) *(see map 1).*

These infrastructure plans are all labeled 'economic corridors'. Generally, an economic corridor is developed through the following steps (Otgonsuren, 2015):
- Investment in the infrastructure of roads and railroads;
- Implementation of regional development plans;
- Facilitation of trade and support for cross-border trade, tourism and services;
- Synchronization between government policy and regional development plans.

1.1.1. The China-Pakistan Economic Corridor

The largest infrastructural project that has been promoted as a focal part of the BRI is the China-Pakistan Economic Corridor (CPEC) which will connect the northwestern Chinese province Xinjiang with the Pakistani port of Gwadar through a network of roads measuring around 3000 kilometers running through the whole of Pakistan leading to the port of Gwadar. The CPEC is widely considered to be the flagship project of the BRI as it is currently the best developed plan. The plan has four pillars: the Gwadar Port, energy, infrastructure and industrial collaboration. In order to provide the Economic Corridor with ample energy infrastructure, the BRI aims to add energy infrastructure capacities that can account to some 17000 megawatts of electricity generation. The infrastructure projects associated with CPEC include the Peshawar-Lahore-Karachi railway, power plants in Tharparkar and Port Qasim, the Gwadar-Nawabshah LNG pipeline, the Karot Hydropower project, the Jhimpir wind farm, Gwadar airport, the Karachi-Thatta expressway and the M9 Hyderabad-Karachi Motorway. All these projects initially amounted to a price tag of 46 billion USD infrastructure development loans from China, however the latest figures amount to a total of 62 billion USD (Tribune, 2017, April 12).

1.1.2. The China-Mongolia-Russia Economic Corridor

The CMREC entails the biggest territory of all economic corridors of the BRI (Soni, 2018). China, Mongolia and Russia were already strongly embedded in the Shanghai Cooperation Organization (SCO). It is therefore not unsurprising that an infrastructural/economic corridor along these countries would be one of the pinpoints of the BRI. It was at a SCO summit of 2014 - the Dushanbe Summit – that trilateral talks between Russia, Mongolia and China agreed to construct and economic corridor linking the tree countries closer together. In June 2016 a landmark was reached for the CMREC: China, Mongolia and Russia signed the guidelines to build a trilateral economic corridor: Mongolia-Russia Economic Corridor (Xinhua, 2017, November 22). The economic corridor emphasizes developing transportation infrastructure and connectivity; intensifying port construction and enhanced supervision of customs. All these developments are pursued in the face of enhancing trade and cooperation in production capacity and investments between the countries. As noted by Otgonsuren(2015), synchronization between governmental policy and regional development plans is of great import for economic corridors. With regards to CMREC this is the case as Mongolia's authorities have decided in 2014 to focus internal policy on the building of the Steppe Road and Russia is working on the Trans-Continental Rail and Road-Plan, which are both complementary to the BRI (Soni, 2018).

1.1.3. The New Eurasian Land Bridge Economic Corridor

For Europeans the most astounding BRI project is the New Eurasian Land Bridge Economic Corridor, also known as the Second Eurasia Land Bridge Economic Corridor. The NELBEC is an international

railway line running from Jiangsu province on the east coast of China all the way to the west coast of Europe. The Chinese section of the line comprises the Lanzhou-Lianyungang and the Lanzhou-Xinjian Railway and stretches from eastern to western China. After leaving China, the NELBEC enters Kazakhstan, Russia, Belarus, Poland, Germany, Spain, The Netherlands, France and even Greece, linking the NELBEC with the Maritime Silk Road Port of Piraeus. International freight train routes linking Chongqing to Duisburg (Germany), Wuhan to Melnik and Pardubice (Czech Republic), Chengdu to Lodz (Poland) and Zhengzhou to Hamburg (Germany) have already been opened (HKTDC, 2018). Jiangsu, where the railway starts, is the province where Shanghai – home of the world biggest container port - is located. On the other end of the Land Bridge is Rotterdam – the biggest port of Europe. Trade between these two centers has been usually conducted by the maritime route. The NELB is aimed to offer a competitive alternative as well as a complement to the shipping trade. The Port of Piraeus will be linked with the NELB through a series of infrastructure projects in Central and Eastern Europe. The coordination of this effort will happen through the 16+1 cooperation format where China and 16 Central and Eastern European countries come together. This framework has been used as an instrument to realize the goals of the BRI. Projects in Eastern Europe entail high-way projects in Serbia and Montenegro and a high-speed railway linking Hungary and Serbia (Xinhua, 2017, November 28; Reuters, 2018, July 18). Several other projects in East and Central Europe are currently under consideration.

1.1.4. The China Central Asia-Western Asia Economic Corridor

The China Central Asia-Western Asia Economic Corridor will be made to link China with the Mediterranean and Persian Gulf through a series of inland infrastructure projects that follow the trajectory of the ancient Silk Road. On June 5, 2014, President Xi proposed to establish the 1+2+3 cooperation network, which would take energy, infrastructure, trade and investment as the primary field of cooperation (Office of the Leading Group of the Belt and Road Initiative, 2017, p. 14-15). The Economic Corridor starts in the Western China province of Xinjiang, then traverses Central Asian countries Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan and Turkmenistan, before entering Western Asia (including Iran, Saudi Arabia and Turkey) (China.org, April 19). The CCAWAEC was highlighted for the first time (although still under the all-purpose name Silk Road Economic Belt proposed by Xi Jinping two years prior in Kazakhstan) at the third China-Central Asia Cooperation Forum in Rizhao, Shandong Province (China), June 2015. At the forum Meng Jianzhu, then member of the Political Bureau of the Central Committee of the Communist Party of China, called on all members of the forum to work together on a new Silk Road 'based on inclusiveness, mutual benefit, peace and cultural integration' (Xinhua, 2016, June 16). Synchronization between national development strategy plans plays a big role in this project as well. The Kazakh Road to Brightness, the Tadjik Energy, Transport and Food Program and the Turkmen Strong and Happy Era all share common ground with the CCAWAEC with regards to Central Asia (HKTDC, 2018). The Middle East is another important region within the economic corridor. The Chinese government has signed Memoranda of Understanding with seven Middle Eastern countries and nearly all Middle Eastern countries within the AIIB pledged to join the AIIB. As I will note further in this paper, the Middle East is critically important for the BRI as the region occupies a strategic position and vast reserves of resources that will eventually be of great importance for China's foreign policy and internal economic strategy. Under the denominator of the BRI – and more specifically the CCAWAEC – China is actively cooperating with Israel to construct a railway that would connect the Red Sea and the Mediterranean from Eilat to Ashdod. Freight train and pipeline links will be enhanced as a way to increase

commodity trade. In Saudi Arabia ideas have been floated to integrate Saudi Vision 2030 – Saudi Arabia's economic reform project – within the BRI, but further details of a strong cooperation in this are still up for debate (Xinhua Finance, 2017, March 14). Additionally, Beijing is establishing a network of railways and roads connecting Central Asia to the Middle East (Kamel, 2018). Given the vast diversity between the levels of development and wealth of all countries involved with CCAWAEC, cooperation and coordination will be key to the success of the CCAWAEC.

1.1.5. The China Indochina Peninsula Economic Corridor

The China Indochina Peninsula Corridor might be the most interesting prospect of the BRI as the corridor lies at a strategically important location for Chinese trade. The corridor's aim is to connect China with the countries on the Indochinese peninsula in order to enhance trade and cooperation between China and ASEAN. The plan was first suggested by Chinese Prime-Minister Li Keqiang during the fifth Leaders Meeting on Greater Mekong Sub-Regional Economic Cooperation Summit, held in Bangkok at the end of 2014. On the Summit, he proposed to deepen relations with the five countries on the Indochina Peninsula (Cambodia, Laos, Myanmar, Thailand and Vietnam) and China through a three leveled approach. First of all, he called for the building of an extensive transportation network and the establishment of several industrial and cooperation projects. Subsequently, Li Keqiang asked for the creation of a new mode of cooperation and fundraising for these projects and lastly the promotion of a sustainable and coordinated socio-economic development. These calls were welcomed by the countries along the Greater Mekong River (HKTDC, 2018). Two years later, on May 26 2016, several MOUs were signed within the framework of the Belt and Road Initiative with Southeast Asian countries, launching the preparation of bilateral cooperation plans (Office of the Leading Group of the Belt and Road Initiative, 2018, p. 15-16). From then on nine cross-national highways, connecting Indochina from east to west and north to south have undergone construction. Besides highway projects, CIPEC also includes a range of railway projects, like the Nanning-Guangzhou high-speed railway via Nanning and Pinxiang to Hanoi and Singapore, and the introduction of air routes to several Southeast Asian Cities. All these projects together are essentially linking South-China to the whole Indochinese peninsula (China.org, 2017, April 19).

1.1.6. The Bangladesh-China-India-Myanmar Economic Corridor

Just as in the CIPEC, Li Keqiang played an important role in facilitating the framework for the Bangladesh-China-India-Myanmar Economic Corridor. It was May 2013, during a series of meetings of the Prime-Minister to India, that the two biggest countries of the world proposed the building of a communal economic corridor (HKTDC, 2018). By the end of the year a Joint Working Group for the Bangladesh-China-India-Myanmar Economic Corridor was convened in Kunming, China. At Kunming, the countries involved decided to go along with the plan and reached an extensive consensus on cooperation mechanisms for the economic corridor (Office of the Leading Group of the Belt and Road Initiative, 2017, p. 17). Whereas reports on the first summits regarding the establishment BCIMEC were ambitious and optimistic about a prospect of China being interlinked with South Asia, results have been poor. The road map of the project is still under consideration, as conflict of interests between China and India concerning economic and geostrategic issues become clearer. India increasingly perceives the BCIMEC as a series of trade facilitations for Chinese exports and is very suspicious about China's involvement within the politics of its geostrategic rival Pakistan through CPEC (Karim & Islam, 2018).

1.2. The Maritime Silk Road

While the Silk Road Economic Belt is focused on inland infrastructure, The Maritime Silk Road is aimed at port development along the way of the Ancient Silk Road – from East China onwards, through the South China Sea and the Strait of Malacca to the Indian Ocean and then through the Suez Canal until eventually ending in the Mediterranean. China, responsible for 10 percent of the global trade in goods, with seven of the ten biggest ports of the world within its borders and therefore a major destination and starting point of international shipping routes, already plays an important role in international shipping. Progressively, Chinese firms are playing a more important role within the logistical aspects of the shipping trade: the construction and management of ports throughout the world. Projects within the framework of The Maritime Silk Road are aimed at increasing China's role in maritime development (van der Putten & Meijnders, 2015).

Contrary to the Silk Road Economic Belt, The Maritime Silk Road does not have any multinational 'subprojects' (besides the Djibouti-Addis Ababa Railway). The MSR entails a series of port projects and maritime focused infrastructure, primarily situated in the Indo-Pacific region. Chinese investments in ports were already under way before Xi Jinping's ASEAN speech in 2013, however post-2013 many of these projects were labeled part of The Maritime Silk Road.

In *The Vision for Maritime Cooperation under the Belt and Road Initiative (2017)* the State Council of China puts forward its development plans with the initiative. Besides calls for enhancement of maritime cooperation mechanisms and the reinforcement of Chinese presence within multilateral frameworks, the document proposed a series of programs and projects. These projects include: the Malaysia Malacca Seaside Industrial Park, the Pakistan Gwadar Port, the port + industrial park and city mode of integrated development of the Kyaukpyu port in Myanmar, the Colombo Port City and the Phase II Hambantota Port Project in Sri Lanka, the railway linking Ethiopia and Djibouti, the railway between Mombasa and Nairobi in Kenya, the China-Maldives Friendship Bridge connecting the islands of the Maldives, and the Piraeus port in Greece. Other non-transportation projects include industrial parks in China's Qinzhou and Malaysia's Kuantan, the Sihanoukville Special Economic Zone in Cambodia and the Suez Economic and Trade Cooperative Zone in Egypt (State Council, 2017) (see Map 2).

2. The Geopolitics behind the BRI

Many foreign policy analysts see the BRI as an unequivocally geopolitical plan from China to assert dominance in its region. Of course, these claims are rebutted by Chinese authorities at any given opportunity. However, it is undeniable that many BRI projects are located in and around areas which have a significant geostrategic importance. Since 2017, when China opened its first military naval outside of China in Djibouti, fears existed – especially from the American side - that this military base would become the first of many and that infrastructure projects related to the BRI were the prelude for this (Funaiole & Hillman, 2018).

As this paper looks more at the geoeconomic side of the issue I will not discuss speculation about the prospect of new military bases in the areas that fall currently under the Belt and Road Initiative. What I will do is try to explain the geographical and geopolitical significance the BRI entails. First, I will discuss the geopolitical implications of the projects of the Maritime Silk Road. I will explain how the location of these port projects builds further on the economic and geostrategic frustrations that have been built up among Chinese authorities. Thereafter I will discuss how the Silk Road Economic Belt points at Central Asia - the region that Brzezinski (1997) named the 'Eurasian Balkans' – and the Middle East. In this chapter I will explain China's involvement within the region through the BRI and why these regions are of such a great importance for the BRI and China's geoeconomic ambitions as a whole.

2.1. Maritime chokepoints

A maritime chokepoint is a maritime location where naval traffic is forced to converge through a naturally narrow channel of shipping. When these chokepoints are located on world famous shipping routes the role of these shipping lanes cannot be overstated – especially for the oil trade. Despite China's dominance in maritime trade, being responsible for 10 per cent of global trade and being the country where most of this trade is conducted by the sea, China holds no real power over the chokeholds the Euro-Asian maritime trade passes: the Strait of Malacca, the Strait of Hormuz, the Gulf of Aden and the Suez Canal (see Map 2).

2.1.1. The Strait of Malacca

Hu Jintao was already aware of this problem as early as 2003. At the closing of a Chinese Communist Party economic work conference in November 2003 then President Hu Jintao coined the term "Malacca Dilemma" for the first time. As China's economy was still booming with double digit GDP growth numbers, it became increasingly clear that if its energy needs would grow correspondingly. This dynamic would make the country's energy security continuously more complex to manage, especially from oil imports from the Middle East. There were two lines of reasoning for Hu to be vigilant about the current state of the Malacca Strait. The first one was the fear of non-state actors disturbing China's naval trade – e.g. piracy or terrorism. The second, and deeper, fear lied in the possibility that other nations – or "certain powers" as Hu Jintao noted – would attempt to exercise greater control over the 1100 km long strait interconnecting the Indo-Pacific area (Lanteigne, 2008).

In 2005 The Washington Times claimed to have obtained an internal report from the American Department of Defense whereby it was stated that China was building up strategic relations along

the sea lanes from the Middle East to the South China Sea with the objective to build up naval power to control the sea lanes (The Washington Times, 2005, January 17). Overall, it remained silent on the issue for almost a decade.

In 2013 this silence was broken when Xi Jinping told the world about the Maritime Silk Road.

While official documents refer to the primary end destination of the MSR as Europe, it is important to note that most of the MSR projects are located in the Indo-Pacific region, especially around Southeastern Asia. The main ports in the Strait of Malacca are Singapore and Port Klang (Malaysia). In both ports Chinese involvement is limited. Especially Singapore's port is in tight hands of the city state's government. As a part of the MSR the Chinese government is heavily investing in the eastern Malaysian port of Kuantan (van der Putten & Meijnders, 2015). Equally important – or even more important - in solving the Malacca Dilemma for China is building an alternative route around the Strait. Investments in the Kyaupyu Port are not coincidental as a revived port in Myanmar in combination with the China Indochina Peninsula Economic Corridor would offer another possibility to for trade to traverse the Indochinese peninsula and reach the southern, landlocked, Chinese Yunnan province without passing the Malayan islands.

Another alternative, which is not announced yet, but is heavily being discussed at the moment, is the digging of the Kra Canal. This envisioned canal would split the southern peninsula of Thailand in half and link the Andaman Sea with the Gulf of Thailand, so offering a route from the South China Sea straight to the Indian Ocean. This route would not only be an equal alternative to the Malacca Strait but an immense commercial upgrade as it would drastically diminish transit time across the busiest maritime shipping route. Official documents are not released and the project has not yet initiated but reports state that China and Thailand signed a MoU on the project in 2015 and the idea is beyond the idea of far-fetched fiction (Menon, 2018).

2.1.2. The Strait of Hormuz

The Strait of Hormuz, located between Oman and Iran, connects the Gulf of Oman and the Persian Gulf. The passage is the most important oil transit chokepoint in the world as almost all oil transports from the Middle East – 7.6 million barrels a year – go through the Strait of Hormuz and half of this is destined to China. The Port of Gwadar, the flagship of the MSR, is relatively close to the Strait of Hormuz but this does not necessarily lead to an advantageous position. As Pakistan is too close to the ports of departure in the Middle East it cannot serve as an effective waypoint for maritime trade between the Persian Gulf and China. The only logical conclusion to this is that Gwadar, which cannot be seen separately from CPEC, is no waypoint port at all. On the long-term Gwadar could be seen as a destination port. The economic corridor would then function as a transit network wherein Gwadar oil could be carried from ships onto trains and trucks, and through pipelines of the CPEC, straight to the Chinese western hinterland (Funaiole & Hillman, 2018).

This project would make the route for China's energy imports from the Middle East considerably shorter (12000 km) as oil would bypass the Strait of Malacca. This on its turn could revitalize the poor western Chinese province of Xinjiang as a new transport hub in the region (Bhattacharjee, 2015; Fulton, 2016).

2.1.3. The Gulf of Aden

As already called upon earlier in this chapter, China's first military base on foreign soil is located in Djibouti, on the coast of the Gulf of Aden. The Gulf is roughly 900 km long and 500 km wide, so it could be argued that the waterway is too wide to be considered a real chokehold. However, as all the shipping trade between Europe and Asia is conducted through this strait, being (militarily) present in the region in order to keep the Gulf secure is not a luxury. The region around the Gulf of Aden is around the world well-known for its instability and security issues. This is why the Chinese People's Liberation Army Navy (PLAN) has set up its own anti-piracy task force in the Gulf of Aden. Since then the PLAN remained present in the region and decided to set up its own military base in the Horn of Africa in 2016 (Henry, 2016). In 2017 the base opened under the name People's Liberation Army Support Base in order to reflect its objective in what the Defense Ministry calls "providing logistical support in one of the world's busiest waterways". Further the Chinese department of Defense has noted that the base is mostly built for resupply purposes, anti-piracy, and humanitarian and peacekeeping operations (SCMP, 2017, May 13).

Critics, like the French Lieutenant Commander Jérôme Henry, see the establishment of the Djibouti base as an effort of the PLAN to protect China's vital interests and the military embodiment of the MSR (Henry, 2016). The Maritime Silk Road itself also has an important infrastructure project in the Horn of Africa. A railway-project linking Djibouti City and Addis Ababa will not only give Chinese merchants foothold in the Gulf of Aden but also a commercial anchor all the way to the capital of Ethiopia (Der Spiegel, 2018, February 8).

2.1.4. The Suez Canal

The Suez Canal is – maybe next to the Strait of Gibraltar – the most well-known chokepoint for Europeans as the strait between the Mediterranean and the Red Sea is essentially the doorway linking the European with the Indo-Pacific sphere. The geostrategic importance of the canal is expected to enhance significantly as China's economy is only supposed to grow in the upcoming years. Because of this, China will only become more dependent on the Suez Canal.

Lately China has deepened its relationship with Egypt. One example of this is the country's significant stake in the Suez Canal. The China Ocean Shipping Company (COSCO) already owns a minority share of the Suez Canal Container Terminal at the northern end of the Canal. Further Chinese construction companies as the China Harbour Engineering Company (CHEC) and China Communication Construction Company (CCCC) have been participating in construction projects at the southern end of the Suez Canal (van der Putten & Meijnders, 2015). These projects have made China the single biggest investor in the development of the Suez Canal Corridor and as Egypt has loosened its investment regulatory framework as a way to attract foreign investment last year, new investments from China are on the way to the North African country (Xinhuanet, 2017, August 13; Egypt Today, 2018, July, July 8).

2.2. Central Asia

In his visionary book, The Grand Chessboard, former National Security Advisor from President Carter Zbigniew Brzezinski pointed to the geostrategic importance of the Eurasian continent. In this already

twenty year old book he listed many issues which are to this day still relevant for an analysis of the Belt and Road Initiative. An applicable idea I will discuss is his notion of the 'Eurasian Balkans' (see Map 3).

The Eurasian Balkans are a region which comes down to essentially Central Asia and entails the countries Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan, Turkmenistan Azerbaijan, Armenia, Georgia and Afghanistan. Brzezinski labels these countries as 'Balkans' as the region is reminiscent of the 'Old Balkans' of southeastern Europe but they are "only much larger, more populated, even more religiously and ethnically heterogeneous". Another point of resemblance between the Eurasian and European Balkans is that they are politically instable and so invite the intrusion of more powerful neighbors, being a structural vacuum. These neighboring countries have vastly diverting interests and are therefore determined to oppose each other. Just as the European Balkans was at the beginning of the 20th century, the region is seen as the key geopolitical pivot area for the great powers of their age due to its location at the crossroads of several spheres of influence[2]. However, there is one factor that sets apart the Eurasian Balkans from the European Balkans: a vast concentration of natural resources.

Chinese interest in this region is clear. As the country has become the biggest net energy importer in the world and its economy is still growing, its interests in gas and oil have gone up correspondingly (IEA, 2018). Two of the six economic corridors from the Silk Road and Economic Belt are pointed towards the Eurasian Balkans: the New Eurasian Land Bridge Economic Corridor and the China Central Asia-Western Asia Economic Corridor. It is important to note that there already is pipeline infrastructure in place linking gas- and oilfields within Central Asia to China, but in the *Visions and Actions* document it is clearly stated that this energy infrastructure should be further enhanced (NDRC, 2015).

Central Asian countries like Kazakhstan, Kyrgyzstan, Uzbekistan, and Turkmenistan are still in the same struggling and instable situation as they were when Brzezinski described them in 1997. Infrastructure, crumbling and desolate, is in dire need for an upgrade. In order to do this, large-scale investments are needed. The BRI intends just to do this, which makes China in the eyes of the Central Asian counties a very attractive partner (Hashimova, 2018, August 13).

But the Eurasian Balkans mean more to China than just another energy reserve. Engagement in the 'Stans' is for China also a way to deal with its inner demons - being defined by the SCO as the three 'evils' terrorism, separatism and extremism. China believes that by acting as a stabilizer within the region through development and wealth distribution abroad, it will ease the tensions of the Chinese government conflict with its Uyghur minority within its borders, which is culturally, ethnically and linguistically more related to its Central Asian counterparts than to Beijing (SIFRI, 2017).

The big question mark of the Eurasian Balkans remains Afghanistan. China has been present in the Central Asian country under the veil of border security efforts to prevent terrorists from entering the country. From a geostrategic point of view Afghanistan can be of immense benefit for Beijing.

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[2] Eastern Europe's strategic importance was summarized in 1919 by J.H. Mackinder(1919) as: "Who rules East Europe commands the Heartland; who rules the Heartland commands the World-Island; who rules the World-Island commands the world".

Located at the crossroads where South and Central Asia meet, Afghanistan could be a central hub for the SREB. Security concerns, however, have scared away investors within China as the governments' financial weakness would make a poor return on investment. As the BRI is a commercial initiative and no aid project, it does not look like there will be a sudden change in Beijing's reluctance to enhance its engagement in the Central Asian country (Stanzel, 2018).

2.3. THE MIDDLE EAST

Just as Central Asia, the Middle East is a region mostly sought-after for its vast energy riches. Right now, there are two main local players: Saudi Arabia and Iran. Even though these countries are currently at loggerheads, they have in common that they are also eager to connect their respective national development plans with China's objectives. Iran has been a big trade and investment partner of China for a while. A weakened presence of the West since the USA withdrew from the Joint Comprehensive Plan of Action created the perfect environment for China to deepen its ties with Iran through the BRI and now China is the biggest trading partner of Iran (Financial Tribune, 2018, February 6). All this together makes Tehran the preferred partner for Beijing's Belt and Road plans in the Middle East. This does not mean that other Middle Eastern countries will be sidelined by China. Other gulf countries are looking to China for an enhanced relationship as a means to obtain profitable infrastructure projects and enhanced trade. However, the disproportionately strong Sino-Iranian alliance could possibly make the BRI a zero-sum game for certain Gulf countries, which would be diametrically in opposition to the BRI's 'win-win' principle (Kamel, 2018).

Iran's main rival, the Kingdom of Saudi Arabia, is looking at the enhanced Sino-Iranian relationship through the BRI with suspicion. However, the Kingdom has not taken a confrontational approach towards China but instead looked into the possibility of integrating China in its Saudi Vision 2030 project - a modernization effort from the Saudi government to diversify its economy away from oil and make the country a global logistics center (Kamel, 2018).

Question remains whether the rivalry between Middle Eastern countries will be enhanced or eased by the Belt and Road Initiative.

3. Investment

Infrastructural connectivity is the key focal point of the BRI. A significant portion of the BRI development activity will be focused towards building basic infrastructure and improving physical connectivity. This will inevitably lead to a strong demand for cross-border financing services, with financial integration as one of the key components (Chan, 2017). The big question is *how* to fund the initiative. While China came up with the idea of the BRI, the financing demand is beyond the country's capability. As the governor of the PBoC, Zhou Xiaochuan noted in 2017: "investment and financing shouldn't be understood as one-way support. The initiative is to build a common community with risk and benefit sharing through extensive consultation and joint contribution." Further he wrote that he favored a market-based approach pooling capital across the world as concessionary loans require government funding, and are likely to cause market distortion and a dependency mentality (China Daily, 2017, May 5). Mutual efforts from countries involved in the project are necessary to provide long-term, sustainable funding support to meet the infrastructure's needs. Financing requirements would thus require multiple sources and mechanisms of funding, such as direct budget investment from fiscal resources, borrowing and market-based financing. A multi-layered system, as governor Zhou Xiaochuan proposed, should include public funding, development finance and private financing through both national and international financial markets (Chan, 2017).

Important to note is that PBoC governor Zhou Xiaochuan stated that he prefers using local currencies for Belt and Road investments and financing. According to the governor, this would help reduce exchange rate fluctuations and ensure financial stability in the region (China Daily, 2017, May 5). However, renminbi internationalization lost its momentum in the aftermath of the 2015 RMB capital outflow and devaluation crisis. BRI financing with RMB is certainly a possibility for the future but the influence of renminbi denominated funds on the total funding is still very marginal. BRI projects could theoretically be financed in RMB if the borrowing of a certain host country would be devoted to paying Chinese construction or energy companies in a quasi-barter system. This however would pose its own risks as it poses its own risks to an overly complicated balance sheet. As it is for now, the dollar seems set to stay the dominant currency within the region (Garcia-Herrero& Xu, 2018).

3.1. China's Reserves

In order to understand the logic behind Chinese outbound direct investment, one has to understand the Chinese growth model and how China has found itself in the situation where it has enough cash in hand to cover for (a large part of) an expensive and – to say the least – ambitious plan like the Belt and Road Initiative.

In 1948, the renminbi and a newly unified monetary policy was introduced by the newly established People's Bank of China. This currency unified and replaced the variety of regional currencies that had been in use until then. In an attempt to make imports cheaper, the government fixed the renminbi's exchange rate at an artificially high level. This policy of artificial currency appreciation scarred the already war-torn China. The newly established PRC had a dwarf economy but it was not isolated from the rest of the world. It was for example, still a significant exporter in the 1950s. The Maoist doctrine of self-sufficiency destroyed these weak but significant links with the global economy. The already tormented economy China had before 1948 was decimated once more by 1977 after the Cultural

Revolution. China's sum of imports and exports accounted for a mere 0.6 percent share of the world trade. With the exception of short-term credits, it did not borrow from international commercial markets or financial institutions, again following autarchic prescripts of Maoist doctrine (Subacchi, 2016).

All this changed since Deng Xiaoping's economic opening up and reform policies in 1978 were formalized. From this period onwards, the People's Republic of China evolved in less than four decades from a war-torn, agricultural nation and one of the poorest countries on earth into a modern, industry-led giant on the world stage.

From then on artificially low interest rates were set in order to enable the state-owned enterprises (SOEs) to borrow cheaply. Adjustments to the exchange rate have kept its exports competitive. This regime also encouraged foreign direct inward investment and brought skill, technology, exposure to external markets and capital to China (Subacchi, 2016, p. 31).

This policy was one of an open economy and a closed financial system through financial and monetary constraints: foreign capital from global investors was welcomed to enter the country but domestic household money was entrenched within the Chinese economy. National savings were able to rise gradually as a share of the country's GDP while the proportion of consumption dropped. Now, it is not that peculiar that savings tend to be high and consumption tend to be low in developing countries. This dynamic, however, has been taken to the extreme in China since the opening up (Wang, 2014). However, the economic growth model proved to be successful as China's real GDP grew about thirtyfold between 1978 and 2015. At the same time annual income per capita increased from a mere USD 300 to approximately USD 8500 today (Subacchi, 2016, p. 31).

After thirty years of extraordinary growth, China has become the largest exporter in the world. As the 'workshop' of the world, trade surpluses have been amplifying as well. In the mid-2000s its surpluses accounted to as much as 10 percent of its GDP. These surpluses resulted in massive reserves and has now made China one of the world's greatest creditor nations. In order to manage these reserves the PBoC established SAFE, the State Administration of Foreign Exchange. For over a decade China has been putting these foreign earnings directly into currency reserves of the PBoC and SAFE. In 2000 the level of exchange rate reserves was a mere 156 billion USD and reached an all-time high of 3.8 trillion USD in 2014, the greatest stockpile of reserves for any country in history (Cohen, 2014).

Whereas in the US the over half a trillion dollar trade deficit seems to be an albatross on the neck of President Trump, the three trillion trade surplus and excess of foreign exchange reserves China has accumulated is not necessarily considered to be a positive thing either. Furthermore, the accumulation of foreign reserves comes at a big cost as when large amounts of foreign reserves are accumulated, the PBoC exchanges these reserves into a corresponding amount of renminbi. This process is called sterilization. In the case of the PBoC, sterilization involves the sale of RMB-denominated financial assets to state-owned banks in exchange for US dollar-denominated assets, which the banks hold. As the PBoC releases more of its currency into circulation, the money supply expands and the renminbi depreciates (Vermeiren, 2015).

But if this excess of reserves comes at such a cost, why then has China accumulated these enormous amounts? The short answer is: because it has been in the interest of the people in charge of the country. As political-economist Victor Shih(2008) notes in his book *Factions and Finance,* career prospects of Chinese career bureaucrats are persistently threatened by the fear of economic

problems, as economic officials are likely to take the blame if a crisis occurs. This makes Chinese technocrats very cautious in their investments. Another political incentive for accumulating foreign reserves is the fact that the political success of political elites is tied to the well-being of export-oriented industries of the megalopolises in coastal China. The long answer to this question is a bit more complex. One view on this can be the purely economic benefit. Two main economic explanations can be put forward why countries would accumulate foreign exchange reserves: the precautionary theory and the mercantilist theory. The former, also known as the self-insurance theory, states that the hoarding of reserves brings further economic stability – a factor highly valued by primarily manufacturing countries. The latter theory comes down to the logic of protectionism. This on its turn promotes exports. Both of these theories, however important, are incomplete, as they tend to downplay the economic (and structural) costs of holding large volumes of foreign reserves. And these costs are significant, as they include: low financial returns, increased inflationary pressures, and reduced purchasing power. When we take these costs into consideration, it is up to debate whether this process of reserve accumulation has increased or decreased aggregate welfare. Economic rationale cannot be the sole explanation for why China has been accumulating far more reserves than any other nation (Steinberg, 2014, p. 76-79).

The two economic theories in favor of foreign reserves accumulation stated in previous paragraph - precautionary theory and mercantilist theory – thus incentivize policymakers to advocate for a weak exchange rate and reserve accumulation on behalf of their constituents (Steinberg, 2014, p. 73).

A big opponent to the accumulation of foreign reserves within the PRC, is the People's Bank of China. Foreign reserve accumulation runs contradictory to the PBoC's mandate to achieve price stability and its ambition to internationalize its currency, the renminbi. Internationalization of the Chinese currency would imply liberalization, which in turn contradicts the economic strategy of state control on capital. Through this capital control regime, China has benefitted the consolidation of an investment-led regime of accumulation that could redistribute income and wealth from Chinese workers to state-owned enterprises (SOEs) and state banks. In other words: the Chinese growth model is based on centralized management of the private capital of middle-class earning people through capital controls which are to the benefit of SOEs and big state-owned banks. This regime has made the Chinese economy excessively dependent on exports and the accumulation of US dollars. This accumulation of dollars has compelled China's elite to challenge the dollar hegemony by promoting renminbi internationalization, which in turn requires the dismantling of capital controls (Vermeiren & Dierckx, 2014).

This contradiction between Chinese ambitions has created a dichotomy between two factions. On one side there are (liberal) elite bureaucrats, led by the PBoC, that see internationalization as a means of advanced financial reforms. During the global financial crisis of 2008, China's vulnerability to sudden shifts in dollar exchange rates was exposed (in literature this is called 'the dollar trap'). This motivated the desire to reduce dependence to the dollar and internationalize their own currency. On the other side there were bureaucrats, bankers and businessmen opposed to renminbi internationalization. Producers' interest groups and banking institutions (many of them state-owned), have been benefitting from the government's firm control over interest rates and credit allocation. This is why there was never a formal declaration of internationalization as an official Chinese policy (Cohen, 2017).

Still, as the PBoC is politically weak, the balance of power within the Chinese political system is heavily tilted toward a policy beneficial to its export-led SOE's and it does not look like there will be a major shift in policy concerning reserve accumulation in the short term (Steinberg, 2014, p. 80-86).

3.2. Going Out and the Belt and Road Initiative

With this excess of dollars in reserves, the question remains what to do with them. From Deng Xiaoping's Opening Up until the end of the millennium, China profited heavily from inwards foreign direct investment and so it became the largest recipient of foreign direct investment. However, this started to change since 1999, when the Going Global or Going Out strategy was launched. This government program was an effort to promote Chinese investment abroad. These investments would be supported by the Chinese government through the establishment of government backed sovereign wealth funds – the most well-known was the in 2007 established China Investment Cooperation which had a starting capital of 200 billion USD. The first ever commercial overseas investment was in 2003-2004, when the Chinese firm TCL acquired the French Thomson SA (BBC, 2013, May 19). Last decade there seemed to be no end to China's reserves. Buying up car manufacturers, football teams, power grids, from Asia to Europe, the US, Africa and Latin America, China has reinvented itself as the *Gaius Maecenas* of the world (Bloomberg, 2018, April 23).

Outbound investments are interesting as they tend to render high yields, but there are also risks involved and Chinese authorities have always been very keen on safe investment. Turns out there is nothing safer than US bonds. A large portion of these reserves have been invested in US Treasury bonds. From 2000 onwards, the acquisition of US Treasury bonds has risen exponentially. Whereas China's total holdings of US Treasury Securities in 2000 amounted for 'only' 159 billion USD, it reached the one trillion USD mark in 2010 (Morrison & Labonte, 2013). The accumulation was hampered in the aftermath of the 2008 crisis, but afterwards it picked up again. At its peak China owned over 1,3 trillion USD at the end of 2013 (Treasury, 2018)[3]. In the years afterwards there came a drop as a Chinese monetary reform put the renminbi under pressure, which in turn had an effect on the accumulation of Treasuriy Securities. A significant part of this distortion was corrected, however, as the total amount of US Treasury bonds held by China never amounted to the same level of 2013.

One could argue that these treasuries in Chinese reserves could be used as a 'weapon' to retaliate against the proposed tariffs from the US. However, it is not the case that 'the nuclear option' of a sudden closeout of American treasuries, is on the table (Reuters, 2018, April 5). It is true that China is gradually scaling down on its treasury purchases but the Press Spokesperson of SAFE dismissed any consideration of an end to Chinese US treasury purchases by calling it 'false news' (SAFE, 2018, January 18).

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[3] The correct amount of Treasury bonds held by China is hard to disclose as it is widely speculated Chinese authorities have been using intermediaries in Belgium and Ireland to buy Treasury bonds for them in the past (Zeng, 2016).

The idea of China from one day to another dumping its entire Treasury portfolio could be dismissed as a far-fetched fiction, as this would hurt China's export-led economy equally hard – some economists say even harder (Pettis, 2018) – than the US'.

Fact of the matter is: China is diversifying its investment portfolio. Part of this diversification effort is connected to the Belt and Road Initiative. China's economy is – even though slower than last decade – still growing, and so are its reserves. A diversification does not necessarily have to imply a sale of a significant part of the assets it already holds.

The importance of infrastructure to national or regional economic development cannot be overstated. As improving the quality and quantity of infrastructure is vital to the increasing productivity and competitiveness of an economy, many countries invest a large portion of its wealth in developing infrastructure. However, national funding in developing countries is typically insufficient to meet financing needs since infrastructure is a long-term investment with high up-front capital investment (Chan, 2017). According to a study carried out by the Asia Development Bank in 2017, named *Meeting Asia's Infrastructure Needs*, infrastructure needs in developing Asia and the Pacific will exceed 22.6 trillion USD over the 15-years from 2016 to 2030 (ADB, 2017). As the BRI primarily focuses on the Asia-Pacific region, it explains why so many countries are willing to cooperate with a massive infrastructure project as the BRI.

It is very hard to find the exact numbers of China's outbound direct investments, as the Ministry of Commerce (MOFCOM) requires its companies to register the first destination of their cross-border transactions and do not include the reinvested earning. In 2014, for example, MOFCOM announced that China had become a creditor-nation with ODI larger than FDI, but more reliable statistics tell us that this milestone year was only reached in 2016 (Garcia-Herrero, Xia & Casanova, 2015; Huang & Xia, 2018)

China's strongest annual growth in ODI came in 2016, with (non-financial) ODI flows surging by 49.3 % to 181.2 billion USD, around the same time the BRI gained steam. These ODIs, although according Chinese investment strategy, were later curbed due to fears of too rapid capital outflows following an unexpected devaluation of the RMB in 2015. In 2017 these fears were addressed as the NDRC along with four agencies formalized the regulatory pathway for ODI approval. This framework classified ODI into three groups, being: prohibited, restricted and encouraged transactions. Prohibited transactions are self-evident: investments that endanger the national interests or security of China. Investments are restricted when they go against the countries' national interests or are prone to "irrational" risks (e.g. real estate, sports clubs, hotels and entertainment industry). The encouraged ODIs are the ones that are deemed strategically important to China's growth (Huang & Xia, 2018).

Belt and Road related infrastructure were from then on even more promoted as part of the encouraged ODIs. Because of this encouragement of BRI-related investments, the ODI flow to BRI countries remained stable at 14.4 billion USD in 2017 - only a slight decrease from the 14.5 billion USD in 2016 – whereas the total amount of ODI still declined. Because of this, the share of investments in BRI-countries increased to 12 % of total ODI (Huang & Xia, 2018).

Another change of the ODI flow post-2017 is the composition. The shares of ODI in the commodity and energy sector increased as the share in the service sector declined. Whereas energy and

commodities only accounted for 29 % in 2016, they rose significantly to 49.4 % in 2017 (Huang & Xia, 2018).

Overall Chinese overseas investments are increasing and so is the portion of these investments in BRI-related projects, but this is solely due to the rate by which new countries enter the Initiative (Scissors, 2018). It could be argued that the Belt and Road Initiative is, more than an investment strategy, a branding operation. As said, the BRI has no real multilateral framework, it is not geographically limited and the definition of the Initiative changes at the whims of Chinese authorities. The BRI can be a haven for China's excess reserves, but up to now this is only an extension of the Going Out policy started almost two decades ago.

3.3. FINANCING THE BRI

Most of the Belt and Road Initiative will be financed through concessional loans. These loans will be provided by three channels: sovereign wealth funds, Chinese banks and newly established multilateral institutions. In the following paragraphs I will look deeper into the roles of these actors and how these institutions have grown since the introduction of the Belt and Road Initiative.

3.3.1. THE SILK ROAD FUND

The Silk Road Fund is a medium- to long-term wealth fund set up in 2014 specifically to provide capital for the BRI. This capital comes from contributions committed by its shareholders, which are: Buttonwood Investment Holding Company Ltd. (65 %), Seres Investment Co. (15 %), China Development Bank (5 %) and Export-Import Bank of China (15 %) (Silk Road Fund, 2018).

It is important to note that the majority shareholders of the Silk Road Fund, Buttonwood Investment Holding (also known as 'Wutungshu Investment Platform Co.) and Central Huijin Investment Ltd. are both subsidiary to the State Administration of Foreign Exchanges, the foreign exchange regulator agency which is in turn owned by the People's Bank of China and so owned by the Chinese government (SCMP, 2016, April 8; Reuters, 2016, March 31). Central Huijun Investment Ltd.'s shares are officially owned by China Investment Company (CIC). However, Central Huijin's principal shareholder rights are exercised by the State Council. The members of Central Huijin's Board of Directors and Board of Supervisors are appointed by and are accountable to the State Council (Central Huijun Investment Ltd., 2018).

When the Silk Road Fund was officially unveiled at the APEC Summit in Beijing in November 2014, it had a capital of USD 40 billion (Chan, 2017. In 2017 Xi Jinping added another RMB 100 billion to the fund (China Daily, 2017, May 14).

Since 2014 the fund has been actively involved in signing Memoranda of Understanding (MoU). In 2015 the fund signed an MoU with Kazakhstan National Export and Investment Agency concerning the creation of a China-Kazakhstan Production Capacity Cooperation Fund, with the Saudi Arabian based International Company for Water and Power Projects to jointly develop and invest in power projects in Arab nations, with the European Bank for Reconstruction and Development for strategic and operational cooperation, with the Serbian government on joint investment and development of Serbian Renewable Energy Projects, with the European Investment Fund, and with the Interbank Consortium of Shanghai Cooperation Organization. Further it is important to note that the Silk Road

Fund signed memoranda of cooperation with Pakistan and the Russian Federation (Silk Road Fund, 2018).

The fund's focus on Russia has been remarkable. In December 2017 the Silk Road Fund bought a 9.9 percent share in one of the largest Russian private natural gas projects, called JSC Yamal LNG. This move by the Silk Road Fund was particularly celebrated by the Chinese media as this is seen as the first Arctic energy project within the BRI (The Diplomat, 2018, January 18).

3.3.2. State-banks

3.3.2.1. China Development Bank

The most important funding source for the initiative is China Development Bank. This bank, dating back from 1994, is the largest of China's three state-owned, non-commercial policy banks (Financial Times, 2017, May 11; Euromoney, 2017, September 26), and so the world's largest development finance institution. As already noted, the Chinese bank falls under the direct leadership of the country's State Council and its shareholders include the Ministry of Finance (36.54 %), Central Huijin Investment (34.68 %), Buttonwood Investment Holding (27.19 %)[4], and the National Council for Social Security Fund (1.59 %). The CDB, which by the end of 2016 had assets of 14.34 trillion RMB (CDB, 2018), describes itself as 'committed to supporting Chinese companies "going abroad", guided by the principle of mutual benefit, cooperation and win-win progress (CDB, 2018).' The major advantage of policy banks is that they rely on national credit and can raise long-term capital to meet the correspondingly long-term financial needs of big infrastructure projects. Contrary to western banks, it relies on national credit. This means that the CDB can raise long-term capital to meet the long-term financial needs of enormous infrastructure projects, like the BRI (Euromoney, 2017, September 26).

Its role within the BRI cannot be overstated enough. The bank provides medium-to-long-term financing facilities that focus on the assistance in the development of "a robust economy and a healthy, prosperous community" (Chan, 2017).

The CDB is very cautious with making official numbers of loans public. Nevertheless, it published in its annual report of 2016 (its most recent public report) that it provided 12.6 billion USD of loans to countries along the BRI.

Of all sectors the CDB is investing in, the one sector that sticks out with the most attention is the energy sector. This process has been ongoing for longer than the existence of the BRI. Between 2005 and 2014, the CDB and the EXIM bank have been spending almost as much in global finance for energy as all the major multilateral banks combined (Bo Kong & Gallagher, 2017). The BRI has only intensified this focus. More than 500 pipeline projects for Belt and Road countries, with a planned total investment of 350 billion USD, were on the funding list of the CDB by 2016.

By the end of 2017 the policy bank had extended 110 billion in loans to projects along BRI-countries, and for now the bank has committed 250 billion USD in total to the BRI, declaring it a 'top priority'

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[4] As explained in the chapter concerning the Silk Road Fund: Central Huijin Investment and Buttonwood Investment Holding are subsidiary to SAFE.

for the bank. The bank has been very active in promoting bi- and multilateral cooperation by organizing several events and hosting multilateral conferences (CDB, 2016). But engagement of the CDB does not stop here as the bank is a primary stakeholder in several China-led regional development funds (Chan, 2017).

Agreed at the Belt and Road forum of 2017, the CDB is actively increasing financial support to the BRI through several multi-currency special credit schemes. Through these mechanisms the CDB can effectively bypass the time and expense incurred in foreign exchange transactions – in line with Zhou Xiaochuan's call of using local currencies for Belt and Road investments. The three schemes where the CDB is a stakeholder in are: the Belt and Road Multi-currency Special Lending Scheme for Infrastructure Development, the Belt and Road Multi-currency Special Lending Scheme for Industrial Cooperation, and the Belt and Road Multi-currency Special Credit Lines for Overseas Financial Institutions. Each scheme will account for an equivalent of 100 billion RMB, 100 billion RMB and 50 billion RMB, respectively. Also, at this forum the CDB signed subscription agreements and memoranda of understanding with several European and Asian investment funds and bank (Xinhua, 2017, May 17). These schemes are currently the primary drivers of RMB internationalization within the BRI. If successful, these mechanisms can be used at a larger scale and -if successful- can play an immense role in bypassing the dollar in the region.

February 2018, the China Development Bank signed a Memorandum of Understanding (MoU) with the British multinational banking and financial services company, Standard Chartered. This MoU entailed an agreement allowing the state-owned bank to provide up to 10 billion RMB to the London-listed bank for projects under the BRI covering the next five years (Reuters, 2018, February 1).

To conclude this chapter, it is also important to point out that the CDB holds a 5 percent share in the Silk Road Fund.

3.3.2.2. China Export-Import Bank

Established in 1994, the bank's mission shifted from initially promoting the exports of Chinese mechanical and electronic products to the promotion of high-tech products (DG of External Policies EU, 2011). The Export-Import Bank of China (CEXIM) is a state-funded and -owned policy bank under the direct leadership of the State Council. With the credit supplied by the Chinese government, the bank plays a crucial role in promoting economic growth and structural adjustment by supporting foreign trade and implementing the "going global" strategy – thus its focus on the Belt and Road Initiative (China Export-Import Bank, 2018).

Along with the CDB, the Exim Bank of China are the two key development financial institutions that have provided crucial funding support for the BRI. As of end-2016 CEXIM has loaned out about USD 700 billion for over 1200 BRI-related projects(Chan, 2017).

Historically, the main focus of CEXIM has been on Africa. The bank has been particularly active in supporting Chinese companies investing in infrastructure, oil, gas, mining and telecommunication projects on the continent. In 2009 African assets accounted for one-third of the total asset base of CEXIM (DG of External Policies, 2011). This Africa-focus has prolonged and on the Forum on Chinese African Cooperation (FOCAC) meeting of 2015 CEXIM along with Buttonwood Investment of SAFE jointly established the China-Africa Industrial Cooperation Fund with a total capital of USD 10 billion. This fund has approved six projects totaling an investment of USD 3.68 billion. Through this fund, CEXIM has a large stake in the pipeline projects in Ethiopia, which are a part of the BRI (Chan, 2017).

But CEXIM's scope doesn't limit itself to Africa alone, it also has a stake in the China-Eurasian Economic Cooperation Fund. Yet another regional development investment fund, this time focused on the SCO area (primarily Central-Asia) with a capital of USD 5 billion (China Eurasian Fund, 2018).

Just as the CDB, CEXIM has increased its financial support for establishing multi-currency special lending schemes. At the Belt and Road Forum in 2017 CEXIM proclaimed to set up two schemes: the B&R Multi-Currency Special Lending Scheme (RMB 100 billion) and the B&R Special Lending Scheme for Infrastructure Development (Chan, 2017).

The China Exim Bank has a 15 % stake in the Silk Road Fund (Silk Road Fund, 2018).

3.3.2.3. China Agriculture Bank

The Agriculture Bank of China (ABC) was created in 1951 by the merger of the Farmers Bank of China and the Cooperation bank (two republican banks). Since the reforms of the late 1970s, the bank has evolved from a state-owned specialized bank to a state-owned commercial bank. In 2010 the bank became a state-controlled commercial bank as it was listed on the Shanghai Stock Exchange and the Hong Kong Stock Exchange (ABC, 2018).

The bank's mission is to promote the development of agriculture in rural areas. Its focus lays on mainland China and less on overseas activities. However, there are indications that the bank may support BRI projects (Chan, 2017).

3.3.2.4. Industrial and Commercial Bank of China

Another leading state bank in BRI expansion is the Industrial and Commercial Bank of China (ICBC) (Chan, 2014). The bank was established in 1994 and just as the BOC and ABC, it was listed on both the Shanghai Stock Exchange and the Hong Kong Stock Exchange (ICBC, 2018. The latest figures of their shareholders structure show us the following two majority owners: Central Huijin Investment (34.71 %) and Ministry of Finance (34.60 %). As only the A-shares are made public, the H-shares are undisclosed (ICBC, 2017).

In 2017 the bank overtook Wells Fargo as the world's most valuable bank brand and it is the largest bank in the world by total assets (SCMP, 2017, February 6). The bank is already very internationalized with branches in 42 countries and seven clearing banks (Wang, 2017). Being this big and already having a global scope on finance, it is very keen on investing in the BRI. The bank is especially invested in the flagship project of the BRI: the China-Pakistan Economic corridor. But its commitment to the initiative doesn't end in Gwadar. In 2014 the bank signed an agreement with China Export & Credit Insurance Corporation to promote BRI investments within the Bangladesh-China-India-Myanmar Economic Corridor (Chan, 2014).

In an interview with Euromoney in 2017 an official of the ICBC said that the bank is taking part in a total of 212 projects along the BRI, with credit facilities already exceeding USD 67 billion, with the prospect of intensifying its support even further. Further he said that the ICBC is exploring the option of giving more capabilities to their overseas institutions in order for them to be an active player in the initiative (Euromoney, September 26).

On October 30 last year the ICBC officially listed "Belt and Road" climate bonds at the stock exchange in Luxemburg. These bonds, totaling USD 2.15 billion, will be issued in three tranches of 450 million dollar, 400 million dollar and 1.1 billion euro. This euro-denominated bond will be the biggest single

biggest in euros denominated green bonds issued by a Chinese issuer and will be used for eligible projects, with regards to renewable energy (China Bonds, 2017).

The ICBC is very active in setting up branches in Belt and Road countries. In 2017 the bank opened its first branch in the Mongolian capital Ulaanbaatar (Xinhua, 2017, September 6). With its internationalized network it will be of big value in providing funding for the BRI.

3.3.2.5. China Construction Bank

The China Construction Bank (CCB), established in 1954, is a large-scale joint stock commercial bank. It was respectively listed on the Hong Kong Stock Exchange and the Shanghai Stock Exchange in 2005 and 2007 (CCB, 2018). According a report by Reuters in 2015, Central Huijin Investment holds 57.31 percent of all shares in the CCB (Reuters, 2015, Augustus 19). Further shareholders are not disclosed.

In April 2016 the CCB signed a memorandum of understanding with International Enterprise Singapore. Under this MoU the CCB would provide 30 billion Singaporean dollar of financing services to support local and Chinese companies to invest in BRI projects in Singapore. Singaporean companies will then be able to in return tap the banks network. At the same time the CCB signed an MoU with the Singapore Exchange to develop the capital market in Singapore and to bring more Chinese companies to the city-state (ChinaGoAbroad, 2016, April 26).

Last year CCB conducted several fundraising events where it was able to raise 100 billion yuan from onshore and offshore[5] investors. This money was raised via the bank's private equity and other investment platforms as an instrument to push broader investment of RMB overseas (Reuters, 2017, August 22).

3.3.2.6. Bank of China

Of all the state-owned banks, the history of the Bank of China (BOC) is the richest. In 1905 the first national bank, then known as the Treasure Bank, was created during the reign of Emperor Guangxu of the Qing Dynasty. 1911 the bank was renamed as the Bank of Great Qing and with 35 branches in China's provincial cities, it soon became the biggest financial institution of the empire. After the Xinhai Revolution in 1911, the imperial dynasty was overthrown and the bank was renamed Bank of China, functioning as the central bank of the Republic. During this period the bank obtained a dominant position within China and it developed a good standing in the international financial community. After 1949, the PBoC took over the mandate of central banking and the BOC became a subdivision of the PBoC. Drawing on its know-how in forex operations, the bank became responsible for managing China's foreign exchange operations and provided crucial support to the PRC's foreign trade development and economic infrastructure by its offering of international trade settlements and overseas funds transfer. In 1994, the bank became a fully state-owned commercial bank (BOC, 2018).

In 2006 the commercial bank was listed on both the Stock Exchange of Hong Kong and the Shanghai Stock Exchange. The main shareholders of the bank are Central Huijin Investment Ltd. (64.02 %), HKSCC Nominees Limited (27.83 %), China Securities Finance Co. Ltd. (2.77 %), Central Huijin Asset Management Ltd. (0.61 %), Buttonwood Investment Platform Ltd. (0.36 %), MUFG Bank Ltd. (0.18 %), HKSCC Limited (0.15 %), Huatai Securities Company Ltd. (0.08 %), Anbang Property & Casualty

[5] According to this source from Reuters, funds from offshore investors would be conducted in USD.

Insurance Co. Ltd. (0.07 %) and China Life Insurance Company Ltd. (0.07 %) (BOC, 2018). This means that of all the shares of this bank, 67.76 % is owned by PRC state owned financial institutions.

As the BOC is historically the most internationalized bank, it owns 11 of the 23 overseas clearing banks -this is the biggest amount of clearing banks of all Chinese banks- consisting of almost 600 overseas branches and representative offices. In 2016 the bank's overseas corporate loan growth surpassed domestic corporate loan growth for the first time (Wang, 2017; China Daily, 2017, March 23).

Also, in 2017 the BOC along with China UnionPay issued the first dual-currency debit card in Hungary. It comes down to a debit card which can both operate in Hungarian forints as well as Chinese renminbi. While having a marginal influence on RMB internationalization, the establishment of a dual-currency debit card sets a symbolic precedent for further financial integration between China and the Central-European country – and to a larger extent with other European countries (China Daily, January, 2017).

The BOC is deemed one of the leading state banks in the BRI. In 2015 the Bank of China's president stated that the bank would focus on overseas activities in ASEAN in order to push forward the BRI and that the bank had a target to channel USD 100 billion to the initiative between 2015 and 2018[6] (Chan, 2017).

By the end of 2016 the bank followed up around 420 major BRI projects and thus far the BOC has provided credit lines of USD 68 billion to the BRI project (Chan, 2017; China Daily, 2017, March 23).

3.3.3. New multilateral institutions

Multilateral organizations have shown some interest in the objective of the BRI, but either do not see an economically beneficial logic in the projects or do not have ample financial capacities. Therefore, China has been active in creating new multilateral banks, in which it is the dominant structural power (Garcia-Herrero & Xu, 2018). However, the stake of these newly established multilateral institutions within the BRI remains tiny (Financial Times, 2017, May 11). The two most important new multilateral institutions put forwards are the New Development Bank (NDB) and the Asia Infrastructure and Investment bank.

3.3.3.1. New Development Bank

The NDB also known as the BRICS Development Bank, is a multilateral development bank established by the BRICS countries in 2015 as an alternative to the Washington dominated financial institutions. As this development bank has pledged to only use BRICS currencies. Article 24 of the *Agreement on the New Development Bank* clearly states that the bank "may provide financing in the local currency of the country in which the operation takes place" (Agreement on the New Development Bank, 2014). This decision reflects the growing discontent amongst the BRICS with the Bretton Woods governance structures at the top of the world finance and monetary order. It could be argued that the NBD could give the BRICS greater influence in international development financing, then again, the scope of the NDB cannot be global as it positions itself as a rival to the financial hegemony of the BWI.

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[6] No official figures are publicly available whether or not this pledge has been followed up.

Initially the biggest problem of the NDB was its lack of credibility. However, these issues seem to be resolved as China Chengxin Credit Rating and China Lianhe Credit Rating gave the multilateral bank the institutional rating of AAA (China Daily, 2017, March 2).

With a subscribed capital base of 50 billion USD, the NDB will be able to play a role in providing a substantial additional poll of capital to the BRICS countries to fund their infrastructure, but compared to other multilateral banks, it remains rather small (WEF, 2017).

In 2017 the NDB signed a MoU with the ICBC to strengthen strategic cooperation and to provide high-quality services for infrastructure projects of countries in the BRI, as well as other emerging economies and developing nations (China Daily, 2017, September 14). As the BRI is not directly linked to the NDB, this is a step in the direction of a closer relationship with the BRI and it opens the door to eventually fund some major projects. As of today, not a single BRI undertaking has been fully adopted or funded by the NDB.

3.3.3.2. Asia Infrastructure and Investment Bank

At the state visit to Indonesia in October 2013here President Xi Jinping introduced the concept of the Maritime Silk Road, simultaneously he proposed the establishment of a new multilateral bank, focused on the development of infrastructure in Asia (China-ASEAN Center, 2013, October 2). Only one year later, 21 Asian countries signed a memorandum of understanding supporting the establishment of this brand-new multilateral institution. Less than a year later this project went into working and as of today this multilateral bank has 84 member countries (including 20 prospecting members), wherefrom 48 are from within the region and 36 are from elsewhere. These 84 share a capital base of 100 billion USD, which makes the AIIB a medium-sized multilateral bank, smaller than the World Bank (250 billion USD) and the Asian Development Bank (150 billion USD) (Callaghan & Hubbard, 2016; AIIB, 2017).

Unlike the World Bank and the Asian Development Bank, it has no overarching objective to reduce poverty. Its mission statement - ‘to improve social and economic outcomes in Asia and beyond’- is unspecific but it was clear from the start on that the fate of the AIIB and the BRI were closely entangled as President Xi explicitly stressed that “the primary task of the Asian Infrastructure Investment Bank is to provide capital for these [BRI] schemes” (Xinhua, 2015, February 10).

Despite calls by several Chinese think tanks to push for the RMB to be included in the basket of currencies to denominate and settle loans for the AIIB, the bank will conduct all of its investments, loans and payments in USD (SCMP, 2015, April 15). It will thus not be a platform for renminbi internationalization. However, the China dominated AIIB will enhance the PRC’s structural power in the international financial order. “There’s no conspiracy here”, AIIB’s chief financial officer, Thierry de Longuemar, affirmed to American news agency CNBC(2017). “The One Belt, One Road Initiative is an initiative by China; it’s a national initiative while we are a global initiative,” he said.

The first bond of the AIIB was by the end of June this year. The minimum size of this (dollar-denominated) bond would be USD 1 billion, but as demand for this bond might be strong, the AIIB is considering issuing a larger size (Reuters, 2018, January 7).

Recently the AIIB came under fire as Forbes exposed that the bank approved just USD 1.13 billion in its first year of operation and USD 3.3 billion in its second, accounting for a grand total of USD 4.43 billion up to date, which is less than a quarter of the expected amount – which was somewhere in between 10 and 15 billion dollars (Forbes, 2018, January 18).

3.4. The Funding Gap

As the economy was flourishing and bank credit was growing at rates of over ten percent a few years ago, banks were confident of their ability to do all the funding by themselves. Today the situation is different. The economy has slowed down and banks' balance sheets are saddled with questionable loans. These loans keep being refinanced and this does not leave much room for massive lending required by the BRI. Even adding up all the capital provided by Chinese policy banks, Chinese commercial banks and newly established multilateral banks will not be enough to meet the enormous infrastructure investment gap of the Eurasian heartland. It seems that there is yet a limit to China's seemingly inexhaustible financial reserves. This is why European banks – still the largest cross-border lenders in the world – are the ideal partners to step in to help China's dream of revivifying the ancient Silk Road (Garcia-Herrero & Xu, 2018).

The western bank that has been the most prominent in its support for the BRI has been HSBC. The UK based investment bank is a firm believer in the internationalization and with cross-border financing services as one of its key focuses, it sees itself at the forefront to become an active partner of the Initiative (Forbes, 2017, May 17).

The New York-based financial institution Citigroup sees investing in the BRI as a keyway to enhance its revenues within China. As the bank suffered a 10.5 percent decline in 2016, following the sale of its stake in Guangfa bank, it expects to book more revenue from providing services for activities related to the BRI, including mergers and acquisitions, cash management, trade finance and hedging (Reuters, 2017, September 22).

During the two-day 9th UK-China dialogue, José Viñals, chairman of Standard Chartered has pledged to offer at least USD 20 billion in financing by 2020 to facilitate projects within the BRI (SCMP, 2017, December 17). StanChart has lately even stepped more upfront to support the BRI as it - as I already mentioned in the chapter about the CDB - has signed a MoU with the China Development Bank earlier this year.

3.5. Silk Road or String of Pearls?

Of course, the BRI is no charity or aid initiative. While investments are made by the Chinese government through the Silk Road Fund and lending facilities are provided by the AIIB, the NDB and more importantly the Chinese state-banks, countries involved with the initiative are still expected to eventually pay for an overwhelming part of infrastructure projects on their respective national soil. Increasingly, important questions are raised about how sustainable the financing of the initiative will be on the long term. Up to this day it remains unclear to which degree the BRI will follow multilateral standards on debt sustainability. As the Belt and Road Initiative lacks a strong multilateral framework and mainly consists of a series of bilateral partnerships, fears for the absence of multilateral standards are not wholly unfounded. On the IMF-PBoC Conference in Beijing even IMF Director Christine Lagarde – while holding an optimistic tone about the Initiative - warned for the potential risks of a problematic increase of debt and the misuse of funds (IMF, 2018, April 12).

Fears that Chinese lending might pose a threat for these countries' national sovereignty are not unfounded. Take for example Sri Lanka. The island state in the Indian Ocean began slipping away from traditional multilateral institutions during the reign of president Mahinda Rajapaksa (2005-

2015). This situation left a financial vacuum for China, which became its leading investor and lender, and its second-largest trading partner (SCMP, 2018, January). Investment from China in the island's infrastructure intensified. The flagship of Chinese investment was the Hambantota port in southeastern Sri Lanka. The Sri Lankan government took on the project in 2007 with the first major loan of 307 million USD from the EXIM bank of China. This loan however, was not unconditional: Sri Lanka was required to accept China Harbor Engineering Company (CHEC) as the port's builder. The vision was that Hambantota would bring more ships to Sri Lanka and ease pressure on the Colombo port in the west and eventually become the largest port of South Asia. Things turned out differently as Hambantota struggled to make money as it was deemed too isolated from the more populous and industrial Colombo region. By 2012 the port was struggling to attract ships and construction costs were rising as the port began expanding. Another loan of 757 million USD was added for further development. Sri Lanka was unable to pay this debt off. In 2016 government officials began meeting with China to strike a deal, hoping to avoid default. Chinese officials did not ask for more money, they demanded a dominant equity in the port. At the end China Merchants (and not CHEC, which built the port) obtained the contract, which entailed a 99-years lease, a plan to convert 6 billion USD of loans Sri Lanka owes China into equity and a 70 per cent stake in a joint venture with the state-run Sri Lanka Ports Authority (SCMP, 2017, December 10; NY Times, 2018, June 25).

In a widely discussed article by the Center for Global Development, authors John Hurley, Scott Morris and Gailyn Portelance (2018), explore the debt vulnerabilities of BRI-countries. The possibility that the Initiative will leave countries with an enormous debt overhang can be considered as a variable that has to be scrutinized carefully, but debt as such is not an inherently dangerous phenomenon. What can be a dangerous evolution is when government's borrowing is not accompanied with a corresponding amount of economic growth and revenue generation that fully services this debt. If growth is insufficient, it can generate a downward spiral that will inevitably end in the need for a debt restructuring or reduction and eventually threaten the national sovereignty of burrowing countries (Hurley et al, 2018).

Results of the research by Hurley et al (2018) single out eight countries especially vulnerable for its problematic debt accumulation: Djibouti, The Maldives, Laos, Montenegro, Mongolia, Tajikistan, Kyrgyzstan and Pakistan. These debt problems are intrinsically connected with the Belt and Road Initiative. Djibouti, the host country of China's only military base on foreign soil, has the largest public external debt of any low-income countries (85 %/GDP). A significant proportion of this debt is owed to the China EXIM Bank (1.4 billion USD) (Downs & Becker, 2017). While a number of Chinese loans has been set at below-market rates, the financing of the Addis-Ababa-Djibouti Railway (a focal project of the MSR on the African continent) is reported to be closer to commercial rates. China is currently investing in the Maldives for the upgrade of the international airport (830 million USD), the development of a new population center and bridge near the airport (400 million USD) and the relocation of the major port (this project is still in a very early phase). Most of the funding will be facilitated by the China EXIM Bank. Laos has reportedly signed a 465 million USD loan with the aim of building a railway network and a 600 million USD loan agreement to build a hydropower plant. Both loans will be provided by the China EXIM Bank within the framework of the China-Indochina Peninsula Economic Corridor. While Montenegro might seem as a somewhat unexpected country in this list, its debt problems are indisputable. The main source of this enormous sovereign debt is the BRI-linked infrastructure project: a motorway linking the port of Bar with Serbia that eventually would integrate the Montenegrin transport network with the rest of Europe. 85 per cent of the total

estimated cost of 1.1 billion USD for the first phase of the project are facilitated by the EXIM Bank of China according to an agreement signed in 2014. This first phase alone accounts for nearly a quarter of the country's GDP. Question remains what the impact will be when the financing of the next phases will be completed. Land-locked Mongolia's economic growth will particularly depend on the successes of the infrastructure projects related to the BRI. In 2017 China EXIM Bank agreed to provide financing under its 1 billion USD line of credit at concessional rates for hydropower and highway projects. The hydropower project has stalled, however. If China loans even more than the provisional 1 billion USD to Mongolia, the prospects of a Mongolian default will only get higher. Tajikistan and Kyrgyzstan are both poor Central Asian countries with significant BRI-related infrastructure projects. According to the World Bank Tajikistan has a high risk of debt distress, but it is only going to increase. China already is Tajikistan's largest creditor, accounting for nearly 80 per cent of total increase in the country's debt over the 2007-2016 period. A 3 billion USD portion of the Central Asia-China gas pipeline will go through the Central Asian country. However, this pipeline project will be financed through the Chinese government. Question remains whether the Tajik government will be put under pressure to eventually cover some of the costs. Kyrgyzstan has a public debt amounting to 65 per cent of GDP of which 90 per cent is external debt. Here China EXIM Bank is the largest creditor with loans that totaled 1.5 billion by the end of 2016 (roughly 40 per cent of the Kyrgyzstan's total external debt). This country is deemed to be a transit country for several railway and gas pipeline projects within the, which are currently under negotiation under the framework of the CCAWAEC. The most populous country prone to a debt crisis is Pakistan. With CPEC being the flagship project of the Initiative, the future of the country will be intrinsically dependent on the future of the BRI and vice versa. The total amount of loans for the project amount to 62 billion USD but the project is currently dealing with a few setbacks. At the end of last year, Pakistan decided to cancel a 14 billion USD infrastructure agreement (the Diamer-Bhasha dam) because it did not accept the conditions anymore. The conditions included China taking ownership of the projects, the operation and the maintenance costs and the pledging to build another operational dam (SCMP, 2017, November 17). This will relieve a portion of the debt problem Pakistan is dealing with. Still Pakistan's loans reflect rates as high as 5 per cent, which could increase the risk of a default (Hurley et al, 2018).

While not on the list of the 'risk-countries' Malaysia exhibited a more cautious tone towards the BRI since the election of Prime-Minister Mahathir. In July, the newly elected Prime-Minister, called a halt to work on three MSR projects: the 20 billion USD East Coast Railway Link and two pipeline projects worth 2.3 billion USD. In his first foreign visit, to Japan, Mahathir made his message clear: "we do not want to be indebted to China" (Reuters, 2018, July 5).

Of course, if China would intentionally pursue a business model according to the 'string of pearls' theory, the Belt and Road Initiative would not be sustainable on the long term and eventually involve massive financial setbacks for the investments the Chinese government has put in place already. Neither can it be ignored that if the Hambantota scenario were to be repeated, trustworthiness of Chinese loans and investments would make BRI-countries more suspicious and bring further the risk of a complete collapse of the Initiative, running contrary to the core values of the BRI - being 'win-win cooperation', 'common development and prosperity' and 'trust'.

4. TRADE

‘Unimpeded trade’ is one of the core values of the Belt and Road Initiative. The BRI’s focus on physical infrastructure is not by accident as ports, airports, roads and rail lines make up the nervous system of the world economy. If all infrastructure envisioned by the initiative would be flawlessly built by tomorrow, we could expect momentous changes in the global trade arena. However, as I explained in earlier chapters, there are still many obstacles along the road to a fully integrated Eurasia as the BRI promises to bring. As the Belt and Road Initiative is still in an early stage of development, it is quite early to already judge its impact on complex developments like trade relations. Most of the infrastructure projects are either in a premature or early phase of construction. Nonetheless I will try to look deeper into the changes, dynamics and prospects of China’s trade with BRI countries.

In general, BRI countries have become increasingly important trading partners for China, especially for its exports. In 2000 the countries that are now considered to be BRI countries only accounted for 13 % of China’s exports and 19 % of China’s imports. By 2015 these numbers reached new heights as exports rose up to 27 and imports to 23 per cent. Of course, these changes in trade cannot be attributed to the Belt and Road Initiative, which was announced less than two years earlier. But it illustrates how China has been diversifying its trading partners, especially in favor of its close neighborhood (Garcia-Herrero & Xu, 2018).

4.1. INFRASTRUCTURAL DEVELOPMENTS

4.1.1. CHINESE SHIPPING

If all infrastructure plans are conducted the way promised, the most important consequence of the Maritime Silk Road could be that ports along the MSR will increasingly function as gateway ports connected to overland networks instead of transshipment ports of containers. Ports from the MSR are inherently connected to the economic corridor projects which will enhance interconnectivity overland. Piraeus will function as the gateway to Europe; Gwadar to the Middle East, Central Asia and West China; and Kyaukpyu to Indochina and Southern China (Konings, 2018).

4.1.2. RAIL AS ALTERNATIVE

As the BRI not only enhances maritime and aerial trade through the establishment and enhancement of ports and airports, it also offers an alternative: interregional freight trains. Now, freight trains are not a revolutionary idea, global-scale investment in rail transport between Europe and China in 2018 is. The rationale for it is easy. While freight train transport is more expensive than shipping transport, it is quicker than shipping and cheaper than airplanes. As speed plays an important role in industries with a supply chain which spans many countries, trains can become a more suitable transport vehicle. Another way interregional freight trains can be used is for finished products where quick delivery is necessary and demand is subject to sudden changes. Several trains have already been sent from China to Europe as a promotion effort for the BRI - including one to Antwerp May this year, carrying industrial minerals, toothpaste and cosmetics (Port of Antwerp, 2018, May 12; Konings, 2018).

Critics have stated that the New Eurasian Land Bridge does not make any sense as an alternative to maritime trade between China and Europe (Forbes, 2017, December 28). What they do not understand that is that is has never been the aim to fully replace maritime trade with rail transport – if so, what would be the point of the MSR? – but rather an effort to change the global supply chain and diversify transport methods. Faster delivery frees up working capital and reduces capital costs. Further, an enhanced freight train network as an alternative to air travel can be seen as a greener option to the carbon-intensive air transport (Konings, 2018).

4.2. FREE TRADE AGREEMENTS

At the moment China has a signed a total of 12 bilateral FTAs (MOFCOM, 2018), but this number is only set to increase. At the 2017 World Economic Forum in Davos, Xi Jinping was clear in his message about Free Trade Agreements as he said: "China will vigorously foster an external environment of opening-up for common development. We will advance the building of the Free Trade Area of the Asia Pacific and negotiations of the Regional Comprehensive Economic Partnership to form a global network of free trade arrangements. China stands for concluding open, transparent and win-win regional free trade arrangements and opposes forming exclusive groups that are fragmented in nature" (SCIO, 2017, April 6).

Since this speech and especially the announcement of the BRI in 2013, China's pursuit for more FTAs was started. For Beijing Free Trade Agreements are seen as a logical next step in pursuit of its economic and political goals. This was already the case as early as 2007 when the establishment of free trade areas were effectively written into the 'national strategy by the 17th National Congress of the CCP. In China's 13th Five Year Plan (2016-2020) Chinese authorities became more specific in setting its goals regarding FTAs. The plan emphasizes the need for the completion of a number of big FTA negotiations, being: RCEP (a proposed FTA with ten ASEAN countries, five non-ASEAN members and China), the China-Japan-Republic of Korea Free Trade Area, the China Gulf Cooperation Council Free Trade Area, and the FTA with Israel. The 13th Five Year Plan also put forward the possibility of a bilateral FTA with Canada, one with the Russia-led Eurasian Economic Union (EEU), one with the EU and another, long-term, agreement with all the members of the Asia-Pacific Economic platform. Besides these big FTAs there have been negotiations about Free Trade Agreements with smaller countries as Sri Lanka, Norway, Pakistan, Singapore, Mauritius, Moldova and Panama. As we are already in 2018, halfway through the Five Year Plan, none of the above FTAs have been completed (Tiezzi, 2018; MOFCOM, 2018). Of these big proposed FTAs, all except the one with Canada could be related to the BRI. Given the vast differences in economic interests of the BRI-countries, it does not look like there will be one big multilateral 'BRI FTA', but rather a web of many bilateral, smaller trade agreements (Hillman, 2018).

China has been more successful with the negotiations about FTAs with small countries. Chinese press widely celebrated the addition of Georgia to the countries that signed an FTA with the Middle Kingdom. On the one hand this FTA is the first with a Central Asian country and the first FTA initiated and achieved since the BRI was put forward, on the other hand Georgia is a country with a GDP of 14.33 billion USD and a population of less than 4 million. The logic behind the enthusiasm could be explained by the notion that China's approach towards FTAs is widely seen as political rather than economically motivated. History teaches us that China prefers to negotiate with smaller, less demanding economies. Within these negotiations China has the freedom to be more demanding and

move extremely quickly. By this way, the China-Georgia FTA was signed less than two years after the first talks were started. The same tactic was used by the Maldivian negotiation, where the agreement was signed less than three years later than the feasibility study and despite protests from the Maldivian Parliament (Riezzi, 2018). As it is currently looking, China will pursue more of the small partnerships with more instant results in the near- and mid-term future.

As FTAs are less economically grounded than politically, China does not hold back in suspending talks about a FTA if it wants to. An obvious example is the rift between China and Norway from 2010 to 2016 when negotiations were put on hold as Chinese dissident Liu Xiaobo was awarded the Nobel Peace Prize in Oslo (Reuters, 2016, December 19). If there is one thing the world has learned from this diplomatic dispute China is willing to use its bargaining power in a FTA to obtain political goals. This pattern should be considered a possibility when countries within the BRI orbit are negotiating FTAs with China.

4.3. COMMODITY TRADE

As the BRI connects the biggest energy importer of the world with the largest oil and gas reserves of the world in Central Asia and the Middle East, commodities will have a very large impact on the trade in resources. China has started to learn its ability to use its monopsony power[7] but can it translate monopsony power to monetary power? Some analysts have floated the idea of crude oil trade with the Chinese currency as a key underpinning of China's ambitions with BRI.

In order to understand the petro-yuan – the oil-backed RMB – one has to understand China's efforts to internationalize its currency. The idea of renminbi internationalisation has been floating since the 2008 financial crisis, when China wanted to make their yuan (the basic unit for renminbi) independent from the American dollar. Although being an essential part of China's foreign, financial and monetary policy, there was no mention of the so-called petro-yuan in key National Development and Reform Commission documents following the October Communist Party leadership gathering. In 2012 plans were laid to start oil-futures trading priced in yuan. Because of the fear of a shock back then, crude oil prices spiked above $100 a barrel. With the lower rates of $50 to $60 at the end of 2017, the time was deemed ripe for a major move like this (Bloomberg, 2017, December 2017).

This strategy to reduce the dominance of the USD in the commodities market doesn't limit itself to only petroleum trading. Since April 2016, Asia Nikkei noted that yuan-denominated futures have been traded on the Shanghai Gold Exchange. In March this year the Shanghai Futures Exchange even went a step further by giving its users the opportunity of being paid for oil-futures in physical gold. This could be a game changer for non-US friendly, oil exporting nations such as Iran, Qatar and Venezuela (Asia Nikkei, 2017, September 1).

Several analysts have been very skeptical of the capacity of China to overthrow the (petro-)dollar hegemony. Analyst Neal Kimberley, for example, claimed in the South China Morning Post that the monetary underpinning of the 1973 Saudi-USA agreement and the geopolitical US military umbrella in the Middle East are still relevant today (CNBC, 2017, October 11).

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[7] Influence that comes from being the world's leading customer.

It is also important to note that China is just one player among many in the crude oil market. If the European Union would be taken as a whole, it would be a bigger importer than China. Market share is one factor, but it isn't defining. The fact that the euro hasn't overtaken the greenback as the go-to crude oil trading currency, is a good illustration for this. Producers are to be considered too. From a purely economic standpoint it could be a possibility, politically it will be very hard to take oil producing companies (read: Saudi Arabia) out of the larger dollar-matrix.

The success of a Chinese yuan-based oil-order will depend on the success of the BRI. As Trump has decided to increase sanctions on Iran, Russia and Turkey, this will bring more bargaining power to China to eventually settle its trade in RMB. As the BRI gains steam, the emergence of pipelines and other connectivity infrastructure to transfer commodities from the Middle East and Central Asia to China will only make it easier for the Middle Kingdom to import commodities from West to East in the currency it prefers.

4.4. MOVING UP THE SUPPLY-CHAIN

Since 2011, the growth rate of the PRC started to decline. According to a report of the ADB(2017) this declining trend is due to the diminishing trend global demand. In 2015 China 'only' amounted to a growth rate of 6.9 % according to official figures. While almost all countries on earth would see this growth rate as significant, there is a growing concern within China that this relative decline is a menace to its growth strategy. Hence, fears are that the PRC could be confronted with the 'middle-income trap' (MIT). The phenomenon of the MIT happens when a rising economy attains a certain level of development, income rises and so the country loses its competitive edge. If an economy is more export-based, it is more prone to the MIT (Vivarelli, 2016). As the Chinese economy is highly dependent of an industry led, labor-intensive export sector, it could be an easy prey for the MIT in the coming decade.

This is where the Belt and Road Initiative appeared as the solution to this conundrum. The BRI cannot be viewed separately from the *Made in China 2025-plan* that aims to transform China from a labor-intensive manufacturing country to a hi-tech powerhouse, dominating advanced industries. When the BRI could create an economic playing field through the implementation of enormous infrastructure plans, *Made in China 2025* can effectively rewire the regional labor distribution (CFR, 2018).

One of the impetuses of this dynamic has been the crisis of 2008. When the Chinese Government countered the 2008 crisis with one of the largest stimulus packages in recent economic history, it had an interesting side effect. The stimulus packet elevated the price of commodities and eventually China ended up with massive excess capacity in steel and cement. This excess was perceived as a sword of Damocles hanging over the Chinese economy. The BRI proved to be the solution for this conundrum, although not in the way people would expect (Cai, 2017).

Instead of boosting the exports in commodities, the Chinese government started to actively push the migration of whole production facilities to foreign countries. This is one of the famous 'win-win' solutions the BRI puts forward. This view has been reflected by a rare speech by Jin Qi, the Chairman of the Silk Road Fund. In 2016 she said that China sits in the middle of the global production chain and it could help countries at an early stage of development to industrialize. Further she noted that "China possesses high-quality industrial production capacity, technology, ample supply of funds and

30 years of development experience. […] [Chinese capital can] help facilitate international production cooperation and reorganize the global production chain"[8] (Cai, 2017).

Trade between countries involved with the initiative accounts for more than a quarter of world trade. Providing better connections through international and interregional infrastructure projects could decrease transportation costs on the long term significantly.

[8] This view of development in connection to a reorganization of the global production chain is especially reminiscent to the Flying Geese paradigm applied by Japan in post-World War II Asia.

CONCLUSION

China has managed to set up the framework of a program which fully entails the Eurasian continent. The ports China is investing in along the Maritime Silk Road are located in such a way that they offer significant geopolitical advantages and can potentially alleviate China's frustration at being unrepresented in the areas in and around the maritime chokepoints. Especially the Malacca Dilemma could stand to be mitigated through the investments in the ports of Gwadar, Kyaukpyu and the industrial parks of Kuantan and along the Malacca Strait. It remains to be seen whether or not the Kra Canal will be realized or not, but if it happens the Malacca Dilemma would be once and for all resolved.

Through economic corridors and its corresponding infrastructure projects related to the Silk Road Economic Belt China will in the future be linked to the resource rich Middle East and Central Asia. This way the Middle Kingdom would have its hands on the energy tap of the world, which will be an answer to the country's energy demand.

With regards to the funding mechanisms we see a few interesting dynamics developing. First of all, we see that the BRI is a way for China to invest its vast foreign exchange reserves, which are used by banks to set up credit lines for infrastructure projects in BRI-countries. Secondly, we see the reconfirmation of the policy-banks' dominance within the Chinese financial system and how this dominance transcends the newly established multilateral banks' financial firing power. Despite all this financial might, it can be noted that the funding mechanisms will not be ample enough to provide for the vast investment needs of the Eurasian continent and is therefore in dire need of Western capital to achieve its goals. Fears of a debt-trap unfolding along the New Silk Road are not unfounded. However, it would be against the interest and ambition from China in achieving its long-term goals with Eurasia and the Indo-Pacific area.

Concerning Free Trade Agreements, FTAs will first be disclosed bilaterally, with smaller players within China's neighborhood before we can entertain the prospect of China entering a multilateral FTA with a large trading block. In order to see the effects on global trade the BRI can have, a few more years' patience is required. However, we can already see China actively using the BRI as a means to rewire the global supply chain through investment in freight trains, the migration of certain sectors to get rid of its excess reserve in steel and allay fears of falling into the middle income trap.

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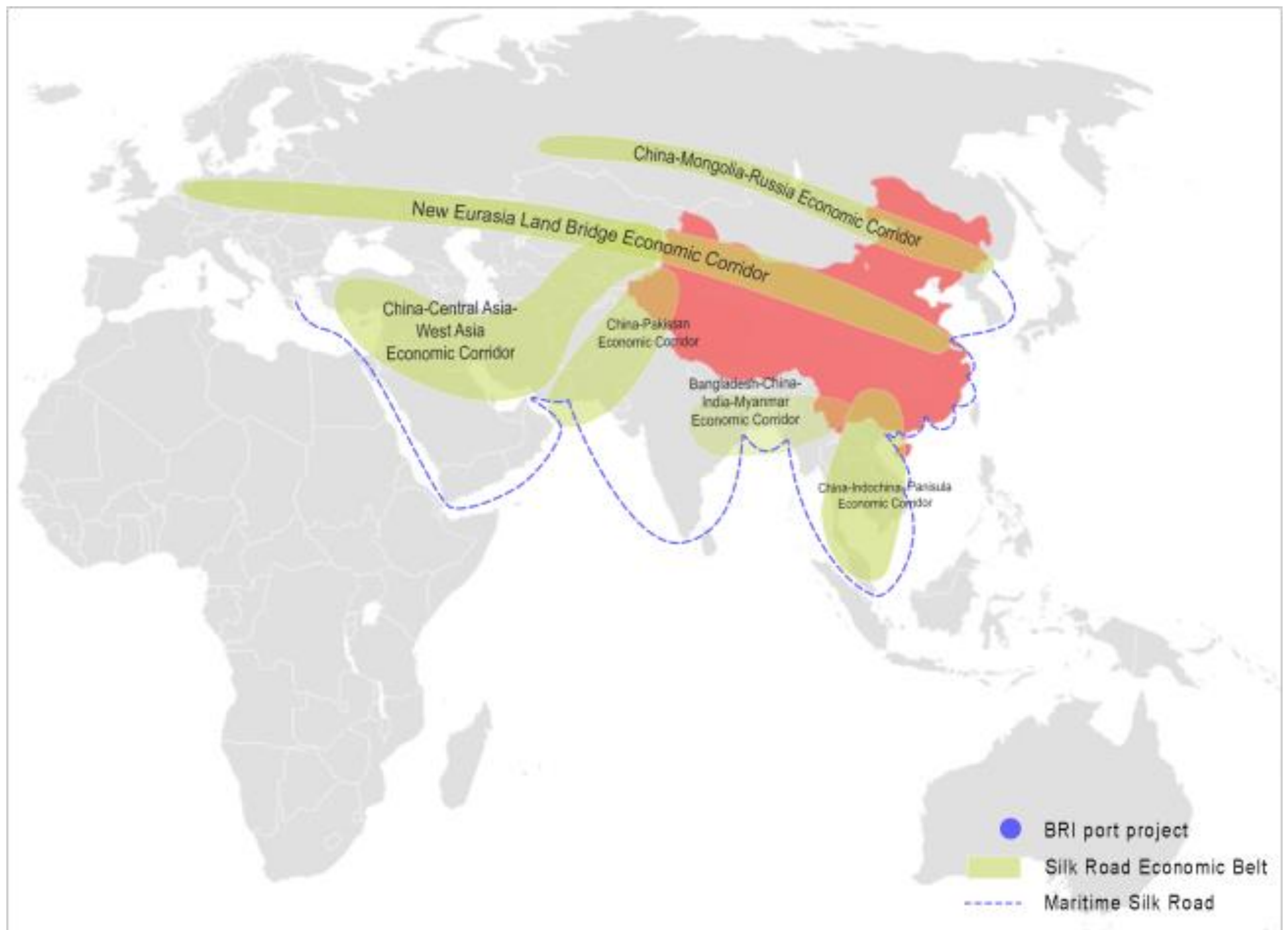
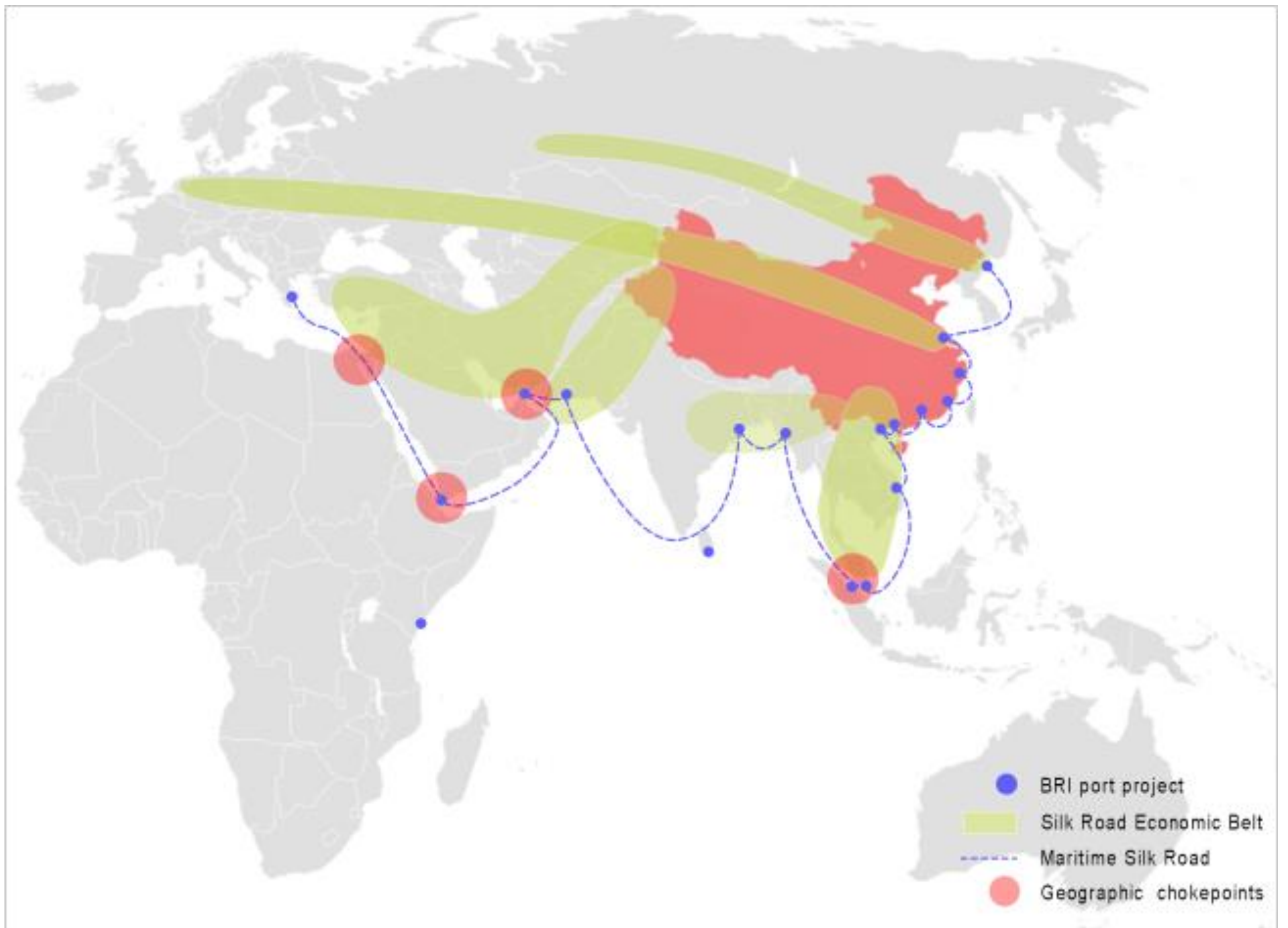
APPENDIX

- Map 1:



- Map 2:



- Map 3: