Geo-economics with Chinese Characteristics: How China’s economic might is reshaping world politics
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Introduction

Mark Leonard, Director, European Council on Foreign Relations

If the big China story of the past few decades was about growth, exports and investments, the story of the next decade will be about the creation of a Chinese economic and political order.

Even as the growth of Beijing’s economy slows, China is becoming part of the fabric of the economic life of most countries around the world. Rather than trying to overthrow existing institutions as many had feared, Beijing is instead using this economic might to link up to the rest of the world and develop a series of relationships and institutions which result in a more China-centric world order. This new economic and political order is structured differently from western-led multilateral institutions which are underpinned by treaties, international law and the pooling of sovereignty. Beijing’s preferred style is to craft a series of bilateral relationships that link it to different capitals, sometimes organised around regional summits.

This geo-economic project, more even than its economic rise, is the real revival of the Middle Kingdom. Just as all roads led to Rome, Beijing is building a wide-ranging set of pipelines, bridges, railways, shipping routes and cables that lead to China. By making itself central to every region, China gains leverage and persuasiveness. China’s objectives include promoting trade and investment, productivity and finding ways to export its surplus capacity. But the effect will be to make China the core of the wider economic and geopolitical system, with countries that are not well-connected to the core becoming peripheral. The speed with which this order is coming into being is almost as breathtaking as the emergence of China’s economy, but there is no “grand plan” and its establishment has been both incremental and flexible.

China’s geo-economic toolkit contains of five key instruments that Wu Xinbo and Parag Khanna describe here in detail: trade, investment, finance, the internationalization of the Chinese currency and China’s infrastructure alliances, most prominently the One Belt, One Road initiative. Because China’s economic rise has been so dramatic, its instruments have the potential to change the economies of different regions and overshadow the Bretton Woods Institutions. China is the world’s largest exporter, with export goods worth a staggering $2.3 trillion in 2014. It has the world’s fastest growing consumer market. China has gone from being a source of cheap imports to a major source of investment, investing over $160 billion between January 2009 and December 2013 alone. Beijing claims its ‘One Belt, One Road’ initiative will create $2.5 trillion of additional trade for 65 countries. And the AIIB budget is the size of the post-Second World War Marshall Plan for Europe.

This essay collection shines a light on China’s actions and projects in every region of the world, exploring how countries are responding in sharply different ways to China’s rise and its geo-economic projects. There are two broad sets of approaches.

Chinese geo-economics around the world

Some countries bind themselves as tightly to China as possible – as can be observed in Africa, Latin America, South Asia and the Middle East.

Pakistan is China’s closest and oldest ally. It is now seeing a relationship which developed during the Cold War transform into a new kind of partnership which will help China move from being a regional to a global power.

Africa and Latin America have largely welcomed Chinese investment as it appeared to come from a friendly nation without strings attached. However, the initial enthusiasm about these growing economic ties is now tempered with unease about the slowing of demand for commodities, imported Chinese labour and corruption – issues that are driving backlashes and protests against Chinese projects.

In the Middle East, many would like China to take on a more active political role to counterbalance US hegemony, which Beijing is actively trying to avoid, also because in South Asia it is doing exactly that and is now in danger of being sucked into Afghanistan.
Another approach – adopted by the US, the Asia-Pacific and Europe -- is to try to hedge against China’s strategic might, while still aiming to take advantage of the economic opportunities.

There has been a policy consensus for many years in Asia and the West, which mixes balancing, engaging, and shaping. By and large there was a clear compartmentalization between the economic and the political and security spheres. Balancing took place in the military sphere and the engaging and shaping took place in the economic sphere and in international organizations.

This is still the approach of Europeans, who are trying to step up their economic engagement with China through their membership of the Asian Infrastructure and Investment Bank and attempts to encourage Chinese investment – including through the UK’s recent warm welcome to President Xi Jinping in London – while continuing to impose their arms embargo and talk about the need to respect the rule of law on maritime issues.

Increasingly, however, the US is changing its approach and developing a more assertive stance. Through TPP and its cyber policies, the US is seeking to firmly balance China in the economic realm as well as the political and military ones. During President Xi Jinping’s visit to the US in 2015, the vice-president used the term “responsible competition” – a long way from the “responsible stakeholder” idea.

**Winners and losers in a China-centric order**

So what does China’s geo-economic strategy mean for the global order? Who will be the winners? Who are the losers? This collection of essays points to some preliminary hypotheses about the implications of a more China-centric world, and also highlights uncertainties over the potential direction events may take.

On the current trajectory, the main beneficiaries of a more China-centric world will be, of course, China, which finds new markets, and its partners, who get help on infrastructure and investment.

European countries stand to gain a great deal from new land and maritime routes through to Asian markets, although much will depend on the ability of European states to unite so that they can negotiate with China from a position of strength rather than being divided and ruled by Beijing.

Top of the losers list – or at least those whose gains are relatively smaller - will be Japan, which will lose ground in South East Asia to Beijing. Even if Japan competes with China through its own infrastructure projects, it could end up helping China: Japan will always be an island, and China will simply be more connected.

Russia is also set to lose ground in central Asian countries in the medium term – even if in the short-term it remains the main security provider for China’s economic incursions. India also worries that it could lose out in neighbouring countries like Pakistan, Bangladesh and Sri Lanka. These nations may ultimately find ways to renegotiate the terms with China, by regaining stronger hands or new leverage points which can reduce the growing asymmetries in their relationship.

Certainly, China’s growing influence is likely to make the competition between states more intense, and raises anxieties amongst smaller nations in its orbit.

One of the biggest stress points could be the transatlantic relationship as Europeans and Americans are increasingly torn in different directions – as the recent spat over the Asia Infrastructure and Investment Bank showed. In Washington, policy-makers see the liberal order and American primacy in Asia as interchangeable while Europeans tend to make a distinction between the two.
A less explored concern is the matter of how companies will navigate a more China-centric order. Most major aspects of most industry value chains pass through or within the orbit of Chinese trade. Presumably then, most companies must become more adapted or well-versed in Chinese geo-economics. Already, thousands of multinational companies are playing by Chinese rules in order to gain coveted access to the Chinese market. Most industry supply chains incorporate Chinese materials or parts. Some industries are heavily dependent on Chinese demand, turning companies into avid “China watchers”. But companies too, may hedge their bets, for example, by not abandoning their markets or establishments in the West or the rest. The private sector may find new strategies for diversifying their investments and limiting their exposure in order to insure their journeys in uncertain waters.

The biggest uncertainty remains over the pace and nature of Chinese growth in the short and medium-term, and what impacts – if any – evolution in either sense will have for China’s geo-economic role globally. Poorly performing investments may have left Chinese investors with a smaller risk appetite, particularly in a slower economy. The shift from manufacturing to services in Chinese GDP may have a cascading effect throughout the Chinese economy with potential manifestations in political and geopolitical priorities. How will China’s leverage develop as the nature of the economy adapts to the 4th industrial revolution? Will its economy continue to be as influential in a world where technology, human capital, and infrastructure define not just economic vitality, but to a large extent, geopolitical power?

China’s ascendancy has already changed the international system, by spurring the development of new institutions, norms and assumptions than those established in the aftermath of the Second World War. The emergence of a China-centric order with parallel institutions may not be a direct challenge or alternative to the Western-led liberal order, but it will make it less central and erode its influence over non-Western countries. What impact will the emergence of different centres of power have on global governance? Will the parallel institutions also compete, and how will established or emerging powers manage these new dynamics? These are the questions that will define the shape of the global economy and geopolitics in the years to come.
China's geo-economic power

Wu Xinbo, Executive Dean, Fudan University

When Chinese economic growth slowed down in summer 2015, its stock market became more volatile and the renminbi (RMB) suddenly devaluated; it sent a chill through the global market, proving the saying that “if the Dragon sneezes, the world gets a cold”. Several Asia-Pacific countries, from Australia to Thailand, experienced sluggish economic growth; Vietnam, Kazakhstan and Turkey faced currency devaluation after the RMB depreciation. What happens in China – the world’s second-largest economy – has global impact.

Hence, China holds significant geo-economic power and serious disruptive potential. Its power particularly lies in five areas.

**Trade.** China is the largest trading partner to over 130 countries. In Asia-Pacific, China is the largest trading partner to North Korea, the Republic of Korea, Mongolia, Singapore, Thailand, Myanmar, Kazakhstan, Turkmenistan, Russia, Australia, New Zealand, and more. It is also the number one source of imports for Japan, Indonesia, Malaysia, Vietnam, Philippines, India, Pakistan, Bangladesh, and others. As the world’s largest assembling hub of manufacturing products, China drove up trade with regional economies which are part of the global production chain and spurred their economic growth. In fact, China today contributes over 50% to Asia’s economic growth, being the most important engine for the regional economy. The Chinese economy has become a significant barometer for the Asian economy.

**Investment.** Since the financial crisis of 2008, China has become an active provider of foreign direct investment (FDI). From 2012 to 2014, China has been the world’s third largest investor, behind only the US and Japan. In Asia-Pacific, China is the number one provider of FDI for Myanmar, Mongolia, Cambodia, Laos and North Korea, as well as a major source of FDI for Kazakhstan, Pakistan, Vietnam, Indonesia, Australia, Malaysia, and others. Unlike US and Japanese investors who focus on manufacturing, most of Chinese investment is concentrated in energy, raw materials and infrastructure. Yet, as labour costs and land prices go up, China has begun to shift more and more of its manufacturing bases to the neighbouring countries, such as Vietnam, Indonesia, Bangladesh, India, etc. Since FDI directly generates opportunities for economic growth, employment and government revenue, China’s growing overseas investment contributes to its geo-economic power.

**One Belt, One Road Initiative.** This initiative, drawing on China’s wide geographical connections with Eurasian countries and the tremendous potential for economic growth that this vast region promises, aims at promoting China’s economic cooperation with countries in South-East Asia, Central Asia, South Asia, West Asia and Eastern Europe. Under the concept of “One Belt and One Road”, Beijing developed the proposals of the Silk Road Economic Belt, The 21st-Century Maritime Silk Road, China-Pakistan Economic Corridor, and Bangladesh-China-India-Myanmar Economic Corridor. These plans are intended to facilitate trade and investment, improve traffic connectivity, as well as trade and monetary cooperation. Many countries in the loop are particularly interested in China’s participation in their infrastructure development as their underdeveloped transport system is a major bottleneck to their economic growth. For instance, China is helping Kazakhstan and Pakistan to upgrade their railway facilities. The One Belt, one Road Initiative, will, when implemented, not only expand China’s economic ties with related countries but also enhance China’s geo-economic influence in Eurasia as it effectively transforms China into the hub of an extensive hub-and-spokes system.

**Multilateral financial institutions.** In recent years, China initiated the establishment of the Asian Infrastructure Investment Bank (AIIB) and BRICS New Development Bank (NDB) to provide financial support for the One Belt, One Road initiative as well as infrastructure development in BRICS countries. China holds over 30% of the shares and 26% of the voting rights in AIIB, and 41% of the shares in the NDB, more than any other member. This gives China a greater say in making the rules as well as operations of the two institutions. As more and more Asia-Pacific countries benefit from services offered by these institutions, China’s geo-economic clout will naturally grow.

1 http://paper.ce.cn/jjrb/html/2015-10/02/content_264730.htm
2 http://news.xinhuanet.com/fortune/2014-06/21/c_1111251750.htm
Internationalization of RMB. Since 2009, China has been pushing the policy of internationalizing the renminbi (RMB); that is, to encourage the use of RMB in international trade and investment as well as it being included in the reserve assets held by central banks in other countries. The progress China has made so far includes 10 agreements on direct exchange of RMB with other currencies\(^4\), treaties on clearing banks in 15 countries, and 32 swap agreements with central banks,\(^5\) and 15 country-specific RMB Qualified Foreign Institutional Investor Quotas.\(^6\)

Many of these arrangements are with China’s neighbouring countries. In addition to official arrangements, the RMB is widely used in China’s neighbourhood, from Vietnam to Myanmar, and Mongolia to North Korea, which is de facto RMB internationalization. As China’s Overseas Direct Investments (ODI) increases, RMB internationalization will expand even further.

Although China’s economic growth will gradually slow down, as compared with the past few years, its share of the global economy will continue to climb, as will its foreign trade and overseas investment. This will surely lead to the further expansion of its geo-economic power in Asia-Pacific and beyond. Over the past decade, Beijing started to exercise its geo-economic power in dealing with some of its neighbours, in the future, the world should not be surprised if China uses it more often and more skilfully.

China’s medium-term Outlook: 2016-2020

Bert Hofman, Country Director, China, World Bank

What is the outlook of China’s economy between now and 2020? What economic policy changes can be expected? And what does this outlook mean for China’s geo-economic power? These questions are not only relevant for China but also important for the global economy.

China’s slowing growth. China’s economy is on course to gradually slow in the medium term as structural adjustments and policy efforts to address the accumulated financial vulnerabilities continue. China’s growth has gradually slowed since 2012, signalling what President Xi Jinping has called the “new normal.” At 7.7% in 2013 and 7.3% in 2014, growth has fallen from the 10% annual growth rate that China has averaged for three consecutive decades. Since the outset of the global financial crisis in 2008, China has been the largest contributor to world growth and even its projected slower growth remains impressive by current global standards.

In the short term, the growth slowdown reflects policies to slow rapid credit growth, contain shadow banking, limit borrowing by local governments and reduce excess capacity in industry. These policies aim at addressing vulnerabilities resulting from the large stimulus package implemented to cushion the effects of the 2008 global financial crisis, which rapidly increased debt levels in the economy.

Over the medium term, the growth slowdown is consistent with a shift in China’s growth model. As China has long recognized, its growth pattern, based on energy- and resource-intensive investment, manufacturing and exports, has led to economic, environmental and social imbalances that have accumulated over time. Reducing these imbalances requires shifts in the economy from manufacturing to services, from investment to consumption, and from exports to domestic spending. Inducing these shifts is likely to further slow growth in the short term.

China rebalancing. There are signs of this shift towards a more sustainable economic structure. In 2012, services overtook manufacturing as the largest contributor to growth, a sign of a development towards a more developed economy. By 2014, the share of the services sector in GDP was 48%, exceeding the share of industry by five points. The transition from investment-led growth to consumption-led growth is slower, although there are signs of rebalancing; in most recent years, consumption grew slightly faster than investment. External rebalancing has been more rapid, with the current account surplus shrinking from almost 10% of GDP in 2007 to about 2% of GDP in 2014. China’s increasingly sophisticated export structure, shift to higher value production, rising R&D spending and growing number of patents awarded domestically and abroad suggest further progress towards a new growth model.

Growth outlook. The World Bank expects Chinese growth to further ease in the coming years, to about 6.7% in 2016 and 6.5% in 2017 (Table 1).

Figure 1: Rebalancing: Internal and External

Rebalancing from investment to consumption has been gradual, but rebalancing from industrial sector to services has been proceeding rapidly. On external side, the current account surplus declined to 2% of GDP in 2014 from about 10% of GDP in 2007. The renminbi has appreciated by about 55% in REER terms since the exchange rate reform in 2005.

A. GDP components

B. Consumption and Investment

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7 The views expressed in this article are the author’s and do not necessarily reflect those of the World Bank, its executive directors, or the countries they represent.

8 According to public statements by President Xi Jinping during 2014, China’s “new normal” growth signifies slower but higher-quality and more sustainable growth as the structure of the economy changes.
The average annual growth rate during the next Five Year Plan period could be 6%-6.5%. Rebalancing of domestic demand will continue, with consumption increasingly taking the lead over investment. Investment will slow as a result of lower credit growth and normalization of the real estate market.

C. Services and Industry

D. Current Account Balance and REERs

Source: World Bank, Haver Analytics, CEIC.
With the shift of production and employment towards services, the labour market is set to remain robust and support private consumption growth. On the supply side, the shift from capital and resource-intensive industries to services will continue, facilitated by policies to ease business regulations in the services sector and rationalize excess capacity in industrial sectors. Growth in services is expected to outpace that in manufacturing, and to contribute more than half of GDP growth by 2020.

**Key reforms.** China is giving market forces a larger role, which will continue to support productivity growth. However, growth will be slowed as China approaches the efficiency frontier in an increasing number of industries. However, further reforms can support higher productivity.

Key reforms include financial sector reforms that improve the allocation of credit in the economy, household registration reforms that will improve productivity of labour and increase domestic demand, and land reforms that will allow for better allocation of agricultural land and higher agricultural productivity.

While the growth outlook assumes that the moderation of China’s growth will be orderly and gradual in the context of continued reforms, there are several risks. Some existing risks, especially of deflation in the Eurozone, have receded, but other risks have taken their place. Deteriorating prospects in some developing economies, especially commodity exporters, are eroding their resilience. Along with the possibility of volatility in US monetary policy normalization, this raises the risk of financial stress. In addition, dollar appreciation could slow the US economy more than expected. If these risks were to materialize at the same time, the disruptions to developing-country could be substantial.

For China, less aggressive efforts to address vulnerabilities risk a faster slowdown in growth due to a disorderly adjustment in investment rates. Because of the global financial crisis, China's debt-service capacity has decreased and global experience suggests that rapid rises in the credit-to-GDP ratio, as in China, are usually followed by slower economic growth. Although China currently has sufficient buffers to prevent a sharp slowdown, this could be eroded over time. At less than 60% of GDP, public debt levels still provide the fiscal space to employ limited stimulus in the event of a sharper than expected slowdown. And capital controls on portfolio investment and bank lending can prevent sharp capital outflows.

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The Geo-economic implications of China’s changing growth strategy

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The rise of China as an economic and trading superpower over the past decade has been striking in its scale and impact, domestically and internationally. Its economy has roughly doubled since 2009 and now challenges the US as the world’s largest economy (subject to various different metrics). Chinese growth has been a stimulus to the world, providing a large and growing domestic market, as well as a source of foreign direct investment and low-cost exports. And with economic strength has come geo-economic influence, as the other chapters in this white paper illuminate.

In 2015 and early 2016, however, worries over the pace of growth and composition of China’s economy and its policymaking skills have led to a significant and rapid change of sentiment. For countries increasingly dependent on a newly questionable Chinese growth model, could their relationships with the world’s second largest economy have become an economic liability rather than a strength? And, as the Chinese economy shifts, could Beijing’s geo-economic influence change too?

The Changing Chinese Economy

In the weeks leading up to the 2015 Annual Meeting of the International Monetary Fund (IMF) in Lima, Peru, headlines warned of IMF staff concerns about the risks of contagion emanating from China. Questionable Chinese government growth forecasts, unpredictable currency movements, steep declines in a nascent stock market and a suddenly unpredictable, unreliable, and unsteady economic policy response in Beijing were the biggest global economic risks to be addressed by the world’s leading economic policymakers.

These concerns increasingly focused on the implications of a Chinese slowdown and questionable policy responses. As global economic and finance leaders met in October, 2015, China migrated from being a “spillover taker”, poking U.S. and European officials over perceived policy missteps that affected countries around the globe, into now being itself a “spillover maker”. Slower growth, currency shocks and a transformation of its economy from infrastructure and investment dominated to consumption and services threatened to upend economies that depended on domestic Chinese infrastructure spending and investment.

Spillovers

It is too early to know how the Chinese economy will evolve and what the cross-border economic impacts of its transformation will be. Linkages are complicated and poorly mapped or understood. Still, as a rule of thumb, the IMF has estimated that each one percent decline in Chinese growth leads to a 0.3% decline in growth across Asia. In ASEAN countries, the decline could be as much as 0.6%, and in East Asia, the impact could be even higher, perhaps 0.7%. Even these broad estimates are imperfect, as there is little concrete data to parse impacts into those caused by slowing growth versus those driven by rebalancing of the economy. With the composition of China’s economy expected to increasingly shift to services and domestic consumption, other economies that were overly dependent on the “old” Chinese growth model – particularly commodities and capital goods producers – find themselves struggling to shift their own growth models.

Moreover, in spite of limited financial linkages and exposures, as 2016 commenced, Chinese stock market declines proved to have global contagion effects, with even US investors starting the year reacting to Chinese market and currency movements and policy choices.

Continued uncertainty in the future of China’s domestic economic model, financial stability and policy response functions have further contributed to increasing pressure on private capital outflows, with Chinese citizens and entities seeking to diversify and find safer havens for their money. This has led to increasing downward pressure on the RMB versus its traditional peg to the US dollar. To maintain promised stability in the currency, the Chinese central bank has been forced to spend significant reserves (well over $450 billion since June 2015 alone). Nevertheless, the RMB has continued to weaken. Regional trading partners are exposed to these monetary spillovers, with both direct and
indirect impacts on their economies and the wealth of their own citizens. People’s Bank of China policy choices have increasingly significant impacts on the economic, financial and monetary health of other nations, which are forced to react, with little input into decisions taken that affect them on multiple levels.

Chinese leadership and policymakers have never confronted their role as an external catalyst for disruption and risk. With an explicit focus on domestic benefits of economic and financial sector policy decisions, the reality that, like it or not, these decisions are now global in their impact, represents new territory, with highly uncertain results as yet to be fully understood, digested and integrated into the Chinese policymaking process.

**Consequences for Chinese Geo-economic influence**

Strong Chinese growth has largely been good for other economies, something Chinese officials point out frequently. Slowing growth, market volatility and increasing spillovers could thus lead to political blowback, increasing the risks that other countries experience a rise in resentment towards China, with implications for Chinese relationships. Economic and financial decisions taken in China to address domestic growth related goals could thus directly affect Chinese economic and strategic power abroad.

It stands to reason that the shifting composition of those accessing Chinese domestic markets could also alter the slate of countries over which China wields influence. For example, commodity exporting countries dependent on China to support their own economic growth model, may find themselves less tethered to China’s economy, and thus able or forced to rethink economic, financial and, indeed, political decisions to reflect this new economic relationship. At the same time, as China becomes more focused on internally generated growth rather than export-driven trade, their incentives and agendas in engaging in multilateral rules based trade and economic regimes may be reviewed and reprioritized. A debate has begun over whether a less trade dependent and more domestically focused China will become more adamant about international economic policy positions, feeling both stronger as their overall economic position continues to increase, and less dependent on existing rules and norms to ensure continued domestic economic health. This is however, far from clear, with other observers pointing towards China’s continued interest in joining mega-regionals, such as the Trans-Pacific Partnership, as evidence to the contrary.

**Economic Governance**

Over the past decades, Chinese economic strength has not only translated into ad hoc influence, it has also enabled Beijing to begin building institutions to combine and concentrate its economic strength and broader strategic and political goals. Nowhere has this been more evident than in the international investment arena, where its efforts to mobilize official sector funds for development and infrastructure projects through the Asian Infrastructure Investment Bank, BRICS Bank, and “One Belt One Road” initiatives.

Some argue that Chinese economic weakness and rebalancing may, paradoxically, actually strengthen these initiatives. As Chinese domestic infrastructure investment slows, Beijing has seized the opportunity to export excess capacity in industries such as construction and steelmaking. Overseas infrastructure investment via multilateral institutions is seen as a means to create less political friction than if they were undertaken bilaterally. These new institutions are intended to provide greater predictability, transparency, and accountability, and to allow Chinese overcapacity to be deployed internationally. However, both the scale and speed of such new projects, as well as the potential backlash from recipient countries finding their own domestic projects benefitting Chinese firms and workers and not their own, makes the outcome of this perceived strategy subject to skepticism.

**Conclusion**

For all the benefits China’s economic engine has provided to the world over the past decade, shifts in the composition of its economy have increasingly global impact. Slower growth and structural transformation threaten to upend economies that had grown overly dependent on Chinese growth and investment. Increased focus on the Chinese currency and monetary policy, as well as on the country’s stock markets and financial sector pose new and unknown threats to Chinese policymakers unaccustomed to grappling with global consequences of what have been heretofore seen as domestic policy choices. China’s increasing centrality to the world’s economy and to the institutions
and norms that govern global trade, commerce and financial flows, represents both new opportunities and risks.

One thing is increasingly certain: China can no longer argue that it is a passive recipient of the policy choices made by others. The impact of Chinese policies are now felt globally. Historically, these have been for the greater good. How the government reacts to its new role and responsibilities will determine the direction of its future trajectory on the international economic policy stage.

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China’s infrastructure alliances

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Nothing tells us more about the future of geopolitics than tracing infrastructure plans on the ground. America’s wars in Iraq and Afghanistan provide ample reminders of how limited a role militaries have in ultimate victory. Meanwhile, after centuries of relations that amounted to little more than trading fruit, China has begun to pave Afghanistan with infrastructure. China is already Afghanistan’s largest foreign investor, explaining why President Ashraf Ghani made his first state visit to China, promoting more investments in roads, railways and mining. For the first time, China is converting its proximity into connectivity. Soon, the US presence will seem a mere footnote in comparison.

Western scholars anticipated that Chinese participation in the World Bank, International Monetary Fund, World Trade Organization and other institutions signalled its desire to play along with a western-centric order: Recently China has created separate frameworks, such as the AIIB, to advance its own agenda. The $100 billion AIIB budget is approximately as much as the Marshall Plan spent in Europe (in inflation-adjusted dollars), and mostly goes to finance roads, railways, pipelines, electricity transmission and other connectivity across Eurasia to smooth China’s westward expansion.

The timing of this One Belt, One Road initiative is propitious. Just as the crumbling post-colonial and former Soviet republics on its periphery desperately need new infrastructure, China is converting its piles of cash into credit for distressed neighbours to rebuild themselves – by buying China’s over-production of steel and cement and with the assistance of Chinese labour.

The AIIB also represents a reform of the international system from the outside, since western powers were unwilling to reform from within. Indeed, the AIIB’s creation provoked western countries to adapt to it rather than the reverse: the UK, Germany, Australia and Republic of Korea have joined the AIIB. The US measures its robustness by its military spending; Europeans and Asians by their infrastructure spending. European and Asian firms (especially from China, Japan and the Republic of Korea) dominate the global engineering-procurement-construction (EPC) nexus, with only Bechtel, Flour and KBR as recognizable US names in the field.

Clearly, western multilateral institutions such as the World Bank and Asian Development Bank (ADB) will lose mindshare and market share in Eurasia as they fall behind in expenditure and efficiency to new bodies such as the AIIB, BRICS Bank, Silk Road Fund, and others.

The AIIB is the first major institution in what might become known as an era of infrastructure alliances in which the material and the diplomatic are two sides of the same coin. The strength of ties is measured not by colour coding countries according to membership of clubs such as NATO, but through mapping connectivity and volumes of flows between them. Infrastructure alliances are more than corrupt deals among autocratic regimes. In fact, they represent job-creating projects that enhance the ability of poor and landlocked countries to participate in the global economy. As a close examination of traditional western aid projects has demonstrated, it is the unrealistic conditions in financing commodities and infrastructure projects that has unnecessarily delayed development and failed to create jobs in ways that only these sectors can. Sharing infrastructure is sharing wealth.

In the long run, the biggest winners from the surging infrastructure investments under way in Eurasia are not only China and Europe, but the many frail and landlocked countries in between whose modernization is being financed and who will more easily be able to bring their goods to global markets.

Westerners have long presumed — largely correctly — that “security” is the most important global public good, and that the world looks to the US to provide it. Today, America’s military “pivot” to Asia deters Chinese expansion, but China diverts that energy into building more infrastructure with its neighbours (and beyond) to more deeply bind them to China, something America cannot deter. On the contrary, infrastructure provision — and the connectivity it represents — has become a global public good on par with security. It is something countries desperately want, and China is its leading provider. With most of the world’s future infrastructure yet to be built, China is set to become the
world’s largest infrastructure contractor. Many countries still want the US military protecting them, but even more want China’s infrastructure finance and low-cost telecoms equipment.

There is a very important global dimension to infrastructure alliances. In their first two years at the helm, the Chinese leadership duo of Xi Jinping and Li Keqiang visited more than 50 countries to sign investment deals. In Latin America, China extends long-term contracts to purchase Venezuelan oil, offers currency swaps to Argentina, and cross-continental railway projects to Brazil. China has offered Ecuador $11 billion in loans since 2008, with $9 billion more promised in exchange for almost all of Ecuador’s oil exports. China is also the main foreign investor in Ecuador’s mining sector. Particularly during resource slumps, such as the one that began in 2013-2014, commodities-dependent economies depend more than ever on Chinese loans, which are disbursed much faster than the IMF can and tailored to allow repayment in raw materials if countries can’t meet financial terms. Indeed, as Ecuador’s debts mount, it is effectively selling one-third of its Amazonian rainforest region to Chinese oil companies for exploration.

Trade is how China builds complementary; investment is how it builds leverage. China the trading power benefits from a weak renminbi to boost exports, while China the superpower takes advantage of the strong renminbi to buy more assets abroad. Indeed, China’s outbound FDI has skyrocketed as its currency has appreciated. Even if its own imports of commodities slow, it wants to own the supplying assets. Acquiring productive assets helps China accelerate market access while also increasing revenues for the local economy. By establishing joint ventures in host countries where it takes a strong (or dominant) financial position, China is hedging itself against host-country demands for more local value-added and ownership over their industries. Should African countries require that smelting, refining, manufacturing, assembly or other production processes take place on their own soil, China will still be needed to finance and staff such upgrades, while training local workers along the way, and will share handsomely in the new revenue generated from these offshore exports.

Infrastructure alliances are not a one-way street. Because infrastructure assets are often built on foreign soil, they can be expropriated or transferred to other partners with repercussions that are hard to predict. Sri Lanka stands out as an evolving case study in this regard. A full 600 years since Zheng He’s Indian Ocean journeys, China has returned to Sri Lanka, underwriting the modernization of its ports as trans-shipment hubs for its gargantuan export volumes. China’s so-called “String of Pearls” strategy has been to develop maritime access points on either side of India, such as Myanmar’s Maday Island, Sri Lanka’s Hambantota Port, and Pakistan’s Gwadar. Hambantota, which was devastated by the Indonesian tsunami of 2004, has been thoroughly rebuilt. China has also invested $1.5 billion in the capital Colombo’s port complex, where a Chinese nuclear submarine docked in September 2014, and upgraded most of the national motorways and roads, cutting travel time in half between any two major Sri Lankan cities.

Under former strongman President Rajapaksa, infrastructure and weapons also made Sri Lanka China’s ally in the Indian Ocean, especially as they helped him terminate the country’s civil war. But just as Myanmar has capitalized on global investor interest to boost its leverage in the tug-of-war with China so, too, is Sri Lanka. The current president, Maithripala Sirisena, warned his countrymen that Rajapaksa had put Sri Lanka on the path to becoming a colony of China, to which it owes more than $8 billion.

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India is leveraging Sri Lanka’s growing suspicion of China. With Chinese-built infrastructure, Sri Lanka has already made big gains in tourism and exports of textiles, garments and tea. Now India can leverage China’s infrastructure to more efficiently deliver its own projects for Sri Lanka, from railways to housing, and use the island as a reliable back office and outsourcing site for call centres and car-part assembly for the huge south Indian market of 300 million people. In 2015, India’s Prime Minister Modi also settled decades-old border disputes with Bangladesh through land-swaps, allowing it to focus on winning the Sonadia Port project from China. India and China now compete to connect to Sri Lanka and Bangladesh – and increasingly in African nations as well.

Cross-border infrastructure investment is a significant geo-economic issue and a two-sided phenomenon: It brings enormous opportunities to modernize post-colonial and post-Soviet nations badly in need of a physical and institutional overhaul, but it also represents powerful new tools of leverage by powers such as China over their neighbours and beyond. Infrastructure alliances mark an important shift from military power as the measure of geopolitical status and economic size as the determinant of geo-economic hierarchy. Infrastructure forces us to view the results on the ground, revealing how the most connected power wins.
China in Eurasia

Sergei Guriev, Visiting Professor of Economics, Fondation Nationale des Sciences Politiques

One of China’s key foreign policy initiatives is the promotion of its trade and investment in Eurasia. The flagship projects – the AIIB and the NDB – foresee tens of billions of dollars in trade-promoting infrastructure investments, including those in Russia and other post-Soviet states. These projects are at the core of China’s strategy of supporting international trade and securing natural resources for its economy, and are, therefore, unlikely to be postponed even if Chinese economic growth slows down. Indeed, investment in Russia and especially Central Asia are vital for the new Silk Road vision connecting China to the leading markets in Europe, Middle East and North Africa.

Traditionally, Russia has been suspicious of China’s growing influence in the Far East and in Central Asia. Until very recently, the Russian government would not allow Chinese companies’ investment in Russia and would try to expand its Customs Union and Eurasian Economic Space to neighbouring countries to fend off Chinese economic influence. However, after the annexation of Crimea, the war in eastern Ukraine and the resulting western sanctions and Russia’s counter-sanctions, Russia is increasingly isolated from the West and is seeking to engage with the East as a counterforce. Even though no tangible contracts have been signed and no new investment projects started, Russia has already declared its interest in AIIB and NDB work, it has allowed Chinese companies to buy stakes in the Russian natural resource industry, and even leased large domains of land in the Far East to the Chinese investors.

Russia’s neighbours (most importantly, Kazakhstan) – worried by “big brother’s” efforts to restore its geopolitical might – are welcoming an increased Chinese involvement in the region. Kazakhstan may be a founding member of the Customs Union and Eurasian Economic Space (“Eurasian Union”), but it is also worried about President Putin’s words that “there was no Kazakh state before Nursultan Nazarbayev”. Given that similar statements about Ukraine were followed by annexation of Crimea, Kazakhstan is interested in a major economic counterweight to Russia’s dominance.

Also, given that Russia’s economy is short of cash, its neighbours are even more interested in foreign investment from the East. Western investments are unlikely to fill the gap, in particular because of high corruption in this region. In this sense, China will remain the most important source of capital for these countries in the foreseeable future.

Will it be the same for Russia? After Russia returns to normalcy, it will certainly restore its relations with the West and will be able to attract western capital. However, given the scale of under-investment in recent years, Russia will need additional hundreds of billions of dollars of investment a year – and will, therefore, be objectively interested in both western and Chinese capital, especially in infrastructure. While post-Putin Russia will be very different in many respects, it will remain the same in the need for economic cooperation with China, both in trade and in investment.
China’s geo-economic power and the United States

Ian Bremmer, President, Eurasia Group

There is a reason why geo-economics between China and the United States are on such vivid display: as a non-violent yet unquestionably potent foreign policy tool, geo-economics is the perfect weapon for a relationship between frenemies. But China’s geo-economic power vis-à-vis the US raises two questions: what are its aims, and what are its means? The answer depends on what playing field one is looking at, for China’s geo-economic influence against the US plays out in four areas: in China, in the US, at an intergovernmental level, and in third-party countries.

In China

The foundation of China’s geopolitical power is its economic might. As such, it is only normal that its geo-economic agenda begins at home. Beijing’s sticks are well-known and frequently reported on: doing business in China as a foreign firm has become increasingly difficult as a focus on national security now permeates the country’s policy decision-making. This trend is felt acutely in the information technology space, where Beijing has rolled out so many new restrictions on foreign players, that it’s hard to keep up. National security law, counter-terrorism law, cybersecurity law, banking IT regulations, to name a few.

What observers are less familiar with is Beijing’s arsenal of carrots. The biggest carrot of all is one that requires no effort on the Chinese government’s part: the colossal size of China’s domestic market. One can argue all one wants that it’s hard to operate under the constant pressure of politicized regulation, but the presence of 1.3 billion potential consumers argues right back. Beyond this de facto head start, Chinese policy-makers will eventually realize that the slowing drivers of their economic model mean they will need American FDI more than ever. This has already led them to initiate overlapping efforts to streamline and expand their country’s investment opportunities.

In the US

The fundamentals of China’s geo-economic hold on the US are well known: Beijing is a leading foreign holder of US treasuries and one of Washington’s largest trading partners. This certainly ensures that every move of China’s policy-makers is closely watched in the US capital, but these two traits are actually not Beijing’s most intriguing policy levers. That’s in large part because the US-China relationship – once nicknamed “Chimerica” – is characterized by mutually assured destruction. In the middle term at least, neither can pull the plug on the other.

More tantalizing is the subtle evolution of China’s approach to direct investment in the US. Though it has been noted that FDI levels between the two parties are under par for economic partners of this scale, recent trends point to a growing Chinese interest in gaining a foothold in America. But what’s most interesting about this investment is not its scale; rather, it’s how it is being rolled out. As Beijing gets better at understanding the rules of capitalism, China is coming increasingly close to beating the US at its own game. Consider the following anecdote.

When the American transport start-up Uber announced that it would attempt to penetrate China’s domestic market, observers held their breath, wondering if local authorities would let the foreigner run free. So when Beijing gave Uber the go-ahead, and Uber took off in the Middle Kingdom, one would have been tempted to laud the unprecedented level of fair play in Chinese-American business relations. And yet, soon came the news that Uber’s largest Chinese rival (a company called Didi Kuaidi), had decided to take its fight to the US by investing in Uber’s greatest American rival, Lyft. In many ways, this move could be interpreted as a warning to US companies seeking to expand into China: be prepared to fend off attacks on both sides of the Pacific.

In international organizations

14 http://www.wsj.com/articles/SB117063838651997830
15 http://www.brookings.edu/research/papers/2015/02/23-us-china-two-way-direct-investment-dollar
16 http://www.slate.com/blogs/future_tense/2015/09/10/uber_s_biggest_rival_in_china_didi_kuaidi_is_backing_lyft.html
A lot of ink has been spilt over whether China seeks to adapt or scrap the United States’ global political and economic order. The answer is simple: both. Beijing realizes that the IMF, World Bank and other such institutions are not going anywhere (that’s just the way path dependency works), so it aims to maximize its leverage within them while they’re still around. In the past, that has meant an attempt to increase its IMF voting rights through a quota reform agreed with the US in 2010, but never implemented. More recently, China’s focus was on (successfully) gaining inclusion for the renminbi into the IMF’s basket of reserve currencies (otherwise known as Special Drawing Rights). Other initiatives include an à la carte approach to partnering with smaller institutions such as the Organization for Economic Co-operation and Development.\(^{17}\)

The problem with these policies, of course, is that they depend on US willingness to accommodate China; a willingness that has been limited. So China has decided to go it alone. Or, rather, it has opted to organize a party of its own and invite everyone, including the US’s closest allies, to defect from the Bretton Woods system. Successfully so – as evidenced by the fact that over the past year (and against Washington’s admonitions) Australia, the Republic of Korea, Saudi Arabia, and even the US’s most faithful partner, the UK, have opted to join China’s AIIB. This was a watershed moment for global politics and a major snub to US efforts to defend what it views as a sacrosanct liberal international order.

**In third-party countries**

It makes sense to conclude this survey of China’s geo-economic influence over the US by looking at Beijing’s presence in third-party countries because recent evolution in this sphere is representative of things to come for China’s geo-economic influence more generally.

Arguably, China has been effective at outplaying the US (and others) in Sub-Saharan Africa and Latin America because Beijing is able to deliver fast cash with no strings attached. But the question is, what happens when China’s financial resources dwindle and Beijing can’t afford to keep throwing money around to keep the US out? I suspect that’s when third-party countries will begin to see the US for what good it represents. Indeed, the United States is not always as virtuous as Americans would like to believe, and Washington has certainly abused its dominant position in geo-economic spheres of late (for example, by “weaponizing” its financial clout). But fundamentally, the US stands for a liberal global order that it sincerely believes in, even if it sometimes bends its very rules. While Beijing’s geo-economic power may be impressive today, it also rests on an economy that will grow increasingly fragile as the years go by, leading to a reappraisal of its external firepower. And so, perhaps US presidential candidates’ obsession with the Chinese economic threat isn’t so grounded after all.
China's geo-economic role in South Asia

Hina Rabbani Khar, Minister of Foreign Affairs of Pakistan (2011-2013)

China has a clear interest to create a stable environment within South Asia. It shares a border with five South Asian countries. If it is to grow and prosper, its attention must not be diverted by security concerns arising from any country in this region.

South Asia has been plagued by distrust, animosity and hostility. It singles itself out as one of the least integrated regions of the world. While Free Trade Agreements may be signed on paper, South Asia continues to be a region with one of the worst intra-trade statistics. As tariff barriers come down, innovative ways are found to keep goods from neighbours near and far from entering each respective country. Profound intentions to invest in infrastructure will be found in almost every communiqué that is generated out of meetings of heads of state and heads of government-level interaction and then little is done to find any resources to pursue the lofty promises of connectivity. In fact, many times when impressive projects of regional connectivity are initiated by the Asian Development Bank or other institutions, a large portion is utilized at a snail's pace or sometimes remains undisbursed due to lack of interest by host governments.

In a region such as this, it is virtually impossible to imagine a China or a US role to be viewed homogeneously by all the countries that comprise South Asia. China’s ingress into South Asia is certain, but each country views its role differently. It is also true that whereas the world has recently been enamoured by China’s role in South Asia, China has had a presence there for a few decades. The numbers may have changed – the outlay certainly has – but for many South Asian countries China’s role is not a new one.

India and Pakistan’s view on China’s role in South Asia offers an insight in how diversely viewed China’s influence is in different countries in the region. Before the Sino-Indian War in 1962, China and India had a relatively calm relationship. Since then, however, both countries have viewed each other as rivals in the region. While China has greatly felt the need to avoid any new or simmering border dispute in the past three decades to be able to concentrate on domestic development, India has very much worked to keep the China threat perception alive both domestically and internationally. Both countries have viewed each other’s influence in South Asia as a competing one, rather than complimentary. India’s late entry in the Shanghai Cooperation Organization (SCO) only came together with that of Pakistan. And China’s desire to become a member of SAARC is, and will continue to be, heavily contested by India. India also views China’s growing strategic influence with its immediate neighbours Bangladesh, Sri Lanka and Nepal with caution. India views China’s strong political and economic bonds with Pakistan as hostile to its own interest.

In Pakistan, China’s role and influence is viewed mostly, if not entirely, as a positive one. Pakistan has been the beneficiary of many important strategic Chinese investments, from the deep-sea water port in Gwadar to the recently announced $46 billion China Pakistan Economic Corridor to partnership in civil nuclear energy, Pakistan views itself to have been a beneficiary of China’s economic largesse. No other country contributes as much to Pakistan’s economic potential as China. The Chinese-financed projects are likely to have a transformational value for Pakistan’s deep energy needs and to convert Pakistan as a potential highway for trade.

For India, these growing Pakistan-China ties are part of a Chinese containment strategy of India within South Asia (China, in turn, views the growing Indo-US ties as a China containment policy).

China’s growing economic interest in countries such as Bangladesh, Nepal and Sri Lanka is also booming. China’s trade levels with Bangladesh have already surpassed India’s trade numbers with Bangladesh, and China’s exports to Sri Lanka, at $4 billion, are coming closer to India’s levels. In the past three years alone, China has disbursed up to $2.5 billion in large infrastructure projects such as an airport and a port in Sri Lanka. In 2013, this relationship was pencilled in as a Strategic Cooperative Partnership.

Nepal, too, has geo-strategic significance for China. Landlocked between China and India, the recent halt of oil supply by India has encouraged China to offer 1,000 metric tons of oil a day, showing a trend for losing and gaining strategic space within South Asia by these two emerging powers.
China’s attention to Afghanistan has also been marked and noticeable recently. China is the largest single country investor in Afghanistan. The Aynak copper mine alone has the potential to give up to $400 million in royalties to Afghanistan annually, which is a sizeable portion of the country’s entire budget. China’s reticence to become politically involved in this fragile country has also seen a marked change. Whereas Afghanistan’s keenness on China’s involvement can be measured by the fact that President Ghani made Beijing one of his first destinations after being elected, China has just now openly started accepting a possible role in encouraging intra-Afghan dialogue.

China is perceived very differently in South Asia than it is in Europe or North America. With the exception of India, South Asian countries view China as a reliable partner that helps countries in a tangible manner while respecting the countries’ preferences. In large part, this has to do with the fact that China is seen to invest in tangible, signature projects that have an immediate economic return. Typically, western countries spend billions of dollars through INGOs and almost always in social sectors. Much of this is neither visible nor very effective in resolving the long-term needs of the country.

China’s growing economic investments in South Asia will inevitably create a sizeable political space for the country. This will erode some of the influence the US and other western countries have had in South Asia. In emerging as an alternative source for infrastructure financing, the likes of the World Bank and the Asian Development Bank will also see their vast influence erode. Within South Asia, India will continue to look at China’s growing influence as a direct threat to its path of emerging as a regional power. For all of the reasons mentioned above, Pakistan, Bangladesh, Sri Lanka, and Nepal will be winners as China offers them much-needed funding in large-scale infrastructure and regional connectivity projects.

In the long run, all South Asian countries, including India will be winners due to China’s increased investment in the region’s infrastructure. If South Asia could get over its trust deficit for neighbouring countries, and SAFTA (South Asia Free Trade Agreement), which has already been signed, could become fully operational, then Chinese-funded motorways, roads and ports will add efficiency and ease to intra-SAARC trade.
China’s geo-economic role in Latin America

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In Latin America, China’s role is more low-key and deferential than in some of the regions geographically closer to the Asian power. Although the region is also the target of Chinese diplomatic and military initiatives, Latin America mainly feels the impact of an increase of Chinese companies operating in the region and growing trade with China, which is slowly leaving its mark on the economies of Latin America and the Caribbean.

In the 37 years since Deng Xiaoping opened the People’s Republic of China to the global economy, the country’s engagement with Latin America and the Caribbean has undergone three important transitions: First, in 2001, the acceptance of China into the World Trade Organization marked the beginning of the geometric expansion of Chinese trade with the region, eventually eclipsing the battle between China and Chinese Taipei, which had previously dominated the relationship. Second, in 2009, investment in, and operations by, Chinese companies in Latin America began to take off, giving China a growing stake in the internal affairs of the countries where they were operating. Third, in 2015, a confluence of decelerating Chinese growth and difficulties with China-backed projects and regimes began to move the region toward a more balanced and pragmatic attitude regarding engagement with China and its potential contribution to regional development.

The twentyfold growth of China’s bilateral trade with Latin America and the Caribbean – from $15 billion in 2001 to $288.9 billion in 201419 – and the receipt of more than $120 billion in Chinese loans since 200520 have significantly impacted the agendas of political and business leaders in the region, captivating them with the possibilities afforded by leveraging China’s resources and accessing China’s substantial market, yet also generating resistance from those whose businesses are threatened by Chinese competition.

The dynamics of the increasing number of China-based companies operating in the region differ by sector. Chinese petroleum and mining companies, for example, have primarily entered the region through mergers and acquisition, whereas in telecommunications, key Chinese actors have grown their presence “from the ground up”. Loan-backed China-based construction initiatives have been most successful in Venezuela, Ecuador and the Caribbean, whereas manufacturing investments involving Chinese companies have occurred primarily in Brazil and Mexico, which both have large internal markets and provide access to important markets of neighbouring countries through NAFTA and MERCOSUR.

As Chinese companies have established operations in the region, their managerial and technical staff have been challenged by a lack of familiarity with the local language, culture and formal and informal rules for doing business, which had to be learned rapidly on the ground.

A changing Latin American economy

Engagement with China also has had an impact on the Latin American economy more broadly. With respect to economic structure, Chinese purchases of the region’s commodities, reinforced by select Chinese investment in their production, has increased the role of commodity exports in the region’s economies.

Expanding trade with China and other Asian countries is transforming the region’s infrastructure, driving the expansion of Pacific coast ports, improved roads to connect them with the interior of the continent, the widening of the Panama Canal, and improvements to Caribbean maritime infrastructure to accommodate the new large ships that will pass through the canal.

Engagement with China is also transforming the trade, financial and intellectual infrastructure of the region, including bilateral free trade agreements signed between China and Chile, Peru and Costa

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Rica. Such transformation also includes numerous government-to-government agreements with China on topics from phytosanitary issues to investment protection, as well as the proliferation and strengthening of China-oriented programmes in Latin American and Caribbean universities.

Expanding Chinese commerce with the region has also transformed the dynamics of Latin American finance, including currency swap agreements in Argentina and Brazil, and contracts denominated in renminbi.

An undesirable by-product of greater commerce with China is expanded transpacific criminal activity, with immigrants, contraband goods, arms and precursor chemicals for drugs flowing from Asia to Latin America, while illegal mining products and drug money to be laundered moves in the other direction.21

Disillusion and pragmatism
China's relationship with the region is arguably now entering a new phase, marked by diminished expectations and greater pragmatism on both sides. The deceleration of China's GDP growth to 6.8%, and perhaps less, has contributed to falling international commodity prices, imposing costs felt particularly by those states which have most benefited from exporting petroleum, mining and agriculture products to China. Weakening industrial demand in China may lead its petroleum and mining companies to postpone programmed investments in Latin America, the Caribbean and elsewhere, where the terms of their concessions allow them to do so.

Apart from a severe crisis in the Chinese financial system, the same weakness in China domestic markets is also likely to motivate Chinese companies to more aggressively pursue loan-financed construction projects in the region, as well as investment in manufacturing facilities in pursuit of access to Latin American markets.

Falling revenues from exports to China, fewer Chinese petroleum and mining investments, and greater competition from Chinese product exporters and construction companies will increase the degree to which China is seen as a competitor, more than a source of opportunity, in Latin America and the Caribbean.

The tempering of Latin American expectations will be reinforced by the substantial number of Chinese projects in the region which have either not been realized or have experienced considerable difficulties. Examples include China's announced, but so far unutilized $35 billion development fund for the region, undone infrastructure projects such as the Nicaragua Canal and proposed “dry canals” in Colombia, Honduras, Guatemala and Mexico, unrealized refinery modernization projects in Costa Rica, Ecuador and Cuba, the Mexico City-Queretaro Railroad in Mexico, and the Rositas hydroelectric dam in Bolivia.22

Examples of violent resistance to Chinese extractive industry projects in the region include oilfields in Tarapoa and Orellana, Ecuador, Caquetá Colombia, and a long list of violent incidents against Chinese mining projects in Ecuador, Peru, Mexico and Bolivia, among others.

At the same time, China is increasingly only one of a myriad of suitors in the region with sometimes competing, sometimes complimentary interests, in an increasingly complex environment shaped by an ever denser web of bilateral free trade agreements across the Pacific and (pending ratification by the US Congress) the multilateral Trans-Pacific Partnership.

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As with Latin America’s experience with other extra-hemispheric actors, the region’s engagement with China will produce winners and losers, with political and business leaders learning to temper both expectations and fears, assuming informed risks, in pursuit of limited but tangible gains.

*The author is not a member of the Global Agenda Council on Geo-economics.*
China’s geo-economic policy in the Middle East

Mahmood Sariolghalam, Professor of International Relations, National University of Iran

Deng Xiaping notoriously noted that China’s new approach to the world should exemplify two characteristics: *hiding brightness and nourishing obscurity*. The Chinese approach in its global outlook is cloaked in these concepts. As a projection of their cultural traits, Chinese politicians believe in instrumentalism, focus on priorities and invisible power projection. Relations with the United States are central in Chinese foreign policy not only because of a half a trillion dollar trade but also due to the role Washington plays in setting rules and defining political objectives at the international level. China realizes that the U.S. is the dominant Middle Eastern power. Therefore, it has set an objective of not confronting American interests in the region while managing China’s image as a responsible global power fully integrated into the contemporary international system.

Many Arab countries have reached out to the Chinese in an attempt to diversify their foreign policies and to counterbalance the US dominance in security and military affairs in the Middle East. But China realizes that the US is the dominant foreign power in the Middle East. It has set an objective of not confronting American interests in the region and tries to manage its image as a responsible global power that is fully integrated into the contemporary international system. In addition, China has limited cultural, military and political capacity to produce outcomes in the Middle East. In fact, Beijing neither has the desire nor the resources to pursue other aims than oil imports and some limited bilateral relations with states in the Middle East. In the great power matrix of the Middle East, China has behaved in an absent, silent and ambiguous manner. Wary of entanglement, China prefers not to have a policy in the Middle East.

Iran has been the most problematic Middle Eastern issue for China. Throughout the 2013-2015 period of nuclear negotiations between Iran and the P5+1, Chinese followed American footsteps, agreeing that Tehran should not become a nuclear power – 40% of China’s trade is conducted through sea lanes and half of Chinese oil imports transits through the Persian Gulf. Beijing is thus particularly sensitive to the security of the seas. It has supported conflict resolution and conflict prevention in the Persian Gulf.

While many Arab countries have reached out to the Chinese in an attempt to diversify their foreign policies, the US dominance in security and military affairs of Arab countries has faced no parallel and competition from any other global power. In addition to oil interests, China has a vision to focus on Central Asia as an avenue of conducting trade with Europe, considering the safety of these trade routes to sea lanes.

Beijing has avoided taking sides in Middle Eastern conflicts. China recognized Israel in 1992 and is now managing an $11 billion trade with Tel Aviv, with Israel’s IT industry being particularly attractive to the Chinese. On Syria, China has often sided with Russia. While in four decades, China used its veto power in the UN Security Council only five times, in only three years over the Syrian issue, it has vetoed resolutions four times, tilting towards Moscow. In addition, in an effort to project soft power in the aftermath of the dire humanitarian circumstances in Syria, China increased its financial support for humanitarian aid and relief capacity.

In general, China has not been in a position to develop strategic relations with any country in the Middle East. China has pursued a policy of hesitancy, non-involvement, inaction and disengagement in Middle East conflicts while focusing on energy imports and limited trade.
China's interests in Africa are multi-faceted. Africa has become a force in the multi-polar world and may be able to help China to counterbalance the western dominance. On the economic front, China's interest in Africa arises from the continent's vast geographical expanse, abundant resources and a population with an important development potential. Africa now ranks among the fastest growing regions in the world, providing a major emerging market for China's exports. China-Africa trade has grown to several hundred billion US dollars, and, for five years in a row, China has been Africa's largest trading partner. China's FDI in Africa has grown to over $25 billion.

In the 21st century, there have been frequent high-level exchanges between China and Africa. A Chinese-African partnership is likely to be mutually beneficial as Chinese development creates opportunities for African development, which, in turn, can benefit Chinese exporters and companies operating in Africa.

China has strengthened its relationships with African countries, both bilaterally and multilaterally through institutions such as the African Union, where it provides support for African integration and upholding peace and security in Africa, and the African Development Bank, where it provides assistance for infrastructure investment. African countries and China have been united in pressing for reforms of international governance systems, as well as on addressing major issues such as global development and climate change.

Areas of cooperation

China and Africa have worked together to protect and promote the common interests of developing countries. China seeks to pursue inclusive development jointly with Africa through its investment and trading relationships. Chinese expertise in science and technology and its abundant capital can complement the abundant African labour and natural resources.

As a geo-economic strategy, China stands ready to share its development experience and opportunities with Africa, including the technologies that China has developed. It has also stated that it is ready to transfer some labour-intensive industries to Africa to promote employment creation, which would benefit the two peoples. Because Africa is viewed as being at the early stage of an economic take-off, while China has moved to a more advanced stage of modernization, both sides can gain from integrating their economies.

Chinese-African cooperation is not limited to energy, resources and infrastructure, but equally includes industrialization, urbanization and agricultural modernization. In addition to promoting the development of labour-intensive manufacturing sectors in Africa, such as textiles, garments and household appliances, and co-operation initiatives to help transform and upgrade the energy and natural resource industries, Beijing would like to see better alignment of industrial development strategies between China and Africa. Moreover, because infrastructure is essential to industrial development, China is actively getting involved in motorway, railway, telecommunications, electric power and other projects in Africa. A high-priority interest is the project to build a high-speed railway network. China has already proposed establishing a high-speed railway research & development centre in Africa to share its relevant technologies, experience, training and management expertise with African partners.

Another area of cooperation involves financial funding projects, such as the China-Africa Development Fund and the African Development Bank's joint financing fund for infrastructure development. There are also Chinese initiatives to promote cross-border local currency settlement, currency swaps and establishment of branches of financial institutions.

As a development partner, China has a variety of programmes to promote businesses, including preferential loan schemes, preferential buyers' credits, China-Africa Development Fund (to encourage Chinese companies to invest in Africa) and zero-tariff treatment from the least developed countries in Africa. China has also provided a number of human resources development programmes, with the focus on training African professionals, providing senior agricultural experts, setting up agricultural technology demonstration centres, building hospitals, constructing malaria prevention and treatment
centres, building rural schools and providing Chinese government scholarships to African students. China has also been engaging with Africa on cultural and people-to-people exchanges, as well as cooperation programmes in science, technology and education and enhanced vocational training to help African countries improve their human resources.

**Risks to the China-Africa relationship**
Africa is likely to play an important role for China’s economy. Because of the Chinese activities on the continent, there is concern that a “second scramble for Africa’s resources” may be taking place, reminiscent of the colonization and plundering of Africa’s resources in the 19th century.

The Chinese authorities have refuted such assertions by insisting that their relationship with Africa is born out of historical friendship, equality, common development, mutual support and mutually beneficial cooperation. The strategic cooperation and partnership between Africa and China rests on a win-win foundation. Indeed, the attractiveness of China as an alternative development partner in Africa has been widely noted. However, Africa should be careful not to rely too much on China and its development model as the panacea for its economic ills.
China's geo-economics in Europe

Mark Leonard, Director, ECFR with Agatha Kratz*, Associate Fellow, ECFR and Angela Stanzel*, Policy Fellow, ECFR

As part of its increased international economic engagement, China has developed an active policy for outward investment, both through its Go Out policy and through the recently launched One Belt, One Road initiative. Thanks to the former, China should be tripling its global assets within the next five years, reaching $20 trillion by 2020. Thanks to the latter, China should be able to reach 3 billion middle-class consumers in the Silk Road regions by 2050, and to generate $2.5 trillion in trade among the 65 countries involved.

Both of these policies have direct potential impacts for Europe. First, because European companies are of particular interest to Chinese investors due to their technological level, innovation capacity, know-how and skills concentration, as well as brand and logistical access to the European market. Second, because Europe is one of the end destinations of China’s New Silk Roads, an initiative that comes in the form of massive investments in sectors where China has developed a strong comparative advantage, but in which Europe also has strong economic and strategic interests.

Besides, those policies emerge at a time when European countries need, and thus are inclined, to actively welcome Chinese investment – especially since the euro crisis and the ensuing shortage of investment from within the European Union. Indeed, recognizing the continent’s need for investment, the EU launched a bid to revitalize the Eurozone economy through an unprecedented European Central Bank bond-buying programme, and by committing to the set-up of an Investment Plan for Europe. China has already displayed public interest to contribute to the Investment Plan.

Yet China is not any partner country, or any investor. It is an economic firepower combined with a (yet) non-state economy. Europeans are very aware that they are dealing with businessmen and companies that are influenced not only by economic but also by political motives and often backed by state support. The level and type of Chinese investment in the EU, therefore, is a reason for concern, as for example with regard to the status and practice of Chinese state-owned enterprises (SOEs) in European markets.

For example, the visit of President Xi Jinping to the UK in October 2015 has triggered a debate on Chinese investment and security issues. China and the UK reached an agreement on China General Nuclear Power Corporation’s investment – within an EDF Energy-led consortium – in the Hinkley Point C nuclear plant, the first nuclear power plant in decades in the UK. On this occasion, concerns were raised over the potential theft of industrial secrets, but also on China’s increased access to information about, and influence on, some of the UK’s most strategic infrastructures.

But this is not exclusively a UK matter. France has also opened up to Chinese investment in strategic sectors, selling a 49.9% stake in the Toulouse airport to a Chinese consortium in December 2014 and thus allowing China to invest in its infrastructure for the first time. Another striking example is that of the Greek port of Piraeus, which has recently become a key hub within China’s Silk Road. Chinese investment in the port has raised alarm at EU level over a possible Chinese monopoly of one of the main Mediterranean ports, as a Chinese state-owned enterprise, which already has a minority stake in the port, is looking to bid to buy the remaining 67% stake held by the Greek state.

Chinese investment in sensitive sectors in Europe has increased – and so have concerns. China’s One Belt, One Road initiative has, too, increased both hopes and worries over China’s ambitions in the EU, not least because of the geopolitical aspect of the initiative. Overall, China’s investment is obviously a welcome financial opportunity for the EU, its member states and its companies, which should be free to leverage China’s increasing financial means as well as clear interest for European assets. One Belt, One Road could, in turn, represent an opportunity for Europe to improve, upgrade or complement its infrastructure network, in particular in Europe’s least connected countries.

However, those investments should abide to a number of conditions. First, the same rules should apply for all Chinese investments in all European countries. There should be no possibility left either to a member state to compete against other EU countries through a levelling down of investment rules and frameworks, or for China to “divide and rule” through preferential investment agreements.
Secondly, wherever possible, Chinese investments should be aimed at complementing EU efforts in terms of investment and growth and employment promotion. Overall, Chinese investments should be levered to respond to EU-specific interests and not simply be seen as a welcome financial contribution whatever the target sector and project. This, however, implies defining a common strategy for investments in the EU. To do so, member states, along with EU institutions, will need to start by identifying needs and defining common priorities at the EU level.

Finally, the ongoing Bilateral Investment Treaty (BIT) negotiations between the EU and China should be used to ensure the EU’s openness to Chinese investments is met by Chinese reciprocity in greater market access and a level playing field for EU companies in China. Additionally, the BIT negotiations should be used as an opportunity to discuss and come to actionable conclusions on foreign investment in strategic industries – potentially defining off-limits sectors and industries to foreign investors, especially in the case of investors from non-(fully)market economies.

Overall, this revolutionary trend in Chinese investment is a great opportunity for Europe to benefit from China’s current financial dynamism, which might not last forever. However, to maximize the benefits, it should think strategically about how to structure these financial flows and direct them in a way that benefits the EU as a whole economically, and preserves its security in the long term.

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China’s role in Asia-Pacific

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China’s role in Asia-Pacific has gone through three phases since the People’s Republic of China was established in 1949: confrontational; constructive; and the current, confused phase.

When the Communist government took power in 1949 in the context of the Cold War, China was cut off from many of its non-Communist neighbours, including Japan, the republic of Korea and many South-East Asian countries. For decades, Chinese radio stations called for the removal of non-Communist governments, a practice only stopped in 1978.

But the confrontational phase had begun its end already earlier, after the Sino-Soviet split in 1969 and Henry Kissinger’s visit to Beijing in 1971. With the strategic alignment of interests between the US and China to balance the Soviet Union, many non-Communist regimes rushed to normalize their relations with China, including Australia (1972), Japan (1973), Malaysia (1974) and Thailand (1975). China’s image in non-Communist South-East Asia improved dramatically after China and ASEAN collaborated closely to reverse the Vietnamese occupation of Cambodia. This constructive phase picked up speed in the 1980s.

While the end of the Cold War and the Tiananmen incident in 1989 led to a strategic pause in the relations between China and the US, it did not deaccelerate relations between China and its immediate neighbours. Indeed, China and the ASEAN countries grew closer in the late 1990s, after China helped the ASEAN countries to cope with the Asian financial crisis of 1997-1998. These relations were given a bigger boost when, at the ASEAN-China summit in November 2001, Premier Zhu formally made the proposal for the formation of a China-ASEAN FTA (CAFTA) in 10 years, making China the first major power to propose a Free Trade Agreement with ASEAN. China offered to open its own market in some key sectors to the ASEAN countries five years before they reciprocated. It also granted special preferential tariff treatment for some goods from less-developed ASEAN states, i.e., Cambodia, Laos and Myanmar. ASEAN accepted these proposals enthusiastically. This move greatly cemented both China’s economic and diplomatic relationships with the region.

China became a full dialogue partner of ASEAN in 1996. China’s trade with its Asia-Pacific neighbours grew by leaps and bounds and China became the number one trading partner of Japan (in 2009), Australia (2007), Republic of Korea (2004) and ASEAN (2013). This constructive phase, which began in the mid-1970s, lasted almost three decades. This flourishing economic interdependence and success, together with sensitive diplomatic relations, laid ample groundwork for strong and lasting peace and cooperation.

There is no precise data to indicate when the confused phase in the relationship between China and its Pacific neighbours began. However, it is possible to point to a few critical events that led to a change in chemistry. With Japan, things took a negative turn in 2010 when China piled enormous pressure on Japan to release a captured Chinese fishing boat captain. After Japan capitulated and released him, China insulted Japan further and demanded an apology. The Japanese public began to fear China. With South Korea, there had been an enormous breakthrough when China established diplomatic relations with it in 1992, despite North Korean opposition. Yet when China remained silent after North Korea shelled South Korean islands and killed South Koreans in 2011, South Korea showed its displeasure by attending the Nobel Peace Prize ceremony for Chinese dissident Liu Xiaobo.

China-ASEAN relations hit a low point in 2012 when China was perceived to have pressured Cambodia to block the regular annual ASEAN ministerial statement because it contained an innocuous reference to the South China Sea. This showed a significant difference in attitude compared with China’s handling of the same issue in the ARF meeting in 1999.

Yet despite these negative political events in the 2000s, China’s economic relations with its Asia-Pacific neighbours continued to grow in strength.

It is thus fair to say that the past decade has been a confused phase in the relations between China and its Asia-Pacific neighbours. On one hand, economic relations between both have grown
significantly. China became the US’s second largest trading partner in 2014, with a total trade volume of $590.7 billion\(^{23}\). China is South Korea’s largest trading partner, with a total trade volume of $290 billion\(^{24}\). China is ASEAN’s largest trading partner, with a total trade volume of $366 billion in 2014\(^{25}\).

In economic terms, China has thus been becoming increasingly entrenched within the region. It has also continued to invest deeply in these ties by funding and building infrastructure for its 21st-century Maritime Silk Road initiatives. Providing capital for these initiatives is a primary goal for the new AIIB, whose signatories include the ASEAN countries, Australia and New Zealand. With this increased collaboration and deepening interdependence, China’s influence in Asia-Pacific, especially South-East Asia, should be going from strength to strength. Yet, political concerns about the rise of China have also grown. The South China Sea disputes, even though they are only between China and four of the 10 ASEAN countries, have cast a cloud over the China-ASEAN relationship. China has consistently said that it believes in a peaceful rise. Before 2005, the region accepted this. Over the past decade, new doubts have risen. Hence, the current state of relations between China and its Asia-Pacific neighbours remain somewhat confused.

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\(^{23}\) http://www.census.gov/foreign-trade/statistics/highlights/top/top1412yr.html


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