China's Belt and Road Initiative
Panel I: Mercantilism with Chinese Characteristics: Creating Markets and Cultivating Influence

Testimony before the U.S. – China Economic and Security Review Commission

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In the fall of 2013, Chinese President Xi Jinping put forward the strategic conception of building the "Silk Road Economic Belt" and the "21st Century Maritime Silk Road," known shortly as the "One Belt and One Road" (OBOR) initiatives. Interestingly, this initiative when announced was very much a top down exercise, an idea that caught Xi's eye from within policy research elements of the Chinese Communist Party (CCP) and put forth with relatively little input from below. Much of the Chinese government bureaucracy that would have to support it found themselves having to scramble to figure out exactly what Xi meant by this, and what the scale and scope of effort needed would be to support it. Given the direct linkage to Xi as a signature policy, the Chinese bureaucracy proceeded to rally quickly to flesh this out and it has subsequently become a cause too big to fail in the Chinese system.

China's official mission statement for OBOR is: "The idea carries forward the spirit of the ancient Silk Road that was based on mutual trust, equality and mutual benefits, inclusiveness and mutual learning, and win-win cooperation. It also conforms to the 21st century norms of promoting peace, development, cooperation and adopting a win-win strategy for all. The conception organically links the "Chinese dream" to the "Global dream" and has far-reaching strategic significance with a global impact."

As mission statements go, that does a great job of capturing all the catch phrases of recent propaganda efforts by the CCP under Xi's leadership, but doesn't capture fully the motivations behind this effort. There are several drivers of this policy that must be fully appreciated to understand why this is of such import to the Chinese leadership. These include:

1. At the time of the announcement of the OBOR policy, China was wrestling with its desired response to the U.S. "rebalance to Asia," and in particular its economic component the Trans Pacific Partnership (TPP). Taken together with the effort by the Obama administration to pursue a similar free trade initiative with Europe (TTIP), China saw the need to present alternative rules and regimes for the future. The relatively vacant space of infrastructure spending provided a ready-made and relatively benign path to do so.
2. The Chinese leadership under Xi Jinping has recognized the need to deal with "supply side" issues of overcapacity, as well as excess foreign

exchange reserves, and an initiative such as this provides a channel to address these issues to China's benefit.

3. A central issue to Xi Jinping is the "rejuvenation of the Chinese nation," which essentially means having China play a much more active and central role in world affairs than that which had been pursued previously under Deng Xiaoping's dictum to hide capabilities and bide time. Xi sees OBOR as an ideal political and economic platform on which to boost China's international position and image, something greater in scope and ambition to the U.S. Marshall Plan after World War II and hard to oppose on the face of the policy given the infrastructure demand in the regions involved. The lack of specific target dates for completion of any initiatives also allows the Chinese leadership to declare success as it sees fit and not be bound to any hard deadlines.
4. The maritime "road" portion of the plan firmly plays to China's desire to build the infrastructure and capacity to diversify its energy supplies and reduce the risk of being "strangled" in the Straits of Malacca in a conflict situation. This matches concerns reflected in internal People's Liberation Army (PLA) planning documents dating back over a decade looking to promote energy transmission routes through Burma, potentially building a canal through the Carat Isthmus in Thailand, and ports in Pakistan, Sri Lanka and beyond.
5. It remains a high priority of the Chinese leadership to more fully develop the western regions of China, for economic as well as domestic stability reasons. This means that Xinjiang, Qinghai, Ningxia and Yunnan are likely to receive a disproportionate amount of funding and attention in the lifespan of this initiative, something certainly welcome to those regions but also a driver for major foreign and domestic investment decisions.
6. Finally, and perhaps most importantly, the ramifications of OBOR must be assessed together with China's massive industrial policy initiative "Made in China 2025." Launched in 2015, this policy seeks to make China the world leader in 10 critical categories of the economy that are on the cutting edge of 21st century industries. In that regard, China has launched the equivalent of 10 Manhattan Project-style initiatives to "gain the commanding heights" in these sectors, driving large scale investment decisions and setting clear market access restrictions. Just the scale of the effort, let alone the degree to which China is successful, will heavily influence world markets in key sectors and be a major player in China's economic relations worldwide.

As has been seen in increasingly glowing government and CCP pronouncements since November 2013, capped off by OBOR's enshrinement in the CCP Constitution at the 19th Party Congress in October 2017, this initiative is a centerpiece for Xi's economic and foreign policies and thus will receive the benefit of the entirety of the PRC's bureaucratic and corporate backing. It is too big to fail, and at least as long as Xi is around, it won't be allowed to fail. The front lines of support are provided by China's recently established Asian Infrastructure Investment Bank (AIIB), a thus far seemingly well functioning new multilateral institution that serves as a showpiece for China's evolving pursuit of an alternative global construct. While up and running in relatively short order, however, the AIIB's importance in financing OBOR, at least thus far, is far outshone in terms of scope by China Development Bank (CDB) and China Export-Import Bank (China Ex-Im). It's precisely the central role of these institutions that is troubling to U.S. and other foreign officials – and companies seeking to get involved - given the very limited transparency in operations they provide, and the clear role they play in advancing China's economic interests. CDB and China Ex-Im are able to act above the fray in China's bureaucracy, and continue to effectively rebuff efforts by foreign governments and entities alike to gain insight into their compliance and decision-making processes.

One must tip their hat to the country that invented bureaucracy, as China has fully harnessed its government departments, domestic state-owned enterprises, and major "private" multinationals to all recognize the benefit (and essentially the necessity) to create their own OBOR policies as a priority and pursue it accordingly. Entities are falling all over themselves to declare their support for OBOR and create units within their respective organizations to drive projects labeled as dedicated to OBOR's success and show their fealty to this policy. It's not only politically correct, but good business. That mindset has transcended to most multinational corporations, including many U.S. firms, who also go out of their way to inform their PRC interlocutors – especially SOE's - that they, too, have created OBOR teams in their entities to help guide their approach to the PRC market and beyond.

As a recent analytical assessment produced by the Conference Board stated, OBOR is clearly an ambitious platform for China to try to soak up at least a good portion of its acute industrial overcapacity and support growth for distressed state industry. It is arguably China's most audacious effort yet to try to engineer growth, and reaffirms the grip and control China's government has over major assets in the economy, as well as the socioeconomic imperative to keep them producing. It also illustrates the leadership's lack of progress, at least thus far, in migrating growth drivers away from state-financed investment toward household consumption. Finally, OBOR represents an intervention and deployment of central government funds that flies in the face of the celebrated November 2013 CCP Third Plenum promise to let markets play a decisive role in China's economy going forward.

This past year has been pivotal in trying to assess what's real and what's hype with OBOR. Many corporate executives, trade diplomats and China watchers worldwide watched in awe – well-founded skepticism but yet awestruck – as Xi Jinping addressed the World Economic Forum in January 2017 extolling the virtues of globalization, openness, connectivity and a free and fair trading order. These were people well steeped in the effects of China's highly protectionist policies at home, thus finding it amazing that they were listening to Xi's anti-protectionist rhetoric abroad and wondering if the world had been turned on its head given the positive reception he received. This is magnified by the fact that the vast majority of US and European observers involved in the region believe that China under Xi has been closing, rather than opening, doors to trade and investment, and accelerating on a path towards isolation, insulation, illiberalism and more government controls.

On the other hand, one must also look at the success China achieved with the May 2017 Belt and Road Forum on International Cooperation in Beijing, seeming to indicate that much of the global community may have a different, and more welcoming, perspective on China's vision and role in the world. The turnout speaks for itself – twenty-nine heads of state and several dozen other ministerial-level national delegations – all coming to Beijing on relatively short notice compared to the norms of international conference planning. Though the officially stated results and joint communiqué issued from the conference was not earth-shattering in significance, it would be hard to point to another gathering drawing such firepower in comparison to what Xi Jinping was able to draw to Beijing.

Somewhat akin to what U.S. presidential candidate Ross Perot famously stated in 1992 about the "giant sucking sound" of investment flows to Mexico should NAFTA pass, the enticement of RMB flows to recipient countries in the OBOR path is at least as real. While advanced economies have tended to focus on China's perceived desire to alter global norms, its paranoia about information and data flows, its lack of reciprocity in trade and investment policies, its internet firewall and increased obsession with national security – all understandable and legitimate concerns – the Belt and Road Forum attendees mostly from developing countries all demonstrated through their attendance that they are not overly concerned about any of these issues. This is music to the ears of Xi and the Chinese leadership, particularly as codified in the recent CCP 19th Party Congress official documentation that China should seek to be seen as a credible leader for 21st century globalization. In this view China is essentially offering ups its blend of state capitalism, socialist market economy, authoritarian political control, and new multilateral institutions as a new path for countries to consider and the possible backbone of a new international order. Given that most of the OBOR interested nations are highly protectionist with state-led economies in their own right, this is not a hard sell for China.

The net effect of these views is that there is an effective dividing line between developed and developing nations in their outlook on OBOR. Essentially there is a battle between those concerned over changing China's behavior on an ample number of trade, investment and governance issues, and those relatively unfazed by this and instead focused on scrambling for the cash. China is betting on the latter side winning, and is being quite transparent in its position and confident in its ascendancy. There is every reason to believe based on the record of the past five years of Xi's leadership, the priorities he ensured were endorsed at the 19th Party Congress, and the very public pronouncements being issued to "grasp the historic opportunity," that China under Xi will not liberalize in the manner that most Western audiences had hoped or expected. The good news, at least to those who are worrying about China's perceived ambitions to change the global order, is that China's actions thus far point to a more regional rather than global scope. This is certainly true in Eurasia and parts of Africa. China has laid down a marker that it is the leading driver of developmental policy in these regions, and is increasingly expecting other nations and existing multilateral institutions to acknowledge this.

So what should multinational companies expect from China's OBOR initiative?

The first thing that needs to be recognized is that OBOR does not provide a level playing field for Western MNC's to compete with Chinese firms. It is plain and simple an instrument of China's political and economic growth and manifestation of the opportunity Xi Jinping sees for China to take center stage in the world. That said, there are, and will be, quite a number of opportunities for foreign businesses to participate in the "best supporting actor" category. We are seeing this on the ground in Beijing and Shanghai among numerous U.S. multinationals that are eager to carve out opportunities. The net effect thus far, and likely for the foreseeable future, is for companies to play sub-contracting roles to leading Chinese enterprises, particularly in the services sector such as commercial insurance, consulting, logistics, technical services provision, etc. Many Chinese firms are bidding on OBOR-related contracts fully knowledgeable that they do not possess the complete expertise in house to carry out the project, but rather will have to subcontract many aspects to foreign firms, knowing that OBOR is much like an affirmative action policy to benefit Chinese enterprise in the leading roles. While this limited role for foreign enterprises is on its face distorted and a tilted playing field, a number of analysts assess that this may turn out to be a good thing given the high risk, low economic return of the vast majority of OBOR projects to date. As has been seen in so many other areas of Chinese economic policy, the rate of return is much less important that the perceived or real political and diplomatic benefits China is seeking. This is why CDB and China Ex-Im, by far the two leading financers of OBOR, are not particularly concerned in moving forward on their projects while private sector entities are taking a comparatively more cautious approach.

So will it work? Like most things, it depends on how you define success. As a political and soft power initiative, it has already proven quite beneficial to China, and is likely to continue on that path unless China unduly overplays its hand or stumbles into scenarios where host sovereignty sensitivities are tweaked. That's a very real potential outcome in such a grandiose project, but China at least to date has gone to great lengths to try to ameliorate these risks. The financing and economic return aspects of OBOR are likely to be the most challenging, and even with China's very large foreign exchange reserves and firm political commitment its hard to see China being able to bear the brunt of this financing any more than a decade out, if even close to that amount of time. The policy is directly tied to Xi Jinping personally, and since he's now enshrined to be China's paramount leader barring upheaval until he goes off to meet Marx, there is every reason to believe that the PRC will do everything possible to sustain this policy.