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CHINA'S BELT AND ROAD INITIATIVE
MOTIVES, SCOPE, AND CHALLENGES

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CONTENTS

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Map of Eurasia and North Africa

INTRODUCTION

For more than 2,000 years, China's commercial ties with the outside world have been symbolized by the ancient Silk Road, which began as a tortuous trading network of mountain paths and sea routes that provided a lifeline for the Chinese economy. Now the leadership in Beijing is reviving the concept with an enormously ambitious plan to build and upgrade highways, railways, ports, and other infrastructure throughout Asia and Europe designed to enrich the economies of China and some 60 of its nearby trading partners. The potentially multitrillion dollar scheme, which Beijing calls the Belt and Road Initiative, has generated enthusiasm and high hopes but also skepticism and wariness throughout the region and in capitals across the world.

What are the motivations for China's oddly and perhaps illogically titled initiative? (The "belt" refers to the land portion of the silk route—the Silk Road Economic Belt—and the "road" refers to the Maritime Silk Road.) Is China's goal to serve as the altruistic equivalent of the US Marshall Plan, the massive post–World War II reconstruction of Europe by the United States? Or is it a plan to cement Chinese leadership and perhaps even hegemony in competition with the Trans-Pacific Partnership, the recently signed trade pact involving the United States, Japan, and 10 other countries on the Pacific Rim? One conclusion is certain, the world is paying attention when one country embarks on an elaborate effort to dramatically upgrade the infrastructure serving three-fourths of the world's population, increasing their mutual economic dependence on China and each other. As big as China's ambitions are, many obstacles stand in the way. If successful, China will be disrupting historical spheres of influence of many countries, most notably India and Russia, which regard the region as their neighborhood just as much as China regards it as its own. The record also suggests that ambitious plans to build infrastructure run into many logistical problems, from cost overruns to "bridges to nowhere" to corruption. If, on the other hand, China treads carefully, heeding warnings from history and the concerns of its neighbors, and transforms its initiative into a participatory exercise rather than a solo act, the whole world can benefit.

In this volume of essays edited by Sean Miner and Simeon Djankov, PIIE experts analyze the Belt and Road Initiative's prospects, the challenges it poses, and China's goal of furthering its economic, political, security, and development interests. They draw on lessons from past initiatives by multilateral development banks and the experience of the United States and United Kingdom in undertaking grand infrastructure projects. The authors find that the initiative presents both opportunities and risks for the United States, China's neighbors, and the rest of the world.

Djankov assesses China's true motivations behind this grand initiative. Miner analyzes the economic and political implications and the steps China can take to broaden the initiative's benefits. Edwin Truman argues that China faces challenges in the way it governs the initiative and that it should redefine its role in multilateral development banks. Robert Z. Lawrence and Fredrick Toohey draw on historical examples to show that such initiatives must be complemented with institutional reforms and policies in countries where the projects are located. Otherwise pressure from profit-oriented firms can rapidly lead recipient countries into quicksand. Cullen S. Hendrix looks at the security implications and whether encroaching on India's borders and Russia's self-defined sphere of influence will cause China more harm than good. Finally, Djankov assesses how the initiative may affect the former Soviet Bloc countries, concluding that success will depend on China's efforts to blend its goals with those of the governments there.

CHAPTER 1

THE RATIONALE BEHIND CHINA'S BELT AND ROAD INITIATIVE

SIMEON DJANKOV

The ancient Silk Road had no national boundaries. For more than 15 centuries merchants travelled freely along a large network of roads and sea routes, trading goods and enabling the transfer of knowledge between Asia, Europe, and the Middle East. In the process, trade and travel along the Silk Road changed the nature of manufacturing activity and services in much of the then developed world, improved the administration of city-states, and enabled the spread of business ideas.

Today, China is attempting to rebuild the Silk Road with the Belt and Road Initiative. The initiative has a prominent place in China's 13th five-year plan, released in October 2015,[1] and is the country's most ambitious foreign trade and investment project. Spanning 65 countries and 60 percent of the world's population, it aims to redraw the trade routes for Chinese products. One arm, the Silk Road Economic Belt, extends from China to Europe through Central Asia, and the other, the 21st-Century Maritime Silk Road, links China to Southeast Asia, the Middle East, and Africa along sea routes. In addition to the 65 countries in Asia, Africa, the Middle East, and Europe that are already part of the Chinese initiative, the European Commission has signed a memorandum of understanding on the so-called EU-China Connectivity Platform, created in June 2015, coordinating the European Commission's Trans-European Networks strategy with new Belt and Road projects.

The Belt and Road Initiative is being compared to the Marshall Plan, an American initiative of approximately $130 billion (in 2015 value) to rebuild Western European economies after World War II, but this comparison is off the mark. The goals of the United States back then were twofold: not only to rebuild war-devastated regions and remove trade barriers for American goods but also to prevent the spread of communism beyond Eastern Europe. In contrast, the Belt and Road Initiative appears to be entirely a mercantile endeavor, designed to fortify China's economic interests around the world and open business opportunities for Chinese companies enduring a slowdown at home.

This chapter reviews the motivation, scope, funding channels, and the challenges that lie ahead for this nascent initiative. These are preliminary analyses, as the stated intentions of the initiative to reach $4 trillion in financed projects are far larger than the projects currently in development, worth $230 billion.

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1. Sidney Leng, "How the next five-year plan will change China: blueprint for nation's development explained," *South China Morning Post*, November 3, 2015.

MOTIVATION FOR THE INITIATIVE

China has several reasons to promote its new Silk Road plan. As the world's biggest trading nation, China's main interest is to reduce the costs of transporting goods. Projects that are already funded under the initiative all report statistics on how much travel time and cost will be reduced as a result of their completion. Because such improvements will affect all cargo using these transport routes, they will benefit world trade. The success of the Belt and Road Initiative is thus of interest to countries beyond the designated Silk Road routes, as their exporters will also use the upgraded infrastructure.

Besides reducing trade costs, there are four other goals for the initiative. First, China is attempting to decrease the economy's dependence on domestic infrastructure investment and the associated growth that comes with such investment. This means that Chinese construction companies, equipment makers, and other businesses that have thrived on the country's building boom have to look elsewhere for opportunities. A key motivation for the Belt and Road Initiative is to find outlets for these companies overseas. China expects that its own companies will plan, construct, and supply the projects it funds, and this expectation is borne out in the analysis of existing projects. A study of loan practices by the China Development Bank and the Export-Import Bank of China in 2013–15 showed that 70 percent of overseas credit was made on the condition that at least part of the funds be used to purchase Chinese equipment and involve Chinese labor.[2]

Second, the infrastructure focus helps China in its quest for greater international stature for the renminbi, to achieve the status of a global reserve currency. In this effort China has the backing of Russia and other emerging markets, as the volatility of their currencies has troubled politicians. With the aim of financing projects where the Chinese currency is used in loans, China in 2015 joined the European Bank for Reconstruction and Development and founded the Asian Infrastructure Investment Bank. These steps yielded success, and the International Monetary Fund added the renminbi to the basket of global currencies.

The third motivation for the Belt and Road Initiative is to secure China's energy supply through new pipelines in Central Asia, Russia, and Southeast Asia's deepwater ports. Energy sufficiency has been a consistent worry for Chinese enterprises, and for good reason. The number of privately owned vehicles in the country shot up from 8 million in 1990 to about 115 million in 2015. And with the growth of the economy, China's energy demand has increased more than 500 percent since 1980. The country is now the world's largest energy consumer and, as of 2014, largest net importer of oil. Its reliance on coal for about 40 percent of its heating and electricity has contributed to pollution in its cities. The Chinese government has set ambitious goals for dealing with the pollution problem, including switching from coal to cleaner—but so far mostly imported—energy sources.

Fourth, infrastructure development in countries along the Belt and Road routes may increase growth in their economies and thus contribute to a growing demand for China's goods and services. In March 2015, China's president Xi Jinping stated that annual trade with the countries along the Belt and Road Initiative would surpass $2.5 trillion by 2025. In smaller countries such as Georgia, projects funded by the initiative may increase annual economic growth by 1.5 percent for the next decade, a considerable boost. Data are not yet sufficient to suggest the extent of this growth effect in other countries, but the initiative clearly represents an interest in finding work for Chinese construction and equipment companies and their engineers.

The Belt and Road Initiative does not so much set out new goals as unite China's economic priorities abroad under a single project. Its precedent, China's 1999 "Going Out" policy, sought to increase outbound foreign direct investment and expansion beyond the country's borders—and led to a dramatic increase of 600 percent in China's trade with the resource-rich countries of Southeast Asia, Latin America, and Africa between

2. James Kynge, "Chinese Overseas Lending Dominated by One Belt, One Road Strategy," *Financial Times*, June 18, 2015.

2000 and 2007. Chinese investors were newly welcomed for the implicit hope of exporting some of the success of "the Chinese growth model" to other countries, and China Development Bank funded hundreds of projects in developing countries for over a decade.

SCOPE

The Belt and Road Initiative is broader in scope than the ancient Silk Road and the "Go Out" policy. Chinese state banks have already invested more than $250 billion in new initiative-designated projects such as railways and power plants.[3] In the first half of 2015 alone, Chinese companies signed 1,401 project contracts worth $37.6 billion under the initiative. These contracts account for 43.3 percent of all overseas project contracts financed by Chinese state banks. At maturity, investment in the Belt and Road is expected to reach $4 trillion, equivalent to China's 2015 foreign currency reserves.

The major thrust of investment thus far is in transportation infrastructure toward Europe, to connect Asia with Europe via rail, roads, ports, industrial parks, and logistics centers. Three Europe-bound train routes are already functioning. One of the trains heads for Małaszewicze, a Polish town near the border of Belarus, and from there goes to Warsaw, Hamburg, Prague, Duisburg, and Paris before ending in Milan. For the route through Russia, trains depart from Zhengzhou on a fortnight's journey to Brest and Minsk in Belarus, before travelling to Moscow and Saint Petersburg, and from there to Helsinki and Stockholm.

In December 2015 a third route was opened through Turkey. Freight departing from Lianyungang traverses Kazakhstan, Azerbaijan, and Georgia and comprises two sea transit segments during a trip of about 14 days (depending on travelling conditions) before arriving in Istanbul, with the option of forwarding by truck to any Turkish city and a rail link to Bulgaria.[4] Chinese companies China Merchants and COSCO Pacific have purchased a 65 percent stake in Turkey's third-largest container terminal, Kumport. Located on the European side of Istanbul and just 35 kilometers from the Bosphorus Strait, Kumport is a gateway to the Black Sea region. From the terminal, China is building a dozen domestic rail lines with Belt and Road financing.[5]

Rail infrastructure is also being built in Southeast Asia. China has commenced construction of the $46 billion China-Pakistan Economic Corridor, and the China-Laos, China-Thailand, and Jakarta-Bandung railways—contracts worth over $20 billion—are to be completed by Chinese companies before 2020. Furthermore, the Chinese banks involved in financing the Belt and Road Initiative are negotiating with two dozen countries to build 5,000 kilometers of high-speed rail, at a total investment of $160 billion.

Belt and Road investments are not limited to infrastructure. For example, China's top cement maker Anhui Conch is building six large cement plants in Indonesia, Vietnam, and Laos, and CITIC Bank owns an oil field and an asphalt factory in Kazakhstan. The Silk Road Fund, a funding vehicle created recently by China's government to invest in equities, bought a 10 percent stake in the Yamal liquefied natural gas project of Russia's second-biggest gas producer, Novatek, in September 2015.[6] The fund has invested in Rusnano, Russia's nanotechnology holding, and is financing a large real estate development in Sri Lanka, with hotels, apartments, and office buildings, to be built on landfill near the Colombo harbor.[7] As another example, the Silk Road Fund is investing in a gas pipeline from the Bay of Bengal through Myanmar to Kunming.

3. Pepe Escobar, "Is There a Place for the West Along China's New Silk Road?" *The Nation*, November 23, 2015.

4. Christina Lin, "Erdogan's neo-Ottoman vision meets Xi's Silk Road dream," *Asia Times*, December 29, 2015.

5. Keith Bradsher, "China Plans a New Silk Road, but Trade Partners Are Wary," *New York Times*, December 25, 2015.

6. Cecily Liu, "Silk Road Fund and Russia's Novatek sign agreements on Yamal LNG project," *China Daily*, December 17, 2015.

7. Debasish Roy Chowdhury, "Sri Lanka clears the decks for controversial Chinese project," *South China Morning Post*, December 28, 2015.

This broad scope of projects suggests that the Belt and Road Initiative can be an umbrella for the expansion of China's general business interests abroad. If economic prospects for other, nonconstruction sectors darken at home, it is likely that Belt and Road funding will be made available for them too to expand internationally.

FUNDING THE INITIATIVE

Chinese banks hold more than $15 trillion in deposits. The country's foreign exchange reserves are over $3 trillion. The big four state-owned banks—the Bank of China, Industrial and Commercial Bank of China, China Construction Bank, and Agricultural Bank of China—have all evolved from government organizations into semicorporate entities and are the main channels for financing the Belt and Road Initiative. The Bank of China has already paid out $82 billion to three policy banks supporting Belt and Road projects: $32 billion to China Development Bank, $30 billion to Export-Import Bank of China, and $20 billion to the Agricultural Development Bank of China. The Chinese government has also earmarked $40 billion for the state's Silk Road Fund, money that comes directly from the national budget.

The multilateral Asian Infrastructure Investment Bank, founded in 2014 over the objections of the United States to finance Asian infrastructure,[8] has contributed $12 billion to the initiative, and its founders expect that it will eventually be able to lend $20 billion to $25 billion a year, similar to the $24 billion annual loan commitments of the World Bank in 2014. The government also expects the New Development Bank (also called the BRICS bank)[9] and the Shanghai Cooperation Organization to "support the efforts of governments of the countries along the Belt and Road and their companies and financial institutions with good credit rating."[10] The participation of so many countries in the two new multilateral development banks will facilitate rapid staffing with experienced professionals from other international financial institutions and thus support a large volume of financed projects.

CHALLENGES AHEAD

The Belt and Road Initiative faces three self-induced challenges. First, and (nominally) simplest, is the implementation of projects. Chinese companies have had some notable successes, for example, in turning around the port of Piraeus in Greece into a well-functioning and profitable enterprise. But they have also had some notable failures, such as the construction of Poland's A2 highway by the Chinese Overseas Engineering (COVEC) Group. The project, which was supposed to show Europeans the efficiency of Chinese construction companies, turned into a debacle.

In 2009 COVEC submitted a price bid that was less than half of the planned budget, based on expected savings from the use of imported equipment and their own financing. The idea of importing construction equipment and building materials was a mistake: China is too far away, and its machines are not certified for use in the European Union. Moreover, the Chinese parent corporation did not supply funding as planned, and COVEC was forced to look for credit financing. Worse still, the Chinese had not factored in the impact of rising

8. The Asian Infrastructure Investment Bank has 57 signatory members, of which 17 have ratified the articles of agreement. Participating countries span the northern and southern hemispheres and range from Australia to Iceland, Brazil to Egypt, Israel to Mongolia, South Africa to the United Kingdom.

9. The New Development Bank was established in 2015 as an alternative to the World Bank and International Monetary Fund to support the BRICs—Brazil, Russia, India, and China, which together operate the bank.

10. National Development and Reform Commission, "Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road," Beijing, March 28, 2015.

fuel prices, which increased costs by 20 percent.[11] In early 2011 the Chinese company tried to renegotiate the contract, and, failing to do so, left the project unfinished.

Then in 2015 in Turkey, the state-controlled China Machinery Engineering Corporation abruptly canceled a $385 million deal to buy a majority stake in the electricity grid of Eskisehir. Turkish Electricity, a nationwide grid company, is suing the Chinese company to collect a breakup fee.

The second challenge is the selection of projects to finance. With less experience in vetting projects than their competitors (e.g., the Asian Development Bank or the European Bank for Reconstruction and Development), the Chinese state banks may be at greater risk of investing in nonviable ventures. For example, industry analysts warn that the railway and road projects through Central Asia may not yield the expected returns if the volume of passengers and cargo is well below the acceptable levels.

The third and most important challenge, however, is to separate economics and politics and to not support projects for primarily political reasons. Failure to make this distinction will have a dual deleterious effect: (1) investments will not achieve the required returns, and (2) they may turn other countries—such as India, Russia, or the United States—against China's new initiative.

CONCLUSIONS

The Belt and Road Initiative is still relatively new. The first building blocks—the financing institutions like the Asian Infrastructure Investment Bank and the Silk Road Fund—are already in place. So are the first significant projects, such as a gas pipeline from the Bay of Bengal through Myanmar to Kunming and the rail link from Beijing to Duisburg.

If it succeeds, the initiative will reestablish Eurasia as the largest economic market in the world and may effect a shift away from the dollar-based global financial system. Its far-reaching geographic and development intentions put it in competition with the regional economic pacts advanced by the United States, the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership, which feature the United States as the economic center and treat Asia and Europe separately.

11. Jan Cienski, "China Group Sees Collapse of Poland Ambitions," *Financial Times*, June 14, 2011.

CHAPTER 2

ECONOMIC AND POLITICAL IMPLICATIONS

SEAN MINER

China's commitment to build a vast network of roads, rail lines, ports, and other infrastructure in more than 60 nations across Asia, Europe, and Africa, at a cost of $1 trillion, is widely seen as one of its major foreign and economic policy objectives.[1] This paper examines China's goals in three areas and outlines the obstacles that could disrupt its plans.

First, at a time when China's export-driven economy is lagging, the leadership in Beijing wants to boost its construction sector and open new markets for its exports, in order to make it easier for neighboring countries to import Chinese goods. China wants to ensure markets for its goods in order to maintain high growth during its transition from an export- and investment-led economy to one more dominated by services and consumption. A serious problem could arise if the recipient countries lack the capacity to build up their own export sectors or China continues to fail to open up its markets to their exports.

Second, in launching the initiative, China hopes to cement its relationship with countries in the region. But the Beijing leadership has yet to show evidence that it recognizes the suspicion that nearby countries may have toward its increasing role in their affairs or the fact that aggressive construction projects may spark wariness in Russia, India, Japan, South Korea, and other neighboring powers.

Third, China seeks to send a message to Europe and the United States that it wants to take its place as the preeminent power in Asia and be treated as an equal by advanced countries of the West. It has enlisted Britain, France, Germany, and other European countries in backing its Asian Infrastructure Investment Bank (AIIB), a major achievement. But it has failed to reassure the United States that it will adhere to international development standards on transparency and environmental protection. If it truly wants to be become an equal to the United States and Europe, China has to do more to adhere to international norms on development assistance, including by improving its internal investment policies and increasing its economic openness.

The world, especially Asia, will be watching closely to see how China acts in the Belt and Road Initiative. Some will be looking for China to misstep. China can show the world it deserves to be treated as an equal with other advanced nations only once it demonstrates that its intentions are good, its standards are high, and its investment will bring benefits to many.

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1. See Charles Clover and Lucy Hornby, "China's Great Game: Road to a New Empire," *Financial Times*, October 12, 2015, https://next.ft.com/content/6e098274-587a-11e5-a28b-50226830d644#axzz3pCLXH5tT.

ECONOMIC OBJECTIVES OF THE INITIATIVE

One of the stated goals of building a new Silk Road is to connect Asian, European, and African countries more closely, by extending loans from the Chinese government to sovereign countries, which will contract with Chinese construction companies. But what are the unstated economic objectives? Is China looking only to facilitate growth in its trading partners? Or is this initiative more about relieving overcapacity?

In theory China could reap huge economic benefits from the initiative, as the United States did in the first half of the 19th century, when it embarked on a huge infrastructure-building initiative to open new markets on its western frontier. China's strategy, however, must recognize the roadblocks in its path, including the unpredictability of Central Asian countries.

China's overcapacity has been well documented. Construction firms used to massive government spending on domestic infrastructure projects now risk sitting idle, and steel producers able to produce record volumes while demand wanes (Zhang and Zhao 2013, Zhou and Zong 2014). Construction of Belt and Road Initiative infrastructure is too far off to relieve many of these firms from their current distress. Moreover, even the higher estimates of spending (which exceed $1 trillion) represent just one-fifth of the $5 trillion a year China invests in fixed assets.[2]

The Belt and Road Initiative could alleviate some problems enough to allow companies to maintain operations, however, allowing firms to rethink their business plans. One option would be to move production out of China, allowing firms to take advantage of lower labor costs elsewhere in Central Asia and using the newly built infrastructure to facilitate exports back to China and globally.

Other advantages of the initiative are much clearer. For example, China has traditionally imported most of its oil and commodities through the South China Sea. But importing goods from the Middle East overland through the Gwadar Port in Pakistan reduces the distance travelled by 90 percent.[3] Common sense projects like this could yield very valuable economic benefits.

China should address concerns from other countries that believe increasing transportation capacity between China and other countries in the region will result in an even more unbalanced trade flow. Many countries along the Silk Road import far more from China than they export. Some rely mainly on the export of raw commodities to China to make up the balance. These countries may not be satisfied with just increasing commodity exports to China; they may want to diversify their exports, especially given the drop in commodity prices.

One way China has tried to sooth these concerns is to link construction of Silk Road projects to investments in industries that potentially could export more to China. Worried about the increasing bilateral trade gap, Russia found a Chinese firm to partner with the Russian Corporation of Nanotechnologies to fund new ventures in the high-tech sector in Russia.[4] Increased investment in select Russian industries could reduce Russia's dependence on China for some technologies and give it new products it could export to China, reducing the trade gap from both directions.

LIBERALIZATION OF TRADE AND INVESTMENT

Beijing could take advantage of the increased infrastructure from the initiative to negotiate more free trade agreements and investment treaties. China is currently a member of the Regional Comprehensive Economic

2. Bert Hoffman, "China's One Belt One Road Initiative: What We Know Thus Far," World Bank blog, December 4, 2015, http://blogs.worldbank.org/eastasiapacific/china-one-belt-one-road-initiative-what-we-know-thus-far.

3. Wu Hongyuran, "Bankers Behind 'Belt and Road' Business Surge," Caixin, December 29, 2015, http://english.caixin.com/2015-12-29/100893993.html.

4. Fu Jin, "China, Russia Eye Investment in Advanced Technologies," *China Daily*, May 11, 2015, http://www.chinadaily.com.cn/world/2015xiattendwwii/2015-05/11/content_20684209.htm.

Partnership (RCEP), a massive regional trade agreement under negotiation that includes Japan, India, Korea, all members of the Association of South East Asian Nations (ASEAN), and other countries. Negotiating RCEP is a start, but developments so far have not been encouraging, as deadlines pass and the degree of liberalization being considered appears to shrink.

China's best bet to facilitate trade with the countries involved in the Belt and Road Initiative is to reduce tariffs under the World Trade Organization (WTO). Doing so would lower tariffs for all most favored nations exporting to China and provide broad benefits, as the majority of benefits from trade liberalization come from reducing one's own trade barriers. To truly be an engine of global growth, a country should be a net purchaser rather than a net seller of global products. In 2015 China had one of the largest merchandise trade surpluses in history at over $450 billion.[5] As a result of its entry into the WTO and subsequent bilateral trade agreements, China has gone a long way in lowering tariffs with its trading partners, but tariffs and nontariff barriers still remain on a wide variety of products (Jiang 2013).

China has largely steered away from liberalization of tariffs on services, a sector in which the percentage of state-owned firms, which are reluctant to open up to further competition, is high. Part of the Belt and Road Initiative is the "digital Silk Road," which seeks to create an Internet community that would facilitate cross-border e-commerce, Internet banking, and media.[6] Many countries cannot compete with China on the production of goods but, enabled by increased Internet connectivity, could help reduce their trade deficits with China by increasing their exports of services.

In order for China to reap increased trade benefits from other countries, it must lower its own trade barriers, including nontariff barriers such as licensing requirements, complex regulations, and product quotas (Bergsten, Hufbauer, and Miner 2014). Reducing these barriers would help further China's goals of repositioning its economy from one driven by investment and exports to one driven more by services and consumption.

CHINA'S POLITICAL AND STRATEGIC INTERESTS

China's long-term goal is to be the dominant power in Asia. To achieve this goal, it must recognize that it has to give as much as it gets. Foreign policy must be balanced and steered away from exploitation.

Central Asia, which traditionally was in Russia's sphere of influence, is increasingly becoming an integral part of Beijing's plans for Asia. The Belt and Road Initiative will step into the territories of other countries (such as India) as well. China has grand plans to prop up Pakistan under the Pakistan-China Economic Corridor, but it may need to tread lightly when working next to a weary New Delhi. It must adopt more mature development policies with Belt and Road countries, avoiding promising the moon and then failing to deliver it.

China must integrate the goals of the Belt and Road Initiative with the mandate of the Shanghai Cooperation Organization (SCO), founded in Shanghai in 2001 (current members include China, Kazakhstan, Kyrgyzstan, Russia, Tajikistan, and Uzbekistan; India and Pakistan are set to become full members in 2016). That mandate includes military cooperation on regional security as well as economic and social development. China has major plans for the SCO. Increased connectedness and exchange among member countries will be key to further developing relations. Fitting India into China's long-term plans will not be easy, but increasing connections between Beijing and New Delhi would be smart long-term policy.

Latin America is an example of China rushing headfirst into big projects without fully taking many issues, including local politics, into account. Now that China's economy has slowed, many countries, and politicians

5. China's State Administration of Foreign Exchange (SAFE) balance of payments data (accessed on February 7, 2016).

6. Zhao Huanxin, "Web Companies Asked to Support 'Digital Silk Road,'" *Telegraph*, July 27, 2015, www.telegraph.co.uk/sponsored/china-watch/technology/11764541/tech-companies-to-build-digital-silk-road.html.

have realized that their dependence on China may be excessive; the economic downturn in Latin America is increasingly being tied to the region's connection with China. Projects have been cancelled or significantly delayed in a number of countries, including Colombia, Mexico, Nicaragua, and Venezuela, some for reasons that could have been foreseen.[7] One example of a poorly thought-out project is the ambitious plan for a railroad stretching from the Pacific to the Atlantic through Peru and Brazil. Many obstacles stand in the way of its development, including local labor laws, which make it difficult to hire foreign workers, concerns about corruption, physical barriers of the Andes Mountains and the Amazon River, as well as a lackluster reputation for actions such as gross overbilling, as is the case of China's state-owned oil firm Sinopec in Brazil.[8]

CHINA'S RISING GLOBAL INFLUENCE

China's ambitious Belt and Road Initiative should adopt international standards while operating in the international development arena. China would do well to reassure the United States and the rest of the world of its intentions. In order to provide the fairest development assistance, China should begin to welcome more foreign investment and trade within its borders. Increasing the reciprocity of trade flows would not only increase the commercial value of the infrastructure, it would increase the commercial value of the infrastructure projects. Sending Chinese ships and trains to Turkey to offload exports and having them return to China empty is not a sustainable model of infrastructure investment.

For its part, the United States has some ground to make up. It initially rejected the establishment of the AIIB, it took five years before it agreed to reforms at the International Monetary Fund (IMF) that gave China and other developing countries a bigger say in the institution's decision making, and it pressured Europe not to allow China to have market economy status in the WTO. Moreover, the United States blocked China's entry into the negotiations of the Trade in Services Agreement (TiSA). The consistently negative signs from the United States give the Chinese cause to celebrate when they win battles against it. China's success with the AIIB (which has more than 60 members) was seen as a decisive victory against the United States in a global soft power battle. Washington would do well to be seen as a cautious supporter of China's Belt and Road Initiative, as it did by not blocking the IMF's decision to make the yuan a Special Drawing Rights (SDR) currency.

To increase the chance of success of the Belt and Road Initiative, China should increase consultations with local communities and conduct more surveys including market research and community concerns. It could also soften its loan requirements that projects must use Chinese goods and workers. Actions such as these could significantly increase goodwill. It would be best for China to communicate its intentions for each project for all stakeholders, including neighboring countries. The projects themselves have to be creditworthy, be built to international standards, and made to last. If the infrastructure does not last long, neither will Beijing's image.

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7. Simon Romero, "China's Ambitious Rail Projects Crash Into Harsh Realities in Latin America," *New York Times*, October 3, 2015, www.nytimes.com/2015/10/04/world/americas/chinas-ambitious-rail-projects-crash-into-harsh-realities-in-latin-america.html

8. China's state oil firm, Sinopec, faces charges of gross overbilling for a pipeline it overbuilt in Brazil. See Eduardo Bresciani, Vinicius Sassine, and Alexandre Rodrigues, "Former Manager of Petrobras Acted to Increase Pipeline Price," *O Globo*, January 8, 2016, http://oglobo.globo.com/brasil/ex-gerente-da-petrobras-atuou-para-aumentar-preco-de-gasodutos-14994716.

CHAPTER 3

GOVERNANCE CHALLENGES

EDWIN M. TRUMAN

The Belt and Road Initiative provides a unique opportunity for China to demonstrate global leadership. Details of the initiative are sketchy at this point, but China clearly will have to address major implementation and governance challenges. Assuming the initiative is real and not just a propaganda platform and assuming that China's neighbors and more distant economies are to be the principal beneficiaries rather than the Chinese economy itself, the Belt and Road Initiative should be implemented through structures and procedures that are as open and transparent as possible.

China should establish a coherent governance architecture involving all potential participants in the Belt and Road Initiative. Ad hoc implementation through an array of bilateral and multilateral arrangements and domestic institutions will be prone to inefficiency, corruption, and conflict.

China is using the initiative to signal the shift in its global role from an international agenda follower to an agenda setter. To reinforce that change China should minimize new borrowing from multilateral development banks (MDBs) and quickly repay what it owes them and strengthen its role as a creditor. This step would not only signal China's changed status but also free up resources in these institutions to support Belt and Road projects in other countries.

CHINA IN THE WORLD TODAY

China's leaders are justly proud of the fact that China is now the largest economy in the world in terms of its 2015 GDP measured on a purchasing-power-parity (PPP) basis.[1] On the other hand, China's GDP per capita, on a PPP basis, ranks only 82nd in the world at $14,200, substantially lower than many of its potential partners in the Belt and Road Initiative, such as Malaysia, Kazakhstan, Russia, Turkey, Azerbaijan, Thailand, and Turkmenistan.[2] Moreover, the International Monetary Fund (IMF) projects that by 2020 China will have moved up only to number 77.

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1. Purchasing power parity adjusts the measurement of GDP in terms of the purchasing power of a country's currency with respect to another country's currency, normally the US dollar. The IMF (2015) estimates that China's GDP in PPP terms was $18.1 trillion compared with $17.3 trillion for the United States. At market prices and exchange rates, China's GDP was $11.4 trillion, compared with $18.0 trillion for the United States. China's income distribution is highly unequal ("China Income Inequality among the World's Worst," *Financial Times*, January 14, 2016). Its income per capita is $8,280, but its median disposable income is about $3,000. (The figures in this footnote are from the IMF's *World Economic Outlook* Database, October 2015, www.imf.org/external/pubs/ft/weo/2015/02/weodata/index.aspx, except the last figure, which is from Scissors 2016.)

2. The United States, on this metric, ranks 11th behind several small countries and oil producers as well as Switzerland.

The central issue for the Chinese economy over the next decade is whether it will avoid the middle-income trap, which few economies have been able to do. Between 1960 and 2008, only 13 economies escaped this trap, including Hong Kong, Ireland, Israel, Korea, Singapore, and Taiwan, while four times that number remained trapped.[3] Rapid growth is often fueled by a demographic dividend from slowing population growth and by a shift of labor from rural areas, where it is underemployed, to urban areas, where it becomes fully employed. Growth, in time, is slowed by a decline in the rate of capital accumulation as more gross investment is devoted to replacing the capital stock, as growth of the labor force slows, and, most important, as total factor productivity declines (Eichengreen 2011).

China does not lack for advice on how to avoid the middle-income trap. The Organization for Economic Cooperation and Development (OECD 2013) argues that the key is continued economic reform to boost innovation, broaden and deepen the financial system, increase the efficiency of land policies and labor markets, among other policies. These reforms should encourage more domestic consumption and discourage reliance on investment and exports. Trade should embody more Chinese value added and direct and indirect reliance on services. Escaping or, in the Chinese case, avoiding the middle-income trap is possible, but there is no magic formula.

In the meantime, the discrepancy between China's economic size and its economic prosperity underlines a tension regarding China's objectives in the Belt and Road Initiative. Is the objective to promote China's leadership in the region and the world, or is the principal aim to advance China's economic development and facilitate its economic transformation? Is this a Marshall Plan for Eurasia or a vent for surplus plan to utilize the excess capacity in China's economy? To date, the answer seems to be both. China is playing a two-level game involving both diplomacy and domestic economic policy. The implementation and governance challenges are whether one game will get in the way of the other.

ECONOMIC ARCHITECTURE

The economic case for the Belt and Road Initiative is overwhelming. The Asian region will benefit from improved infrastructure, increased cross-border investment, and reduced barriers (both economic and logistical) to trade, in particular in Central Asia. By also seeking to build better links to Europe and likely Africa, the initiative has the potential to touch the lives of an estimated 3 billion to 4 billion people in 60 countries or more. However, the range of estimates of how many people and economies will benefit from the Belt and Road Initiative indicates the vagueness of the enterprise.[4]

Infrastructure in the Asian region, as in other parts of the world, needs to be improved significantly. The region also is underserved by Asian-centric multilateral institutions. Moody's rates more than 35 multilateral institutions around the world, and the Asian Development Bank (ADB) is the only one that is active predominantly in the Asian region, soon to be joined by the Asian Infrastructure Investment Bank (AIIB). Unlike the Marshall Plan, which laid the foundation for post-World War II European economic integration through the European Payments Union and the Organization of European Economic Cooperation (superseded later by the Organization for Economic Cooperation and Development), China has not proposed an international architecture to coordinate the Belt and Road Initiative.

With respect to financing, China proposes to use the AIIB, the New Development Bank (NDB), and potentially a Shanghai Cooperation Organization (SCO) financing institution as far as multilateral institutions are concerned (NDRC 2015). Otherwise it plans to rely on Chinese-only institutions such as its Silk Road Fund,

3. *Economist*, May 27, 2012, www.economist.com/blogs/graphicdetail/2012/03/focus-3.

4. China itself has investment and construction projects estimated at $462 billion in East Asia, West Asia, and the Arab Middle East and North Africa, 38 percent of the global total of $1.2 trillion (Scissors 2016).

the China Development Bank, Export-Import Bank of China, and other policy banks. The role of financing from the private sector is undetermined.

As far as cooperation and coordination are concerned, China again proposes to use existing forums ranging from the SCO and Asia-Pacific Economic Cooperation (APEC) to the China-Arab States Cooperation Forum (CASCF) and the Asia-Europe Meeting (ASEM). China envisions using vehicles such as memorandums of understanding, bilateral pilot projects, and other mechanisms as well as extending its network of swaps and trade agreements (NDRC 2015).

It is far from clear how all these pieces will be put together without an overarching architecture for the initiative's design and governance. It would appear that China intends to wield the majority of the levers at least as far as Chinese money is involved. As is always the case with this type of endeavor, outsiders can be suspicious of whether the project will be oriented inward toward China's needs or open to the rest of the world. Will the construction result in Fortress Asia or a Chinese Co-Prosperity Sphere? The leaders and citizens of other countries, whether potentially directly involved or not, are justified in being somewhat suspicious of China's motives in putting forward the Belt and Road Initiative. Is this a soft-power initiative, a hard-power initiative, or hard power wrapped in soft power?

FIRST RECOMMENDATION

To allay some of these concerns, my first recommendation to the Chinese authorities is that they establish a formal mechanism for cooperation on and coordination of the Belt and Road Initiative. The structure might stop short of full institutionalization, but it should have a secretariat drawn from participating countries. These countries should commit to following international standards and safeguards in implementing Belt and Road projects. A governance structure would facilitate the design and financing of successful multilateral projects, which is very challenging. The vastness of the Chinese vision for the Belt and Road Initiative might dictate the establishment of several parallel structures, for example, linked to East Asia, West Asia (including the subcontinent), and the Middle East and Africa.

IMPLEMENTATION

A number of potential participating countries in the Belt and Road Initiative have a weak record on issues such as corruption. Chinese officials are fond of saying that they do not interfere in the internal affairs of other countries. But countries, such as China, that aspire to responsibility for the stability of the global economy and financial system cannot duck their obligations by turning a blind eye to violations of international norms. An implementation and governance structure would enhance the transparency of the Belt and Road Initiative as a whole.

The test for China is not just how well it organizes and executes the Belt and Road Initiative but also how well it exercises its responsibilities in the global economic system now that it has claimed a place as the largest economy, its voting share in institutions like the IMF has increased to third place, it is positioned to assume a greater share of votes in the World Bank, and its currency has been accepted into the basket of currencies used to set the value of the IMF's special drawing rights. Big important countries have increased responsibilities along with their increased rights.

China's major focus in its Belt and Road Initiative should not be primarily to make sure that the various projects directly support the Chinese economy by utilizing excess capacity in industries such as steel. In any case, experts such as David Dollar (2015) and Bert Hofman (2015) estimate that the likely benefits in this respect are minimal in contrast with the views of Francis Cheung and Alexious Lee (2015). China should instead use the Belt and Road Initiative to benefit other countries and thereby indirectly benefit its own economy. If the project boosts the economies of its neighbors and partners, China will reap some economic benefits, just as the United States did from the recovery of the European economies as a result of the successful Marshall Plan, but aiding the US economy was not the primary objective of that initiative.

The Chinese authorities have exercised their responsibilities admirably in connection with the establishment of the AIIB. They have not reserved the majority of voting and other powers to China; they have been open to the employment of nationals from nonmember countries; they have been open to procurement in nonmember countries; and they promise that the AIIB will respect international standards and safeguards with respect to the environment and fairness to affected parties, even though the leadership of the AIIB has indicated it wants to streamline the application of those standards and safeguards. The small question is whether the AIIB, in its role as one of the financing vehicles of the Belt and Road Initiative, is broadly successful in living up to international expectations.

China also wants to streamline the project approval process in the AIIB compared with other MDBs and not to have a resident board of directors that has to approve each project.[5] Some modernization of the standard practices of MDBs is a reasonable goal as is some degree of competition among MDBs.

A larger question concerns Belt and Road activities that are not vetted through the AIIB or other MDBs and instead are financed by Chinese institutions or organized as ad hoc joint projects. What standards and safeguards will be applied in those projects? Without the transparency associated with international standards and safeguards, the scope for corruption is increased. A related issue involves the responsibility for the projects themselves. If they are largely Chinese managed and built, not only will the domestic economy not benefit from the employment benefits but also the scope for conflicts and inefficiencies is increased.[6] Derek Scissors (2016, 6) reports that $273 billion in Chinese investment and construction projects around the world are "troubled transactions that have experienced cost overruns, lengthy delays, or just outright failure after terms were supposedly finalized and activity begins." He notes that China is not solely or at all responsible in some of these cases.

When it comes to the financing of Belt and Road projects *inside* China, the authorities should maximize use of their own financial resources or rely on resources from the private market and minimize their drawing on the limited financial resources of the multilateral institutions such as the World Bank, the ADB, the AIIB, and potentially the NDB.

SECOND RECOMMENDATION

Consequently, my second recommendation to the Chinese authorities on implementing the Belt and Road Initiative is that they should signal a change in China's global status by accelerating the repayment of its existing obligations to the World Bank and ADB and minimizing any new borrowing from these institutions. China has $17 billion in outstanding obligations to the World Bank and was the second largest borrower in 2015.[7] At the end of 2014, ADB exposure to China was $14 billion, 26 percent of its total exposure. It would not make a

5. NDB also may play a role in the Belt and Road Initiative. Less is known about the intentions and operations of this institution and to date participation is limited to only its five founding members, of which Russia, India, and China are slated also to be touched by the Belt and Road.

6. See Vietnam's experience with the Chinese project to build an urban railway in Hanoi, which is three years behind schedule (*Washington Post*, "Wary of Beijing, Vietnam leans toward U.S.," December 29, 2016; see also *New York Times*, "China's Global Ambitions, Cash and Strings Attached," July 24, 2015, "China Plans a New Silk Road, but Trade Partners Are Wary," December 25, 2105, and "A Chinese Company in India, Stumbling over a Culture," December 30, 2015.

7. This figure does not include substantial International Finance Corporation (IFC) investments in China.

dent in China's international reserves to accelerate the repayment of these obligations.[8] China's action would free up financial resources for other less-well-off participants in the Belt and Road Initiative.

The leadership of China will have difficulty embracing this suggestion. They still see China as a developing country with the advantages that come with that status. They also reportedly value the Banks' technical assistance and capacity building and oversight of projects in distant provinces where governance is weak. On the other hand, the leadership of China aspires to first-rank status, and countries that enjoy that status, as well as many others, do not borrow from development banks though they may still receive technical assistance. Nevertheless, countries that have major responsibilities in international institutions and also are major borrowers from them risk the appearance, if not the reality, of conflicts of interest.[9]

CONCLUSION

The world is watching how China manages its Belt and Road Initiative. The potential benefits to China, its immediate neighbors, and a large portion of the world are substantial. For the initiative to succeed, China should establish a coherent governance architecture to oversee the projects in each region. To reinforce China's emergence as a major economic and financial power through this initiative, China should accelerate the repayment of its obligations to the World Bank and ADB and minimize borrowing from these MDBs or the AIIB for its own Belt and Road projects.

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8. China is repaying the World Bank on a net basis. Over the past five years it has borrowed $5.2 billion and repaid $9.2 billion.

9. See the controversy surrounding the IFC's investment in the privatization of China's Postal Savings Bank (*Financial Times*, "World Bank Exit Highlights China Fears," December 30, 2016).

CHAPTER 4

SILK-ROAD TYPE PROJECTS: LESSONS FROM SOME HISTORICAL EXAMPLES

ROBERT Z. LAWRENCE AND FREDRICK TOOHEY

China's Belt and Road Initiative is a project of truly historic proportions. If successful, it has the potential to deliver significant benefits to China and its neighbors.

To realize this potential, both China and the recipient nations must overcome numerous institutional challenges. This chapter draws on a variety of historical experiences to explore the nature of these challenges. It does so not to argue that history will repeat itself or to imply that the project replicates the precise conditions of the examples chosen but to reflect on what history tells us about both the potential and pitfalls that have been associated with such endeavors in the past.

The first section shows that Central Asia's trading potential is severely constrained by both poor infrastructure and weak institutions. The second section uses the example of Great Britain's involvement in the United States in the 19th century to show that internationally funded infrastructure projects can significantly boost growth and development in countries when accompanied by appropriate policies. The third section shows that funding and building infrastructure are not enough: Projects must reflect the priorities of recipient countries, respond to market forces, and be accompanied by domestic policies that maintain and regulate the use of the infrastructure. The fourth section argues that although they are led by governments, these projects are economic ventures that rely heavily on profit-oriented firms. History suggests that private and public incentives often collide in these types of initiatives. It is important that governments avoid letting firms pressure them into costly and disastrous political and economic entanglements.

NEED FOR THE INITIATIVE

Inadequate infrastructure in Central Asia has greatly restrained economic development in general and trade in particular.[1] Most of the region's infrastructure was built as a single system during the Soviet era and was not designed to meet the needs of separate countries (International Crisis Group 2011). After the collapse of the Soviet Union, some Central Asian countries claimed sole ownership of pieces of infrastructure as a way to assert their independence (Odum and Johnson 2004). Post-Soviet regimes have made little effort to repair or replace aging infrastructure. In Tajikistan the situation has become so bad that residents have access to electrical power for less than 12 hours a day (International Crisis Group 2011). These deficiencies suggest that Chinese

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1. The World Economic Forum ranks the quality of the region's roads at 3.3 out of 7, lower than any other region except Sub-Saharan Africa, which scores 3.2. China scores 4.6 and developed countries average 5.6. Rail infrastructure is even worse, with the average score for Central Asian countries of just 2.9 (WEF, Global Competitiveness Index Historical Dataset, 2005–2014).

investment could provide an important boost to Central Asia's struggling economies. Improved infrastructure alone will not be able to integrate them into the international economy, however. Both maintenance and appropriate regulation of the infrastructure China provides are essential.

Regional trade in Central Asia is held back by regulations that are inefficient or reflect rent seeking and corruption. The average ranking of Central Asian countries on the World Bank's Doing Business measure of ease of trading across borders is 127th.[2] The World Economic Forum's *Global Enabling Trade Report* also highlights the poor quality of customs administration throughout the region (WEF 2014).

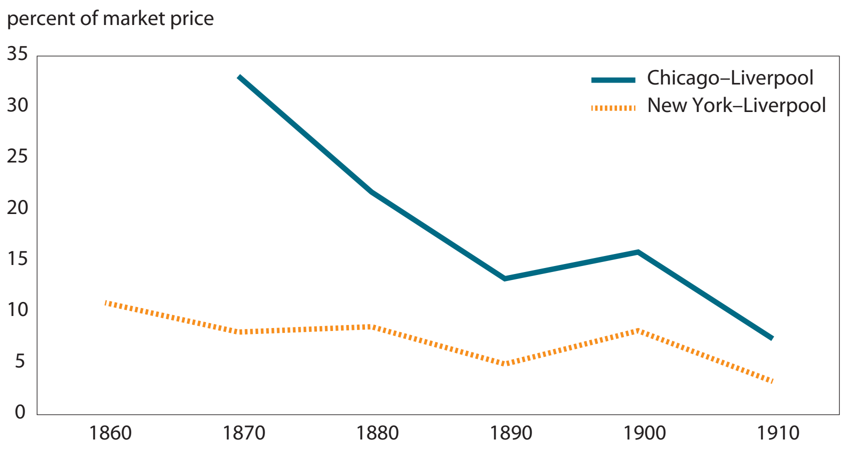
China's plans for the Silk Road do not ignore these problems. The National Development and Reform Commission (NDRC 2015), China's premier economic planning agency, states that the initiative intends to promote greater regulatory harmonization with its neighbors and encourage "opening up" in the countries where it invests. The plan also emphasizes the importance of sovereignty, however, and China's desire to cooperate with existing regimes. This dual commitment presents a dilemma for Chinese economic planners, as Central Asia's ruling class benefits greatly from privileges and rents, which open trade and more contestable markets could undermine. Central Asia would benefit greatly from Chinese infrastructure investment, but the Belt and Road Initiative is unlikely to succeed unless China reconciles its policy of political noninterference with the necessity of reform.

A SUCCESS STORY: THE UNITED STATES AND GREAT BRITAIN IN THE 19TH CENTURY

In the history of industrialization in the 19th century, the United States stands out as a shining example of how complementary trade policies and investments in infrastructure can contribute to growth. Britain's elimination of tariffs in 1846, with the repeal of the Corn Laws, provided the United States with huge opportunities to export agricultural goods.[3] Additional opportunities were created in the 1870s, when technological advances and investments in infrastructure (financed by Britain) dramatically lowered transportation costs (Findlay and O'Rourke 2007). Before the 1870s, most grain from the US Midwest traveled to the East Coast by way of the Great Lakes and the Erie Canal. From this point forward, railroads took over as the primary mode of transportation.

Transatlantic transportation costs fell 5 percent between 1870 and 1890 (figure 1), while transportation costs between

Figure 1 Cost of transporting wheat from Chicago and New York to Liverpool, 1860–1910



Source: Findlay and O Rourke (2007).

2. Documentary compliance for imports costs $317, significantly more than the world average of $242 or the Chinese figure of $171.

3. Tariffs on corn had been as high as 40 percent (Schonhardt-Bailey 2006).

the US interior and the East Coast fell roughly 15 percent. The impact of railroad development in the United States—most of which was financed by British capital—was thus enormous. Sensing opportunity after the repeal of the Corn Laws, British investors began to pour money into US railroad companies, helping mileage grow 2,000 percent between 1850 and 1890 (US Census Bureau 1890). As these new lines stretched into the interior, they enabled American farmers to take advantage of newly opened British markets. Complementary regulation sped this process, as the US government granted huge tracts of land to railroad companies, significantly reducing the cost of building new railway lines. Later, in the administration of Theodore Roosevelt, regulations were introduced to control the railroads' monopoly power.[4]

It is often claimed that US growth in the 1800s was the result of protectionism, because especially in the second half of the century, the government enacted high tariffs on many goods. However, the fact that transatlantic price differences of both raw materials and manufactured goods narrowed dramatically over the century shows that reductions in transportation and logistics costs were larger than the increase in tariffs and that the US economy actually opened up to the rest of the world over this period.

It is unlikely that Central Asia will follow the same meteoric trajectory as the United States. However, the impact of British railroad financing in the United States does suggest that improvements to Central Asia's infrastructure would allow the region to become a much more active player in the international trading system. The benefits of the railroads would have been more subdued without the repeal of the Corn Laws: High tariffs presented stiff headwinds for US exports and dampened enthusiasm for investment in US railroads. This observation suggests that Central Asian governments should also be given access to export markets in both China and the rest of the world. A more open Chinese market can complement Chinese finance.

FAILURE: THE TAZARA RAILROAD PROJECT

History is littered with projects that failed to reach completion or quickly fell into disrepair. A perfect example with which many Chinese are familiar is the Tanzania-Zambia Railway (TAZARA). Built by China in the early 1970s, it was designed to provide copper-rich regions of Zambia and Tanzania with an export corridor that did not traverse unfriendly, white-ruled Rhodesia or South Africa.[5] Planners imagined not only a bustling industrial corridor that would benefit mining companies but also an artery that would bring life to hundreds of new agricultural settlements along the tracks.

TAZARA was completed in 1975, two years ahead of schedule. At the time of its completion, it represented the third-most expensive infrastructure project ever undertaken on the African continent. Upkeep on the railroad proved similarly expensive. China had footed the bill for construction, but repairs were left to the much poorer governments of Tanzania and Zambia (French 2010). This arrangement meant that TAZARA struggled to maintain its equipment from the outset, and the situation quickly deteriorated as bureaucrats from both countries took advantage of opportunities for corruption. By 1978—just three years after the railway was completed—breakdowns had reduced the number of daily trains traveling on TAZARA from 17 to 2.

Financing is not solely to blame for TAZARA's failure: Tanzania and Zambia also lacked enough trained personnel to maintain the railway. During construction China supplied more than 13,000 engineers and technical advisors, but they were there to build the railroad, not develop local capacity. Compounding these problems, Tanzania and Zambia never invested in infrastructure along the tracks, meaning that the hoped-for agricultural belt never took shape, leaving demand for the railroad flat (French 2010).

4. The Hepburn Act of 1906 set maximum shipping rates, prevented preferential treatment of some customers, and gave the Interstate Commerce Commission power to set reasonable rates unilaterally.

5. Tanzania-Zambia Railway Authority, "Our History," http://tazarasite.com/?page_id=131.

TAZARA's failure should remind Chinese officials of the importance of a comprehensive strategy that involves local commitments and buy-in. Infrastructure is not a one-time investment, and it does not exist in a vacuum. To succeed, China's Belt and Road Initiative must make an ongoing commitment to the projects it funds and engage deeply with host governments to ensure responsible operations and complementary policies.

CONFLICTING OBJECTIVES AND POLITICAL ENTANGLEMENTS

The Belt and Road Initiative has explicitly political objectives: A primary goal is to "establish and strengthen partnerships among countries along the Belt and Road" (NDRC 2015). Officials will incentivize investment in projects to advance China's interests, hoping that firms will conduct business in a way that achieves these benefits.

History shows that international investments can have negative political side effects. Even if an economic agent is created to support a country's foreign policy objectives, it can quickly develop interests of its own that are fundamentally at odds with those of the state. In the most disastrous of cases, an economic agent can drag the sovereign into a political or military quagmire. The British East India Company was set up to operate on a strictly economic basis, reaping profits from trade with India's Mughal Empire. It made modest profits before realizing, around 1748, that it could gain much more by manipulating the political situation. The company used superior European military technology to conquer most of India, repressing local populations in order to extract as much wealth as possible. It ruled India until 1857, when a rebellion forced the British Crown to intervene. The next century of colonial governance was not a strategic decision made by the country's foreign policy establishment but a necessity created by the rational, self-interested action of a private company.

Similarly, the British became embroiled in the Opium War as a result of the East India Company's trade in China. The company profited greatly by selling opium, which wreaked havoc on China's population. Efforts by the Qing Empire to block the drug's sale represented an existential threat to the East India Company's profits. To protect those investments, the British government waged war against the Chinese, eventually securing the right to free trade in China and the possession of colonies, including Hong Kong.

Britain was not the only country that allowed private interests to pull it into foreign conflicts. The United States also succumbed to the pressure of a private company when the United Fruit Company convinced it to support a coup in Guatemala in 1954. United Fruit owned huge tracts of land, as well as most of the country's transport infrastructure. It therefore felt threatened when Guatemala's president, Jacobo Arbenz, announced sweeping nationalization and land reform programs. To protect its interests, the company—which counted Secretary of State John Foster Dulles among its shareholders—launched a campaign to paint Arbenz as a dangerous communist. The coup installed a series of brutal dictators who ruled until 1996, embarking on campaigns of genocide against the Mayan peoples and contributing to instability in the region.

It is by no means certain that the Belt and Road Initiative will drag China down a path similar to the ones presented here, but the diversity of these experiences—as well as their enormous consequences—demonstrates the need for caution and strong political oversight. China has made it clear that it will respect the national sovereignty of the countries in which it will sponsor Belt and Road projects. In practice, however, once large investments have been made, it can be difficult to remain neutral and aloof in the face of domestic political conflicts that threaten the viability and solvency of projects in which a country has invested. Investments by the Chinese government and its enterprises have made China the largest foreign investor in many of the least stable countries in the world.[6] The Belt and Road Initiative is likely to add to these risks. Considerable politi-

6. Clifford Krauss and Keith Bradsher, "China's Global Ambitions, Cash and Strings Attached," The China Factor, Part I, *New York Times,* July 24, 2015, www.nytimes.com/2015/07/26/business/international/chinas-global-ambitions-with-loans-and-strings-attached.html.

cal and diplomatic skill will be required to deal with the potential challenges these investments are likely to present.

If the past is indeed prologue, the Belt and Road Initiative has the potential for high payoffs for both China and the countries in which it will invest. But history also points to the likelihood that these payoffs will be realized only if the financial resources provided are complemented with institutional reforms and political policies.

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CHAPTER 5

ROUGH PATCHES ON THE SILK ROAD? THE SECURITY IMPLICATIONS OF CHINA'S BELT AND ROAD INITIATIVE

CULLEN S. HENDRIX

On its face China's Belt and Road Initiative is an economic policy predicated on infrastructure development, designed to radically expand trade and investment in Asia and around the Indian Ocean. The proposed investments are precisely the types of trade-facilitating projects development economists have long called for—but its geopolitical implications are not uncomplicated. From the restive western Chinese province of Xinjiang to Jammu and Kashmir, the Myanmar-Chinese border, and the South China Sea, Belt and Road–related initiatives target or traverse some of the world's most contested territories. Major power development programs—such as the United States' Marshall Plan and Alliance for Progress—have always been predicated on a mixture of economic and security concerns. Like them, the Belt and Road Initiative is intended in part to address security concerns emanating from these regions by improving economic prospects.

On the security front, the initiative provides one big potentially security-enhancing opportunity stemming from the security effects of further regional economic integration, particularly with countries currently perceived as competitors, at least in certain contexts. The picture, however, is not entirely rosy. The Belt and Road Initiative entails significant security risks, stemming from the short-term creation of soft targets related to specific infrastructure projects in potentially volatile areas and the longer-term geopolitical impacts of these projects for India. In both the best- and worst-case security scenarios, the elephant in the room is of the *indicus* subspecies.

OPPORTUNITIES

The Belt and Road Initiative seeks to further integrate China with the economies of Asia, Africa, and the Middle East and establish common interests among China's trading and investment partners as well as between linked countries. Trade and financial integration tend to reduce conflict between states, raising the opportunity costs—in terms of forgone trade and access to capital—associated with conflict and creating vested domestic interests that prefer peace to war (Oneal, Russett, and Berbaum 2003; Gartzke 2007). The rise of global supply and production networks—in which intermediate goods are often not immediately substitutable from other sources and therefore incentives to maintain existing supply chains are strong—only enhances these tendencies (Brooks 2007). If the Belt and Road Initiative ultimately supports such production networks, they should yield some security dividends.

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Whether Belt and Road–related investments are a boon to regional prospects for peace will hinge crucially on whether these investments come in the form of quasi-public goods (which can be accessed and used by all parties) or whether they constitute some form of club good for Chinese allies or even private goods for Chinese interests. If Chinese-financed ports in Bangladesh, Iran, Kenya, Myanmar, and Sri Lanka are open to ships from any country, the security ramifications of these ports will be small. If access is limited to Chinese vessels or those of closely allied powers, these ports will be viewed as provocations.

Many parallels have been drawn between the Marshall Plan and the Belt and Road Initiative. Most focus on the wrong detail—the difference in magnitude of the financial commitments associated with each. The scope of the Belt and Road Initiative is staggering. Just one of its components will reportedly develop 81,000 kilometers of high-speed rail, more than doubling the world total.[1] If the Chinese government reaches its pie-in-the-sky funding target of $4 trillion, the investment would be roughly 31 times larger than the Marshall Plan.

A more striking similarity is that of intention: Both initiatives reflect self-conscious attempts by major powers to develop and integrate the economies of their neighbors and trading partners in order to avoid militarized competition. The Marshall Plan was one of the most successful security initiatives of the Cold War, helping integrate European economies and forestall a return to the economic competition and arms races that had catalyzed two world wars. It remains to be seen whether the Belt and Road Initiative will match the successes of the Marshall Plan, but it is similar in ambition.

In this vein, the realization of joint gains from the Belt and Road Initiative could help resolve long-standing territorial disputes. Simmons (2005) argues persuasively that mutually recognized borders reduce uncertainty about investment in previously disputed territory and thus reduce uncertainty about the benefits of cross-border investment and trade. To the extent the Belt and Road Initiative facilitates greater trade integration between linked economies, it may help resolve long-standing territorial disputes, such as the disputes in Jammu and Kashmir (especially the Trans-Karakoram Tract, jointly claimed by China and India) and emergent disputes between China and a host of neighbors (the Philippines, Vietnam) with claims in the South China Sea, where China is busily building infrastructure (and in some cases, the islands on which that infrastructure rests).[2] Although not all relevant actors are likely to see dispute resolution as an unambiguously positive development—militaries, for example, have grown accustomed to the inflated budgets and clout these territorial disputes confer—the potential economic and security gains are significant (Gibler 2012, Schultz 2015).

RISKS

The potential security benefits of the Belt and Road Initiative are large. They are balanced, however, by several risks stemming both from infrastructure expansion itself and its geostrategic implications for India.

Vulnerability of Infrastructure in Volatile Areas

The Belt and Road Initiative is a series of massive infrastructure projects, including highways, railways, ports, pipelines, electrical substations, and dams. It will create a vast network of Chinese nationals and Chinese firms—and therefore Chinese national interests—in areas where local actors may wish to provoke responses from the Chinese government.

1. Zhiqun Zhu, "China's AIIB and OBOR: Ambitions and Challenges," *Diplomat*, October 9, 2015, http://thediplomat.com/2015/10/chinas-aiib-and-obor-ambitions-and-challenges/ (accessed on December 8, 2015).

2. See the Asia Maritime Transparency Initiative, http://amti.csis.org/category/south-china-sea/ (accessed on December 22, 2015).

Much of this investment is slated to occur in volatile areas. South and Southeast Asia are home to a disproportionate number of the world's national self-determination movements (such as the movements of the Timorese in Indonesia and the Assamese in India), virtually all of which have used violent means to contest state claims to rule (Gallagher 2014). The China-Pakistan Economic Corridor (CPEC), for instance, plans to link the western Chinese city of Kashgar to Pakistan's warm-water deep-sea port at Gawdar. To do so, the project will need to traverse territory dominated by marginalized ethnic minorities in both states (the Balochs in Pakistan, the Uyghurs in China) and pass through the contested Jammu and Kashmir region, already the site of competing territorial claims (as described below). The Bangladesh-China-India-Myanmar Economic Corridor (BCIM), a planned highway connecting Kolkata and Kunming, would pass through territory in Myanmar dominated by Kachin or Shan ethnic autonomy movements.

Infrastructure is the skeletal system of the state: Roads and power grids are the most obvious mechanisms by which the state projects it authority in areas where its penetration is otherwise weak or contested (Besley and Persson 2010). For this reason, infrastructure projects are especially contentious when they occur in areas where ethnic or religious minorities seek autonomy or self-determination (Morgan and Reiter 2013).

Infrastructure and the attendant construction projects make for enticing targets for violent dissidents looking to make headlines, wreak havoc, and/or ensnare a more powerful foe in a costly counterinsurgency campaign. The risks associated with attacks on infrastructure projects are both direct (affecting workers, companies, and local service providers in unstable environments) and indirect. If historical precedent holds, Chinese laborers will bear much if not most of the burden. Internally, the greatest risks are in the vast Xinjiang Uyghur Autonomous Region. Xinjiang has been called the core area of the Silk Road Economic Belt, the overland component of the Belt and Road Initiative that would connect China via road, rail, and energy networks to eight bordering countries (Afghanistan, India, Kazakhstan, Kyrgyzstan, Mongolia, Pakistan, Russia, and Tajikistan). Domestically, the region has been targeted for economic development since 2000 as part of the Western Development Plan, a sweeping set of investments in education, infrastructure, and industrial development designed to address the region's lagging economic prospects; solidify Chinese government authority; and extend Han Chinese influence in the region.

Xinjiang is home to 10million to 15 million members of the Uyghur ethnic group, a Turkic, overwhelmingly Muslim people. Smaller numbers of Uyghur live in several neighboring countries. Groups claiming to represent the Uyghur people have contested Chinese rule since at least 1960. They received the backing of the Soviet Union after the Sino-Soviet split; Uyghur-Chinese conflict precipitated the Sino-Soviet border conflict of 1969.

More recently, the Chinese government has sought to link Uyghur separatist groups, particularly the East Turkestan Islamic Movement (ETIM), to al-Qaeda and other international jihadist groups.[3] Although China has not been a hotbed of terrorist activity, unrest in Xinjiang may be on the rise. Dramatic attacks on Ürümqi (the Xinjiang provincial capital) and nearby Kunming in 2014, ostensibly by Uyghur dissidents, killed more than 100 civilians in 2014.[4] Fifty more civilians were killed in an attack on a coal mine in Aksu in September 2015.

Externally, violent dissidents may attack Chinese interests in hopes of provoking a diplomatic or militarized response by the Chinese government, especially when the Chinese government has significant economic or political leverage over the government against which dissidents are in rebellion. Conflict dynamics along

3. "China Says Global War on Terror Should Also Target Uighur Militants," *Reuters*, November 16, 2015, www.reuters.com/article/france-shooting-china-idUSKCN0T506M20151116 (accessed on December 8, 2015).

4. National Consortium for the Study of Terrorism and Responses to Terrorism (START), Global Terrorism Database, www.start.umd.edu/gtd (accessed on December 8, 2015).

the border between Myanmar and China already highlight some of the potential dangers. Kachin and Shan separatists have been at war with the Myanmar government for most of the last 40 years; some of the pipeline projects intended to diversify China's energy infrastructure pass through their territory. Rebels killed two Myanmar nationals working as subcontractors for the China National Petroleum Corporation (CNPC) at a compound of the Myanmar Oil and Gas Enterprise (CNPC's local partner) in May 2013.[5] Though the official Chinese response was muted, China has flexed its muscle in the past when Myanmar's internal conflicts have affected it. In 2013 it essentially forced the Myanmar government and Kachin Independence Organisation (KIO) separatists to the negotiating table after clashes between the KIO and the Myanmar armed forces led to shells being fired into Chinese territory (International Crisis Group 2013).

Both internally and externally, infrastructure projects related to the Belt and Road Initiative will put Chinese workers and Chinese interests in contested areas, increasing the likelihood that they will become targets of attacks and increasing the likelihood that the Chinese government will feel compelled to do something about it.

The Indian Elephant in the Room

Credible projections have India nosing out the United States to become the world's second-largest economy (after China) by 2050, though the gap may be much larger than the current gap between the China and the United States (PwC 2015). These events will make Asia the undisputed locus of the global economy, with the Indian Ocean supplanting the North Atlantic as the world's most important shipping corridor.

The Belt and Road Initiative will include India, but it will also effectively encircle it by creating a system of overland and maritime trade and transit routes that tie China to India's neighbors, several of which have fraught security relationships with India. The initiative potentially threatens Indian interests in at least three ways (two direct and one indirect), by increasing Chinese and Pakistani activity in the disputed Jammu-Kashmir region, increasing the Chinese naval presence in the Indian Ocean, and raising concerns about asymmetric gains from Belt and Road–related economic development.

Jammu-Kashmir is one of the last powder kegs in global geopolitics. Most of Asia's land-based claims have been resolved or lay dormant. The competing claims of India and Pakistan to Jammu-Kashmir are a live issue, pitting nuclear armed rivals against one another in the shadow of a third larger nuclear power (China) with its own ambitions in the region. The creation of the CPEC, slated to run through the disputed territory, will solidify Pakistan's de facto control of the area. Although it is unlikely to lead to direct military confrontation between the Indian and Pakistani governments—which deescalated a series of border skirmishes in 2014 and 2015—the region is home to a variety of armed nonstate groups. Lashkar-e-Taiba, the Pakistan-based militant group responsible for the 2008 Mumbai attacks, and its successors, Harkat-ul-Mujahideen and Al-Badr, are just some of the militant groups seeking to establish Islamic rule in Indian-held parts of the region. On the Indian side, armed Hindu civil defense forces and Bajrang Dal, the youth wing of the Hindu nationalist Vishva Hindu Parishad (VHP) party, have engaged in agitation in the region. If development spurs an uptick in cross-border clashes between nonstate armed groups, it may be a matter of time before national militaries once again become involved.

While India's defense community watches developments to the north with keen interest, longer-term challenges may lie to its south. China's People's Liberation Army Navy (PLAN) focuses largely on coastal de-

5. Jacob Gronholt-Pedersen and Celine Fernandez, "Myanmar Pipelines on Schedule Despite Attack," Dow Jones Newswire, May 17, 2013, www.rigzone.com/news/oil_gas/a/126556/Myanmar_Pipelines_on_Schedule_Despite_Attack (accessed on December 8, 2015); National Consortium for the Study of Terrorism and Responses to Terrorism (START), Global Terrorism Database, www.start.umd.edu/gtd (accessed on December 8, 2015).

fense, the securing of China's territorial and commercial interests in the East and South China Seas, and some antipiracy activity in the Gulf of Aden. However, its vast network of global economic interests is poised to change that focus, especially in the Indian Ocean, the principal sea lane connecting China to Europe, the Middle East, and Africa. China's maritime Belt and Road–related projects, such as port development in Bangladesh, Iran, Kenya, Myanmar, and elsewhere, are intended to boost Chinese trade and engagement with Indian Ocean partners.

Greater Chinese emphasis on the Indian Ocean will increase Indian suspicion of China's activities in its maritime backyard. India has been the ocean's regional hegemon since the 1990s, and it still fields two aircraft carriers to China's one. This hegemony may be threatened. India's carriers are based on the aged Soviet *Kiev* platform (the *Liaoning* is based on the *Kiev* class's successor, the *Kreml* class); China's rapid development of attack submarine and ship-to-air missile defense technology will soon mitigate any advantage these carriers might have conferred (ONI 2015).

Setting aside the Jammu-Kashmir and Indian Ocean issues, there is the more general concern that the Belt and Road Initiative will be a larger economic boon to India's rivals than to India, engendering concerns about relative gains with respect to perceived military competitors. Security scholars have long debated whether states are concerned primarily with absolute gains or gains relative to potential adversaries (Waltz 1979, Grieco 1988, Powell 1991). If relative gains are of greater concern, states may forgo international cooperation in the economic and security realms if they believe the distribution of benefits tilts the balance of power between them and their potential adversaries in an undesirable manner.

If states are not initially enmeshed in conflictual—or at least contentious—relations, concerns about the security implications of relative gains are relatively trivial, and both states can be expected to pursue Pareto-improving deals without worrying much about the relative distribution of benefits (Snidal 1991). To the extent that states perceive their potential partners as military rivals, however, concerns over relative gains may become key.

This question has obvious relevance for India. Although it will be involved in some Belt and Road projects, the greatest gains from the initiative may accrue to countries it perceives as real or potential security threats. There is little doubt that India perceives China as a competitor in South Asia and the Indian Ocean (whether China perceives India as a competitor is less certain). India clearly perceives Pakistan—set to be a major beneficiary of Belt and Road largess—as a rival. To the extent the Belt and Road Initiative increases China's already considerable economic lead over India and contributes to more rapid development in Pakistan, the Indian government can be expected to perceive these developments as unsettling, if not outright threatening. Of course, this source of tension may be mitigated by India's ability to make use of Chinese-funded infrastructure. To the extent these investments are truly public (albeit congestible) goods, India may gain as much as or more than its potential competitors.

CONCLUSIONS

The Belt and Road Initiative has the potential to radically alter the security landscape in Asia, linking regional economies in ways that massively increase the economic costs of war and instability and bringing development to long-marginalized regions and people. Both developments would promote peace. However, the process is likely to entail some significant security risks, in both the short term, as infrastructure projects expand into restive regions and contest local authority, and the long term, as the initiative includes but also encircles India. Given that economically the 21st century will belong to China and India, maintaining peaceful relations between the two powers will be one of the century's central foreign policy challenges.

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CHAPTER 6

THE BELT AND ROAD INITIATIVE IN THE FORMER SOCIALIST BLOC

SIMEON DJANKOV

In April 2012 the first China–Eastern Europe New Silk Road forum took place in Warsaw, hosted by Polish Prime Minister Donald Tusk and attended by nearly all Eastern European prime ministers. At the meeting Chinese premier Wen Jiabao announced the start of a large Eurasian infrastructure project that would link the two continents through land, sea, and rail—and thus European politicians first learned (informally) about China's Belt and Road Initiative.[1]

China also offered to coorganize an annual event in different Eastern European capitals to gauge progress on the new initiative, and Eastern European and Chinese prime ministers met in Prague (2013), Belgrade (2014), and Suzhou (2015) to discuss and sign several projects. Such gatherings are now called the "16+1 Cooperation Program" of the Belt and Road Initiative.[2] Two-way trade has taken off between China and the Eastern European countries since the announcement, exceeding $65 billion in 2015.

But so far there are few realized projects under the Belt and Road Initiative. A high-speed rail completed under the initiative now connects Budapest and Athens to move (mostly Chinese) cargo from the Greek port of Piraeus, privatized to the Chinese company COSCO in 2010, to Austria and Germany. And China is financing, at a total cost of $2 billion, the construction of a bridge over the Danube in Serbia and a Budapest-to-Belgrade rail that will continue through Macedonia and Greece back to Piraeus. Thanks to Chinese investment in upgrading and expanding container terminals, Piraeus has become the fastest-growing port in Europe, and by end-2016 should have the same capacity—6 million containers a year—as the ports of Rotterdam, Hamburg, and Antwerp.

The success of the Belt and Road Initiative in Eastern Europe will depend on how closely it can corroborate governments' own efforts to develop their economies and raise the standard of living of their population. This success also depends on whether the Belt and Road Initiative can incorporate the countries lying between China and Eastern Europe—countries of the former Soviet Union. From that perspective this chapter reviews three case studies of former Soviet countries that have become eager participants in the Belt and Road Initiative: Kazakhstan, Georgia, and Russia. As progress on infrastructure projects is still nascent, the chapter aims to show how the initiative may fit into these countries' national development agendas.

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1. China officially announced the initiative in October 2013.

2. The 16 Eastern European countries are Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Montenegro, Poland, Romania, Serbia, Slovakia, and Slovenia. Updates on meetings and activities are posted on the website for Cooperation between China and Central and Eastern European Countries (China-CEEC Cooperation; www.china-ceec.org/eng/).

CASE STUDY 1: KAZAKHSTAN

Kazakhstan has been an early supporter of China's Belt and Road Initiative, seeing it as an opportunity to diminish its dependence on Russia for exports and transit routes. Indeed, the volume of Kazakhstan's trade with China now exceeds that with Russia. Trade between the two countries leapt from $1.3 billion in 2001 to $28 billion in 2015, now accounting for one-third of Kazakhstan's foreign trade.

A major locus of activity under the initiative is Korgas, a town that straddles the border between Kazakhstan and China and until recently was known largely as the most corrupt international crossing for backpackers on their way through Asia. That is likely to change soon, as Kazakhstan has selected the town for the site of a new dry port and rail yard. Kazakh and Chinese politicians expect that enhanced Korgas facilities will handle 20 million tons of cargo a year by 2020. This is so far the most significant Central Asian transportation project under the Belt and Road Initiative.

The Korgas pass was used for cross-border trade from the times of the original Silk Road until 1971, when the Soviets closed it. It is now part of a larger Belt and Road investment package for Kazakhstan, building on recent major developments. In December 2011 Kazakhstan completed a 180-mile railway from Korgas to its largest city, Almaty, using loans from the Asian Development Bank and World Bank. The tracks from the Chinese and Kazakh sides of the border were connected the following year, and by the end of 2015 the tracks will be upgraded for cargo train use, making this the second Europe-China rail link via Kazakhstan. It complements the existing 6,950-mile Yuxinou (Chongqing-Xinjiang-Europe) International Railway from China into Kazakhstan and from there through Russia, Belarus, and Poland and ultimately to Duisburg, Germany.

Another large Kazakh infrastructure project with Belt and Road financing is the 5,100-mile Western Europe–Western China road, which will be the shortest highway link between Central Asia and Europe. When completed in late 2016, it will be used to promote the growth of industry in the vast economically underdeveloped region. The European Bank for Reconstruction and Development, World Bank, Asian Development Bank, and Islamic Development Bank are providing $4 billion in funding for the highway, and the Silk Road Fund has offered another $3 billion toward its completion.

China and Kazakhstan are collaborating on other fronts as well. In December 2014 they signed an investment agreement on infrastructure, energy, and logistics worth over $14 billion, and in May 2015 the two countries signed another $30 billion in potential projects, mostly in energy infrastructure, making Kazakhstan the largest single beneficiary of China's largesse.

However, nearly all these projects are yet to be started, and some are not even on the drawing board. Moreover, the economic rationale for Kazakhstan's investment in these projects is unclear: Although it is true that eventually China will be able to ship cargo to Europe more cheaply using rail than existing sea routes, there is little to ship from Kazakhstan to China. The return trips are empty.

Furthermore, China is mostly interested in financing projects that transport oil and gas to fuel its economy. As one example, Kazakhstan has received a $1.8 billion loan from the China Development Bank to construct an 800-mile gas pipeline from Beyneu in western Kazakhstan to Shymkent near the Chinese border. From there, the newly constructed pipeline will connect with the Central Asia–China gas pipeline. Silk Road Fund financing is also under consideration for the construction of Pipeline C, a third gas pipeline into China. When all three pipelines are fully operational, they could deliver up to 60 billion cubic meters of gas to China annually—about half of China's anticipated demand. This clearly serves China's needs. How well it serves Kazakhstan's desire to diversify the drivers of its economic growth away from natural resources remains to be seen.

CASE STUDY 2: GEORGIA

Georgia has been particularly active in drumming up interest in its investment opportunities under the Belt and Road Initiative. This is understandable: The country has fallen on difficult times, squeezed on the one hand by its neighbor Russia and on the other by the slow-moving process of accession to the European Union. Both Russia and Europe have traditionally been the largest investors in Georgia, and their lack of enthusiasm lately because of the falling national currency has dampened economic growth. Hence the eager seeking out of a new investor: China.

To pique the interest of Chinese investors, Georgia hosted a regional Belt and Road forum in October 2015 and intends to make it an annual event. Politicians and businesspeople from 30-odd countries attended, and the Chinese delegation alone numbered several hundred. At the forum Prime Minister Irakli Garibashvili outlined four possible projects for Belt and Road investments:

- Construction of a new deepwater seaport in Anaklia, to handle 100 million tons of cargo per year, with the capacity to receive large Panamax-type vessels.
- Modernization of Georgia's railway network. Two large tunnels being constructed to connect Georgia's east and west regions will increase rail speed in the country by 50 percent and triple its capacity.
- Construction of a new railway connecting Georgia and Azerbaijan to Kars, Turkey, and through it the European Union. The new Baku-Tbilisi-Kars railroad will allow 45 percent faster transport of 5 million tons of cargo and 1 million passengers annually from Asia to Europe. Its capacity can triple in subsequent years.
- Expansion of the East-West Highway, Georgia's main transport road, with support from the World Bank, Asian Development Bank, and other donors.

The proposed railway projects are in keeping with other Belt and Road projects being financed in Afghanistan, Kazakhstan, Macedonia, Pakistan, Russia, and Serbia.

To illustrate the possible benefits of investment in Georgia's railway system, the government reported the results of a recent experiment that tested and demonstrated the efficiency of transport connections between Xinjiang province and the Georgian port of Poti, a distance of some 2,300 miles: Railway cargo loaded in China on January 29, 2015, was unloaded in Georgia on February 6.[3] The experiment involved not only Georgia and China but also Kazakhstan and Azerbaijan, as the cargo passed through their territory and was inspected by their customs authorities.

This transit test yielded an unintended finding. The seven days it took for the cargo to travel comprised five days of actual travel and two days for border control and other inspections. In other words, nearly a third of the time in transit was spent dealing with administrative hurdles. So even if Belt and Road financing enables improvements in the infrastructure for high-speed trains, the total duration of the cargo transport will improve by only a day or two. But if at the same time customs procedures are simplified and standardized along the whole transportation corridor, time will be cut in half. The message to Belt and Road officials is clear: Invest in administrative reforms too. Improvements in concrete infrastructure are only part of what is needed.

Here, Georgia has something to offer all other Belt and Road participants: According to the World Bank's Doing Business project, it has the region's most simplified customs procedures.[4] If China, Kazakhstan, and Azerbaijan—the countries alongside this route—adopt the same rules, the new transportation corridor will be much faster—and therefore cheaper.

3. Speech by Prime Minister Irakli Garibashvili at the regional Belt and Road Forum in Tbilisi, October 14–15, 2015.

4. Data available at www.doingbusiness.org (accessed on February 11, 2016).

CASE STUDY 3: RUSSIA

At a June 2011 meeting in Moscow, Russian and Chinese presidents Dmitry Medvedev and Hu Jintao set targets of $100 billion in bilateral trade by 2015 and $200 billion by 2020. The two countries were initially on track to meet these goals, but recently attainment has become impossible because of falling energy prices, currency devaluations, and Western sanctions on some Russian industries.

Between 2011 and 2014 trade between Russia and China grew nearly 30 percent, to $96 billion in 2014. Russia exported $42 billion to China, mostly in oil and gas, but also ferrous and nonferrous metals and timber, while China exported $54 billion to Russia, mostly in light machinery, apparel and shoes, chemicals, and food products.

To enhance trade between the two countries, the new Trans-Eurasia railroad was built in 2011–14 from southwestern China through Kazakhstan and Russia to Belarus, Poland, and finally Germany. The 6,950-mile line, now complete, is primarily used by China to ship $3 billion worth of goods to Europe annually. Russia is also starting to use it and shipped about $260 million worth of goods to China in 2014.

When Presidents Medvedev and Hu announced their bilateral trade goals, the Chinese economy had nearly double-digit GDP growth (9.3 percent in 2011), world oil prices were $110 per barrel (Brent crude), and an extension of the Eastern Siberia–Pacific Ocean oil pipeline to supply China with an additional 300,000 barrels a day was just completed, boosting Russian exports. Several bilateral megaprojects were under discussion too. The most ambitious were negotiations by Gazprom and China National Petroleum Corporation (CNPC) on the construction of the Power of Siberia pipeline, worth a projected $400 billion; the Altai gas pipeline, terminating in China's Xinjiang region; and Novatek's Yamal liquefied natural gas project, in which CNPC planned to increase its stake from 20 to 30 percent, with a capacity of 16.5 million tons of oil per year.

Since then, bilateral trade has hit a snag. According to Russia's Federal State Statistics Service, in 2015 the country's trade with China dropped by 30 percent, to $64 billion, largely because of the plunge in natural resource prices, particularly for oil and gas.[5] Fossil fuels account for nearly two-thirds (62 percent) of Russian exports to China. Another factor is the Russian economy's recession in the wake of sanctions imposed by the European Union and United States. Russia imported 36 percent fewer Chinese goods in 2015 relative to the preceding year. This decline is also partly due to the currency devaluation by both countries, especially Russia. No wonder that at the September 2 meeting between Presidents Vladimir Putin and Xi Jinping in Beijing, there was a proposal to base future trade relations and joint investment projects on local currencies (both the ruble and the yuan). The two countries moved from proposal to agreement in 2015.

Overall, lower energy prices, the slowing Chinese economy, and Western sanctions on the sale of technology for oil and gas exploration have slowed or frozen all megaprojects. The Power of Siberia project may be pushed back by a year, and negotiations on the Altai pipeline have been temporarily suspended, as has further Chinese investment in the Yamal liquefied natural gas project. These suspensions are in part because CNPC has scaled back its forecast for Chinese demand for gas in 2020 from 400 to 310 billion cubic meters, due to the slowdown in the economy.

Russia needs to find ways to diversify its exports to China. One sector that has benefited (at least temporarily) from the imposition of Western sanctions is food processing. Turning this into a lucrative export sector is not an easy task, but it is achievable over a five-year span. Meat and dairy products are one promising subsector that can gain efficiency and create export-driven growth. Other such sectors are nanotechnology, heavy machinery and equipment, and aviation. All require substantial investments and new markets.

5. Data available at www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/en/figures/trade (accessed on February 11, 2016).

This is where the Belt and Road Initiative may serve Russia's interests. When it was first announced in 2012, Russian officials viewed it with suspicion—as an instrument of Chinese influence in Russia's backyard of Central Asia. In response, Moscow pushed hard for the implementation of the Eurasian Economic Union, a competitor project. Since then, however, Russia has had a change of heart and joined several Belt and Road projects and become a founding member of the Asian Infrastructure Investment Bank (AIIB). The Belt and Road Initiative is used to circumvent Western sanctions on the Russian banking sector and gain access to much needed investment and credit lines.

In February 2015 Russian companies signed the first financing projects under the Belt and Road Initiative: a $5.8 billion high-speed rail between Moscow and Kazan (to be extended to Yekaterinburg at a later date); a $966 million credit line to Sberbank, Russia's largest state-owned bank, to finance road and logistics infrastructure; and a $483 million credit line to VTB, the country's second-largest state-owned bank, for investments in agriculture and transportation. The high-speed rail project is of particular importance as it links cities that will host the 2018 World Cup.

And these are just the initial investments. The full rail project connecting Russia's capital to the border with Kazakhstan is priced at $21.4 billion, mostly Chinese investment and with the bulk of the construction work expected to be performed by Chinese companies. Russian companies will likely participate in the construction of infrastructure in Central Asia, where initial projects, mostly in Kazakhstan, are estimated at $200 billion. In a period when the Russian government has reduced budget expenditures on infrastructure by a third, due to the increasing fiscal deficit, these projects provide a welcome substitute.

It also helps that all contracts are now signed in local currency, thus obviating the need to worry about currency exchange fluctuations and dependence on the dollar. Over time, Chinese and Russian policymakers expect that a full-fledged Belt and Road Initiative, worth the equivalent of $4 trillion, will reduce the power of the dollar as global currency.[6]

6. Chen Aizhu, "Russia, China Agree to Settle More Trade in Yuan and Rouble," Reuters, September 9, 2014.