

# A ROAD TO RICHES OR A ROAD TO RUIN?

THE GEO-ECONOMIC IMPLICATIONS  
OF CHINA'S NEW SILK ROAD





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*The Hague* Centre for Strategic Studies (HCSS)

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**Authors:** Sijbren de Jong

Willem Th. Oosterveld

Michel Roelen

Katharine Klacansky

Agne Sileikaite

Rianne Siebenga

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*The Hague* Centre for Strategic Studies

Lange Voorhout 16  
2514 EE The Hague  
The Netherlands

info@hcss.nl  
HCSS.NL



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## **A Road to Riches or a Road to Ruin?**

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### ***The Geo-economic Implications of China's New Silk Road***

*The Hague* Centre for Strategic Studies

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## 1. Introduction

China's One Belt One Road (OBOR) project was formally introduced by Chinese President Xi-Jinping in 2013. The project, aimed at integrating trade and investment in Eurasia, encompasses over \$900 billion in planned investments of infrastructure across Central and South Asia, the Middle East, and Central and Eastern Europe (CEE) (Figure 1).<sup>1</sup>



Figure 1: China's One Belt One Road (OBOR). Design: HCSS.

China further demonstrated its determination by hosting a 2-day Summit on the 'New Silk Road' in May of 2017. The Summit welcomed delegates from over 100 countries, taking the opportunity to announce lavish new financing plans. A \$14.5 billion contribution was pledged to the Silk Road Fund,<sup>2</sup> RMB 250 billion (\$38 billion) in special lending schemes will go to the China Development Bank, and RMB 190 billion (\$19.9 billion) will be dedicated to the Export-Import (ExIm) Bank of China to support cooperation on infrastructure, industry capacity and financing.

A dedicated forum for cooperation with CEE countries has been around now for several years. Originally created in April 2012, 'the so-called '16+1' framework'<sup>3</sup> constitutes a platform which brings heads of state together annually to strengthen

<sup>1</sup> Tom Hancock, "China Encircles the World with One Belt, One Road Strategy," *Financial Times*, May 4, 2017, <https://www.ft.com/content/0714074a-0334-11e7-aa5b-6bb07f5c8e12>.

<sup>2</sup> The Silk Road Fund is a state-owned investment fund to aid investments in countries along the OBOR route that was established in December 2014.

<sup>3</sup> The 16+1 forum brings together leaders from China and 16 Central and Eastern European states: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Montenegro, Poland, Romania, Serbia, Slovakia, and Slovenia.

dialogue and cooperation between China and the CEE region. In November 2016, during the last Summit of the '16+1' framework, China launched a €10 billion investment fund to finance projects in the CEE region.<sup>4</sup> Because CEE presides over a population of over 120 million with an ever-increasing per capita income, it offers market opportunities for Chinese products and Foreign Direct Investment (FDI). Moreover, many countries in the region have a good ratio between the quality and the cost of labor infrastructure. More importantly is the geographical proximity to Western Europe, which allows it to act as a 'bridge to Europe' and ensures that it plays a crucial role in ensuring that the OBOR reaches its final destination.<sup>5</sup> For this purpose, Chinese investment interests within the CEE region appear strongly related to privatization opportunities, including large scale infrastructure projects and public procurement opportunities.<sup>6</sup> China's interest in the region, and the creation of the '16+1' format in particular, also gives rise to concerns that China is attempting to use the region as a medium through which to influence the EU from within. This influence manifests itself primarily in the form of initiatives which aim to persuade and/or pressure CEE countries to adopt favorable policies vis-à-vis China.<sup>7</sup> These concerns stem from two directions. First, there is a fear that some deals concluded with China may not comply with EU rules on public procurement, or other regulations and guidelines. Second, there is a fear of political influencing, which some see exhibited by the EU in avoiding direct references or statements towards China's legal defeat over the South China Sea after the objection by some member states.<sup>8</sup>

Turning to the Middle East, China's engagement in this part of the world is arguably the most important component of the OBOR initiative as far as its strategic objectives are concerned. This is because China needs the region's fossil fuels – which account for over half of its total consumption – to sustain its economic growth, if not its long-term economic stability. As a result, China's interest in the region is likely to remain significant in the decades to come. Based on the 1-2-3 strategy that Beijing laid out in its 2016 Arab Policy paper,<sup>9</sup> it enunciates a clear interest in developing strong structural ties within the region, particularly with fossil fuel exports being the centerpiece, at least for the initial stage. This also means of course that China will

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<sup>4</sup> Reuters, "China Launches \$11 Billion Fund for Central, Eastern Europe," *Reuters*, November 6, 2016, <http://www.reuters.com/article/us-china-eastern-europe-fund-idUSKBN13105N>.

<sup>5</sup> Shannon Tiezzi, "China's 'Belt and Road' Reaches Europe," *The Diplomat*, November 26, 2015, <http://thediplomat.com/2015/11/chinas-belt-and-road-reaches-europe/>.

<sup>6</sup> Valbona Zeneli, "Central and Eastern Europe: China's Stepping Stone to the EU?," *The Diplomat*, November 30, 2016, <http://thediplomat.com/2016/11/central-and-eastern-europe-chinas-stepping-stone-to-the-eu/>.

<sup>7</sup> Dragan Pavličević, "China in Central and Eastern Europe: 4 Myths," *The Diplomat*, June 16, 2016, <http://thediplomat.com/2016/06/china-in-central-and-eastern-europe-4-myths/>.

<sup>8</sup> Angela Stanzel, Justyna Szczudlik, and Dragan Pavličević, "China's Investment in Influence: The Future of 16+1 Cooperation," *European Council on Foreign Relations*, December 14, 2016, <http://country.eiu.com/article.aspx?articleid=1774788161&Country=Latvia&topic=Economy>; Robin Emmott, "EU's Statement on South China Sea Reflects Divisions," *Reuters*, July 15, 2016, <http://www.reuters.com/article/us-southchinasea-ruling-eu-idUSKCN0ZV1TS>.

<sup>9</sup> See "China's Arab Policy Paper," accessed February 13, 2017, [http://www.fmprc.gov.cn/mfa\\_eng/wjdt\\_665385/2649\\_665393/t1331683.shtml](http://www.fmprc.gov.cn/mfa_eng/wjdt_665385/2649_665393/t1331683.shtml).

almost inevitably get embroiled in political matters, and thus pose a challenge to the interests of other key players such as Russia, the US and the EU. While China seeks to avoid becoming yet another outside power that meddles in the region's affairs, it does already show signs of being prepared to become politically engaged.

In its engagement in the Middle East, China's policy is banked on the hopes of being the newish entrant in the region, which absolves it from any imperialist or interventionist baggage. This notwithstanding, regional players, are going to be tempted to play the China card when dealing with the other major (outside) powers, which will effectively pull China into the region's political vortices. China's early forays of dispute settlement activity (Israel/Palestine, Syria) could therefore be seen as ways to test its reputation in the political realm.

Given OBOR's unprecedented scale, the goal of this paper is to investigate the extent to which OBOR related investments in CEE and the greater Middle East bring sufficient economic weight to both regions that at the same time can be turned into political influence. If this is indeed the case, a pertinent question to ask is whether China is prepared and willing to play a greater political (and/or security) role in CEE and the Middle East in the first place? In addition, the paper seeks to understand whether China's role can be judged as positive or negative for regional security, as seen from the viewpoint of Europe and the Netherlands.

## **2. China's economic activities in Europe**

The formation of the '16+1' agreement between China and 16 CEE countries in 2012 marked the first step towards an expansion of China's trade plans in the region. From 2010 to 2015, trade between China and the 16 CEE countries increased by 20%, reaching a total of \$56.2 billion.<sup>10</sup> A year later, China launched an \$11 billion investment fund to finance projects in the CEE region.<sup>11</sup> When looking at Central Europe, China's investments into the Czech Republic are noteworthy. Between 2014 and 2015 Chinese FDI into the country skyrocketed by \$279.9 million (Figure 2); a significant engagement.

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<sup>10</sup> Xinhua, "'16+1' Mechanism Opens up New Chapter of China-CEE Cooperation," accessed May 23, 2017, [http://english.gov.cn/premier/news/2016/11/07/content\\_281475485506400.htm](http://english.gov.cn/premier/news/2016/11/07/content_281475485506400.htm).

<sup>11</sup> "China's Twelve Measures for Promoting Friendly Cooperation with Central and Eastern European Countries," January 26, 2015, [http://www.china-ceec.org/eng/zdogjhz\\_1/t1410595.htm](http://www.china-ceec.org/eng/zdogjhz_1/t1410595.htm).

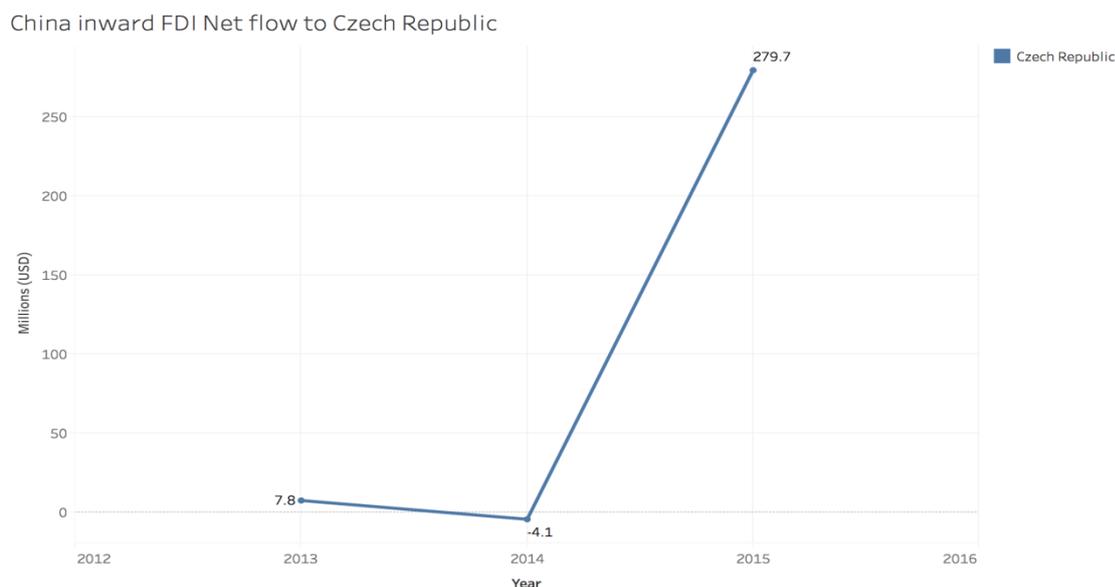


Figure 2: China inward FDI to the Czech Republic. Data: OECD. Design: HCSS.

This jump in FDI came about after Czech President Miloš Zeman brought a group of Czech businessmen to Beijing in 2014.<sup>12</sup> That same year, Czech-Slovak financial services J&T and the Chinese Energy Company (CEFC) agreed to an investment of €1.4 billion, marking a new phase of strategic cooperation.<sup>13</sup> In 2015 CEFC continued its shopping spree by buying a 60% stake in football club SK Slavia Prague,<sup>14</sup> 10% in Travel Service;<sup>15</sup> operated by the airline Smartwings—the second-largest shareholder in Czech Airlines after Korean Air. In 2016, the company handed over \$311.50 million for a nine-story building in Prague where it will house companies such as the Bank of China and HSBC.<sup>16</sup> In 2016, the Bank of China and Huawei made over \$700 million in investments in the Czech Republic.<sup>17</sup> By contrast, Poland and Hungary attract more erratic investment flows from China. Outside of a \$200 million investment in building the second largest Huawei supply center in the world near Budapest,<sup>18</sup> China’s focus in these two countries tends to be concentrated on the energy and railway sectors.

<sup>12</sup> André Kühnlenz, “Chinese Investments in Eastern Europe,” 2015, <https://www.apa.at/cms/ceeAward/pdfGenerator.html?doc=CMS1447849748055>. p.14

<sup>13</sup> Ibid.

<sup>14</sup> Emma Gonzalez, “CEFC Takes 60% Stake in Slavia Prague,” *China Daily*, September 8, 2015, [http://europe.chinadaily.com.cn/business/2015-09/08/content\\_21815690.htm](http://europe.chinadaily.com.cn/business/2015-09/08/content_21815690.htm).

<sup>15</sup> Jason Hovet, “China’s CEFC Adds to Czech Buying Spree with Airline, Brewery Deals,” *Reuters*, September 5, 2015, <http://www.reuters.com/article/us-czech-china-cefc-idUSKCN0R50B320150905>.

<sup>16</sup> Cheyenne Hollis, “Czech It Out: China Heads Further into Europe With \$312M Prague Deal,” *Mingtiandi*, November 14, 2016, <http://www.mingtiandi.com/real-estate/outbound-investment/czech-it-out-china-heads-further-into-europe-with-312m-office-buy/>.

<sup>17</sup> Giacomo Fracassi, “#China: Xi Jinping’s Czech Visit Aims to Reach out to Europe,” *EU Reporter*, March 30, 2016.

<sup>18</sup> Marton Dunai, “Factbox: China’s Investments in Hungary,” *Reuters*, June 25, 2011, <http://www.reuters.com/article/us-hungary-china-factbox-idUSTRE75O1DY20110625>.

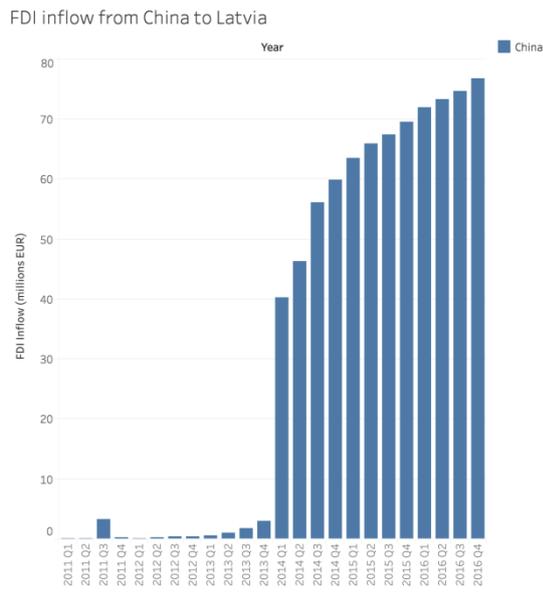


Figure 3: China inward FDI into Latvia. Data: Bank of Latvia. Design: HCSS.

In the Baltic States, Latvia has been a steady recipient of Chinese FDI (Figure 3). Latvia is the first Baltic nation to have established a direct rail freight route with China under the unified brand ‘China Railway Express’ that will connect China with the rest of Europe.<sup>19</sup> Latvia features prominently in China's plans as it seeks to make the Baltic nation the northern European logistics and distribution center in the Europe-Asia land transportation corridor.<sup>20</sup> Rail transport in general is a prominent feature of China's Silk Road, as witnessed by China Railways Corporation's (CRC) RMB 800 billion (\$119.71 billion) investment into as much as 9531 km of new railway lines.<sup>21</sup>

Other Baltic States attract far fewer Chinese investments. In 2016, Lithuania began to see an increase in Chinese FDI, which in the third quarter amounted to €6.34 million. This amount pales in comparison to the investments made in Latvia. The focus for Lithuania is to be part of a rail-transit route to its neighbor in the north, and towards the south of Europe. In 2015, Lithuanian Railways and the China Merchant Group signed an agreement confirming freight services from China via Belarus to the Baltics.<sup>22</sup>

Looking to Belarus—and in light of the prominence that China attaches to freight transport by rail—the former Soviet republic plays a crucial role in China's plans. Although, the Belarusian economy has been performing poorly, this has not deterred China from increasing its investments by as much as 1,587%, or \$174.6 million, between 2011 and 2016 (Figure 4).

<sup>19</sup> “Feature: Latvia Greets First Trans-Eurasia Cargo Train from China - Xinhua | English.News.Cn,” June 11, 2016, [http://news.xinhuanet.com/english/2016-11/06/c\\_135808541.htm](http://news.xinhuanet.com/english/2016-11/06/c_135808541.htm).

<sup>20</sup> “Latvia Open to Chinese Investments in Transportation Sector,” *The Baltic Course*, May 28, 2015, [http://www.baltic-course.com/eng/good\\_for\\_business/?doc=106789](http://www.baltic-course.com/eng/good_for_business/?doc=106789).

<sup>21</sup> “China to Expand Railway Network to 150,000 Km by 2020,” *Reuters*, July 20, 2016, <https://www.reuters.com/article/us-china-economy-infrastructure-railways-idUSKCN1000IK>.

<sup>22</sup> Lithuanian Confederation of Industrialists, “11 Cooperation Agreements between Lithuanian-Chinese Businesses Have Been Signed,” November 23, 2015, <http://www.lpk.lt/en/11-cooperation-agreements-between-lithuanian-chinese-businesses-have-been-signed/>.

Belarus FDI Net flow from China

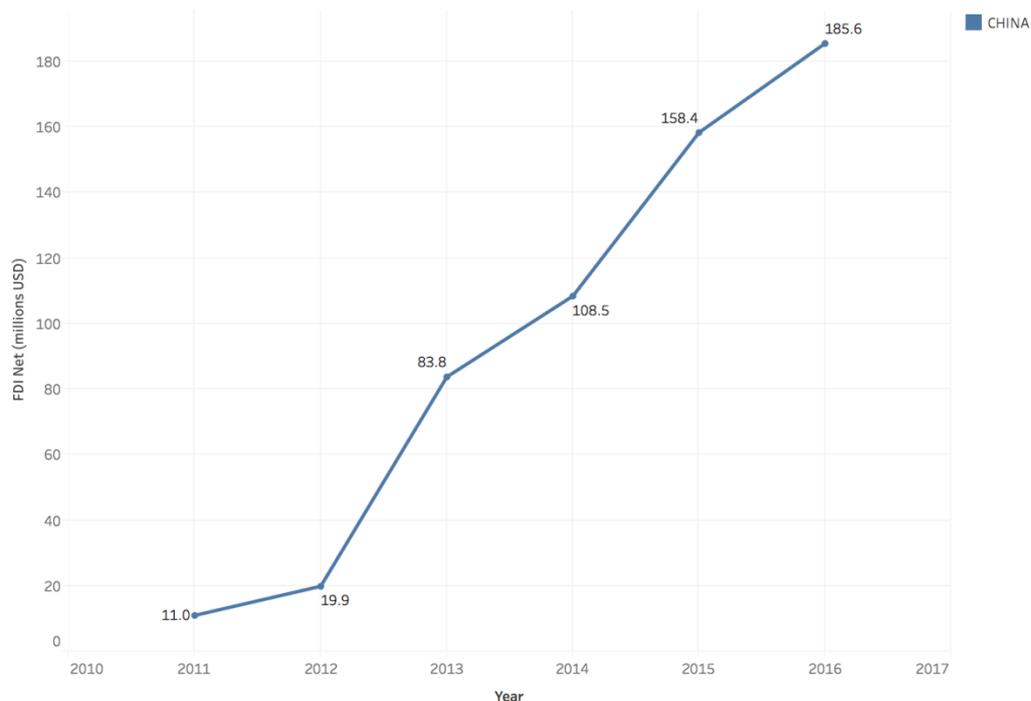


Figure 4: China inward FDI into Belarus. Data: National Bank of Belarus. Design: HCSS.

The bulk of Chinese FDI goes towards energy, manufacturing, and rail infrastructure. Since 2010, several Chinese rail and cargo companies have expressed interest in using the Belarusian railways as their gateway to the rest of Europe. In effect, China has provided \$63.9 million in funding for the electrification of the main railway line that leads southeast from Minsk.<sup>23</sup> In 2013, a \$5 billion development agreement with China Merchants Group was established to develop an industrial park around Minsk’s international airport that is 40% larger than Manhattan.<sup>24</sup> In 2016, China National Electric Engineering Company (CNEEC) announced that it is investing \$230 million into the Vitebsk Hydro Power Plant.<sup>25</sup>

Although Belarus remains much more economically dependent on the EU and Russia than it is on China, the country’s investments are fostering a greater degree of economic integration with Beijing. This is not without its local consequences. Belarusian citizens – fearing forced evictions, environmental degradation and overbearing influxes of Chinese workers<sup>26</sup> – have been critical of the industrial park being built around Minsk Airport. In addition, complaints about the excessive influx

<sup>23</sup> John Daly, “China, Belarus Deepen Ties,” *Refworld* 12, no. 164 (September 14, 2015), <http://www.refworld.org/docid/55fabe6a4.html>.

<sup>24</sup> “China Merchants Group to Invest \$550m in Logistics Subpark in China-Belarus Industrial Park,” *Invest in Belarus*, accessed February 16, 2017, <http://investinbelarus.by/en/press/news/a44b0ebc32eaf3df.html>.

<sup>25</sup> <http://www.hydroworld.com/articles/2016/06/cneec-to-construct-us-230-million-40-mw-vitebsk-hydroelectric-project-in-belarus.html>

<sup>26</sup> Wesley Garner, “On the Shoulders of Giants: China’s Interest in Belarus,” *St. Andrews Foreign Affairs Review*, March 10, 2017, <http://foreignaffairsreview.co.uk/2017/03/chinas-interest-in-belarus/>.

of Chinese workers over hiring locals echo those concerns voiced by African nations in the past.<sup>27</sup>

In Southeast Europe, most of China's trade is with EU member states Romania, Greece, Slovenia and Bulgaria. When it comes to FDI, most investments are geared towards (highway) infrastructure and the energy sector. Of the countries in the region, Serbia plays the most prominent role in OBOR related activities, and has already attracted over \$1 billion in investments in the form of soft loans to finance road building and energy projects.<sup>28</sup> Other notable investments in the region include a €580 million loan granted in 2013 to Macedonia from China's ExIm Bank for a motorway that will connect the Montenegrin Adriatic Sea to the north with the Serbian border<sup>29</sup>, and a \$3.19 billion project led by the China Pacific Construction Group (CPCG), the country's largest private builder, to build an expressway between Montenegro and Albania.<sup>30</sup> Along this corridor, ExIm bank and several other Chinese companies have signed deals for the construction of power plants in Serbia<sup>31</sup> and Bulgaria.<sup>32</sup> Though these deals amount to \$2.2 billion in investment, it should be stressed that not every major infrastructure project in this region is a success. The much-vaunted Belgrade to Budapest high-speed rail line – originally launched as China's 'express lane to Europe' – is being investigated by the EU for possible infringements of European requirements for public tenders.<sup>33</sup>

Despite the hype surrounding China's investments in Greece given the latter's precarious financial position, FDI inflows into Greece have actually significantly decreased since 2012 (Figure 5).

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<sup>27</sup> David Pilling, "Chinese Investment in Africa: Beijing's Testing Ground," *Financial Times*, June 13, 2017, <https://www.ft.com/content/Of534aa4-4549-11e7-8519-9f94ee97d996>; David Dollar and Astrid Hass, "China's Export of Capital Offers New Opportunities for Africa," *Financial Times*, April 4, 2017, <https://www.ft.com/content/8e887bdc-04f3-11e7-ace0-1ce02efodef9>.

<sup>28</sup> Alexander Vasovic, "China's Xi Highlights Serbia Trade as Beijing Signs 22 Deals," *Reuters*, June 18, 2016, <http://www.reuters.com/article/us-serbia-china-idUSKCN0Z4oC6>.

<sup>29</sup> AidData, "China EXIM Loans 580 Million USD for Highway Projects in Macedonia, Implemented by SinoHydro to Macedonia, FYR in 2013," accessed May 23, 2017, <http://china.aiddata.org/projects/42307.aid>

<sup>30</sup> Reuters, "China Pacific Construction Signs \$3.2 Bln Montenegro-Albania Highway Deal," *Reuters*, December 2, 2015, <http://www.reuters.com/article/china-pacific-construction-montenegro-idUSL3N13L3Q720151202>.

<sup>31</sup> Kühnlenz, "Chinese Investments in Eastern Europe." p. 14

<sup>32</sup> Bulgarian Chinese Chamber of Commerce Industry, "The Chinese Investments in Bulgaria Will Increase," 2015, <http://www.bulgariachina.com/en/news/view/14.the-chinese-investments-in-bulgaria-will-increase.htm>.

<sup>33</sup> Wade Shepard, "Another Silk Road Fiasco? China's Belgrade To Budapest High-Speed Rail Line Is Probed By Brussels," *Forbes*, February 25, 2017, <https://www.forbes.com/sites/wadeshepard/2017/02/25/another-silk-road-fiasco-chinas-belgrade-to-budapest-high-speed-rail-line-is-probed-by-brussels/>.

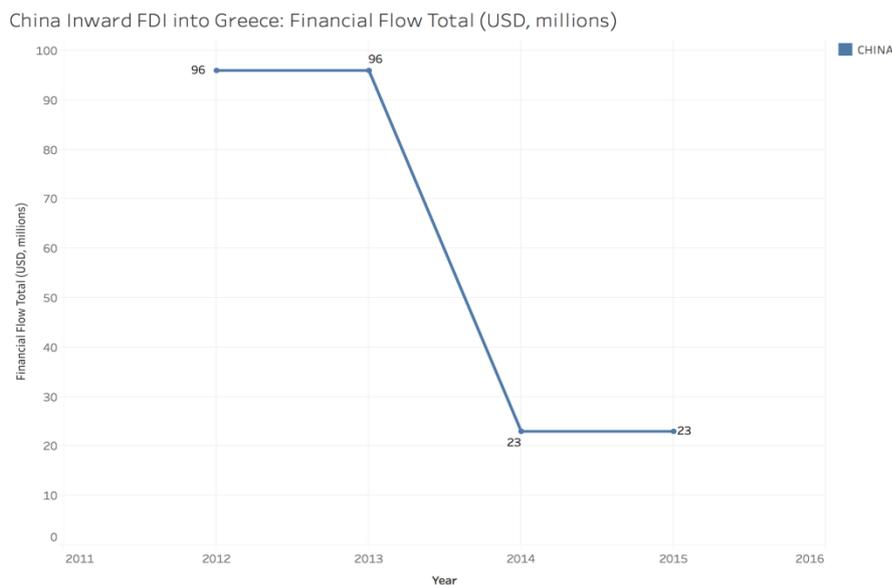


Figure 5: China inward FDI into Greece. Data: National Bank of Greece. Design: HCSS.

Although, the Port of Piraeus has an important gateway function for Chinese companies such as ZTE, Samsung Electronics, Dell, Lenovo, and LG who wish to distribute their products to the rest of Europe,<sup>34</sup> the half a billion dollars invested by the Chinese shipping company Cosco Holding Co. appears not to have opened the door to a surge in Chinese FDI into Greece. Rather, the Port of Piraeus appears to function as the bridgehead for an investment push into CEE countries. Combined with an overhaul of the transport system in the Balkans, Piraeus could thus grow into a large and strategic container port that can serve as an entry point for Chinese goods shipped to Europe.<sup>35</sup>

### 3. The issue of debt

Notwithstanding the clear increase in FDI in the countries mentioned above, total Chinese FDI stock in most European countries along the OBOR route is still relatively small. More interesting are the loans and export credits that China provides (Table 1).

<sup>34</sup> Aleksander Bauranov, “The Port of Piraeus – Opportunity for Railways in South East Europe?,” *European Railway Review*, September 8, 2016, <http://www.europeanrailwayreview.com/29672/railway-extra/port-piraeus-railways-south-east-europe/>.

<sup>35</sup> Nicola Casarini, “Greek Port Is Spearhead of Chinese Investment,” *Oriented World*, September 23, 2015, <http://orientedworld.com/articles/greek-port-is-spearhead-of-chinese-investment-push-in-europe/>.

Table 1: Loans provided by China in the context of OBOR. Source: IMF, World Bank, National Banks.

	Export share	Trade balance	Loans	FDI	
	%	US\$ mn	US\$ mn	US\$ mn	%
<b>Albania</b>	6	-192	176	7	0
<b>Belarus</b>	2	-187	3500	476	3
<b>Bosnia</b>	1	-70	1780	8	0
<b>Macedonia</b>	3	62	560	2	0
<b>Moldova</b>	1	-96	1000	2	0
<b>Montenegro</b>	1	-118	909	2	0
<b>Serbia</b>	0	-399	2120	50	0

Although granted under soft conditions, the loans inadvertently lead to an increase in these countries' debt burden. Given the current account deficit in all these nations except Macedonia it is difficult for them to repay the debt. In addition to negatively impacting economic stability, this will reinforce difficulties surrounding the establishment of a domestic industrial base. It should furthermore be stressed that through these loans China will be able to exercise leverage over these countries, should they get into financial difficulties.

There is ample precedent for this. For years, China has provided loans – up to around half of all foreign credit provided – to the Venezuelan government. In its quest to tap into new export and resource markets and make friends in the western hemisphere, oil-rich Venezuela proved an attractive choice. For Caracas the Chinese money provided the leadership with a way of reducing its reliance on the US market. The problem for Venezuela however was that these loans were never offered against soft conditions. Given the high risk premium on Venezuela, Beijing made sure to provide only hard commercial loans. Now that the Venezuelan economy has collapsed due to years of mismanagement which has been bitterly exposed by the collapse of the oil price, China refuses to renegotiate the country's debt.<sup>36</sup>

Similarly, in April 2017 Pakistan faced rapidly depleting stocks of foreign exchange due to a combination of falling exports, rising imports, and a decline in remittances from abroad. In response, China offered Islamabad a bailout worth \$1.2 billion.

<sup>36</sup> Anders Aslund, "Venezuela Is Heading for a Soviet-Style Collapse," *Foreign Policy*, May 2, 2017, <https://foreignpolicy.com/2017/05/02/the-maduro-regime-is-heading-for-a-soviet-style-collapse-venezuela/>; Christopher Balding, "Venezuela's Road to Disaster Is Littered With Chinese Cash," *Foreign Policy*, June 6, 2017, <https://foreignpolicy.com/2017/06/06/venezuelas-road-to-disaster-is-littered-with-chinese-cash/>.

Though this staved off an emerging currency crisis, the loan did nothing to address the underlying factors that triggered the crisis in the first place. Taking into account that China is slated to invest at least \$52 billion in Pakistan for the creation of the China-Pakistan Economic Corridor,<sup>37</sup> more pressure on Pakistan's already scant foreign exchange reserves should be expected.<sup>38</sup> If Pakistan's economic performance does not improve, it is unlikely that it will be able to repay the full package of loans provided by Beijing.

#### **4. Political and security implications**

Beijing's principal aim with respect to OBOR is to develop a series of trade and economic corridors and to use Chinese companies to help China develop domestically.<sup>39</sup> In that respect, OBOR is a tool that contributes to sustained economic growth; something that is viewed by the Chinese leadership as a crucial condition for domestic stability. Chinese investment interests within CEE appear strongly related to ongoing privatization opportunities, including large scale infrastructure projects and public procurement opportunities.<sup>40</sup> Although the extent of FDI differs greatly per country, it is certainly the case that across the region the number of Chinese-funded major infrastructure and developmental projects, acquisitions and equity investments is growing.<sup>41</sup> Looking at the distribution of these investments, it becomes clear that Central Europe often acts as the headquarters for Chinese firms. Latvia and Greece are the maritime points of entry, and countries such as Belarus act as main transport corridors for delivering the goods.

It should be pointed out that there is a certain expectations gap between China and countries in the CEE region. CEE countries are primarily interested in Greenfield investments, increased exports, and more Chinese tourists. Put differently, those kinds of investments and economic activities that actually create jobs.<sup>42</sup> The problem is that notable cases of Chinese job-creating Greenfield investments as such have so far proved small in number. In comparison, other EU countries and the US remain by far the largest investors in the region.<sup>43</sup>

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<sup>37</sup> The China Pakistan Economic Corridor represents a network of highways, energy pipelines, power-generation facilities and industrial parks stretching from the port of Gwadar on the Gulf all the way to the Chinese border.

<sup>38</sup> Henny Sender, Kiran Stacey, and Farhan Bokhari, "China Bails out Pakistan with \$1.2bn Loans," *Financial Times*, April 25, 2017, <https://www.ft.com/content/3ae64c9a-ffd8-11e6-96f8-3700c5664d30>.

<sup>39</sup> Raffaello Pantucci, "China: Understanding Beijing's Belt and Road Initiative," *RUSI*, May 12, 2017, <https://rusi.org/commentary/china-understanding-beijing%E2%80%99s-belt-and-road-initiative>.

<sup>40</sup> Zeneli, "Central and Eastern Europe: China's Stepping Stone to the EU?"

<sup>41</sup> Pavličević, "China in Central and Eastern Europe."

<sup>42</sup> Richard Q. Turcsányi, "The Limits of China's Cooperation With Central and Eastern Europe," *The Diplomat*, December 4, 2015, <http://thediplomat.com/2015/12/the-limits-of-chinas-cooperation-with-central-and-eastern-europe/>.

<sup>43</sup> Kerry Brown, "China's Geopolitical Aims: The Curious Case of the 16-Plus-1," *The Diplomat*, May 3, 2017, <http://thediplomat.com/2017/05/chinas-geopolitical-aims-the-curious-case-of-the-16-plus-1/>.

There are also issues with the extent to which China is said to be abiding by European rules and standards when it rolls out its OBOR investments. The investigation by the European Commission into the tendering procedure surrounding the Belgrade-Budapest high speed railway is a good example.<sup>44</sup> Here, worries extend beyond procurement and tendering rules. During the OBOR Summit held in May 2017, France, Germany, Estonia, Greece, Portugal and the UK were among the countries that refused to sign up to the Summit text. Concerns included a lack of transparency on public procurement and social and environmental standards. The warnings issued by Germany's economy minister – in which she states that “more guarantees from Beijing on free trade, environmental protection and working conditions are needed before the EU will be able to sign a joint statement on China's "One Belt, One Road" trade initiative”<sup>45</sup> – are further illustrative of these tensions.

Due to the presence of an arms embargo and the large geographical distance between Europe and China, real ‘hard security’ issues of a military kind are notably absent. This is also because Europe itself is considered ‘secure’, which allows Beijing to conclude that the presence of Chinese security actors is unnecessary. This is not to say that security issues involving Europe and China are absent in the context of the New Silk Road. Rather, they manifest themselves in different ways. A potential worrying issue for the long term is that if China indeed primarily wishes to export its overproduction and provide work for its construction companies abroad, the projects that are actually being built may not necessarily suit the needs of the countries in question. Similarly, trains coming from China are for the most part full when they arrive, but are empty when they go back. If that persists, there is the risk of fostering an uneven trade relationship.<sup>46</sup> In cases where there is a poor match between the host country's needs and China's aims for pursuing a particular project, there is a risk that the projects do not generate the required revenue in order for the loans to be paid back. That in turn will hurt a country's credit rating, as well as leaving China with bad assets.<sup>47</sup>

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<sup>44</sup> James Kynge, Arthur Beesley, and Andrew Byrne, “EU Sets Collision Course with China over ‘Silk Road’ Rail Project,” *Financial Times*, February 20, 2017, [https://www.ft.com/content/003bad14-f52f-11e6-95ee-f14e55513608?accessToken=zWAAVpg26nIkc8AO6oU9S8R5tOV7vFOVVE2CA.MEUCIQCoTNIWNQd1rENSF9ENnOkOqzSYuDOFqH7219Tm7ChXAIgcTGW6EQ1Z7jxD\\_-6sMO7MQVmii09oU7XNCzPnwOfflw&sharetype=gift](https://www.ft.com/content/003bad14-f52f-11e6-95ee-f14e55513608?accessToken=zWAAVpg26nIkc8AO6oU9S8R5tOV7vFOVVE2CA.MEUCIQCoTNIWNQd1rENSF9ENnOkOqzSYuDOFqH7219Tm7ChXAIgcTGW6EQ1Z7jxD_-6sMO7MQVmii09oU7XNCzPnwOfflw&sharetype=gift).

<sup>45</sup> The Independent Uganda, “China Decries Protectionism, but Europeans Rain on Silk Road Parade,” May 15, 2017, <https://www.independent.co.ug/china-decries-protectionism-europeans-rain-silk-road-parade/>.

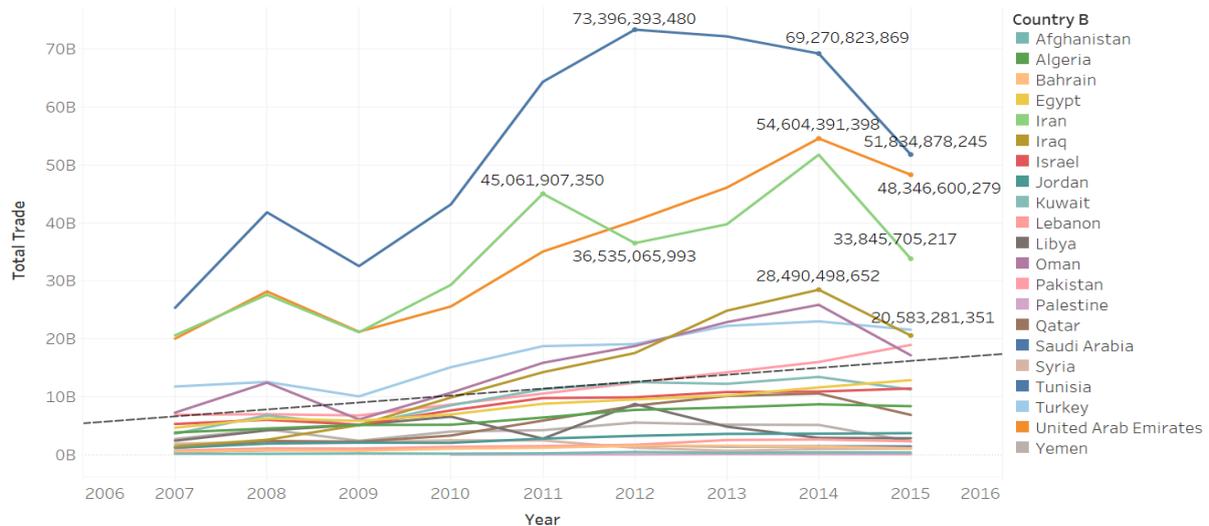
<sup>46</sup> Pantucci, “China: Understanding Beijing's Belt and Road Initiative.”

<sup>47</sup> The Financial Times, “One Belt, One Road — and Many Questions,” *Financial Times*, May 14, 2017, <https://www.ft.com/content/d5c54b8e-37d3-11e7-ac89-b01cc67cfeec>.

## 5. China's economic and security footprint in the MENA region

In general, the trend line in terms of China's economic involvement in the greater Middle East is gently but firmly sloping upwards, with some significant gains made over the years in a specific number of countries (Figure 6).<sup>48</sup>

China to MENA region



The trend of sum of Total Trade for Year. Color shows details about Country B. The data is filtered on Country A Groups, which keeps China. The view is filtered on Country B and Year. The Country B filter keeps 21 of 210 members. The Year filter ranges from 2007 to 2015.

Figure 6: Total trade between China and the MENA region. Data: IMF. Design: HCSS.

When focusing on three distinct regions within the Middle East, some significant differences in Chinese trade relations emerge.

First of all, in North Africa – while total trade has steadily increased with Egypt and Algeria – it has been patchy with Libya and Tunisia. Overall though, Chinese gains are insignificant in comparison with European (EU-28) dominance of trade with the Maghreb countries, whose share veers between 60-90%. Some signature projects in the region include construction of a new port near Algiers,<sup>49</sup> as well as a high-speed railway line between Cairo and Alexandria, showing that China manages to carve out a visible niche for itself on the southern shore of the Mediterranean.

In the Eastern Mediterranean, China's involvement is already more significant than on the south shore, but here too, Europe continues to predominate. Most significant growth in trade has been registered with Turkey and Israel while the next biggest partner, Jordan, does not top the \$4 billion range. The relationship with Israel is remarkable because it involves cooperation on various kinds of technology that chime with the 1-2-3 approach, including on space and renewables.<sup>50</sup> In relative

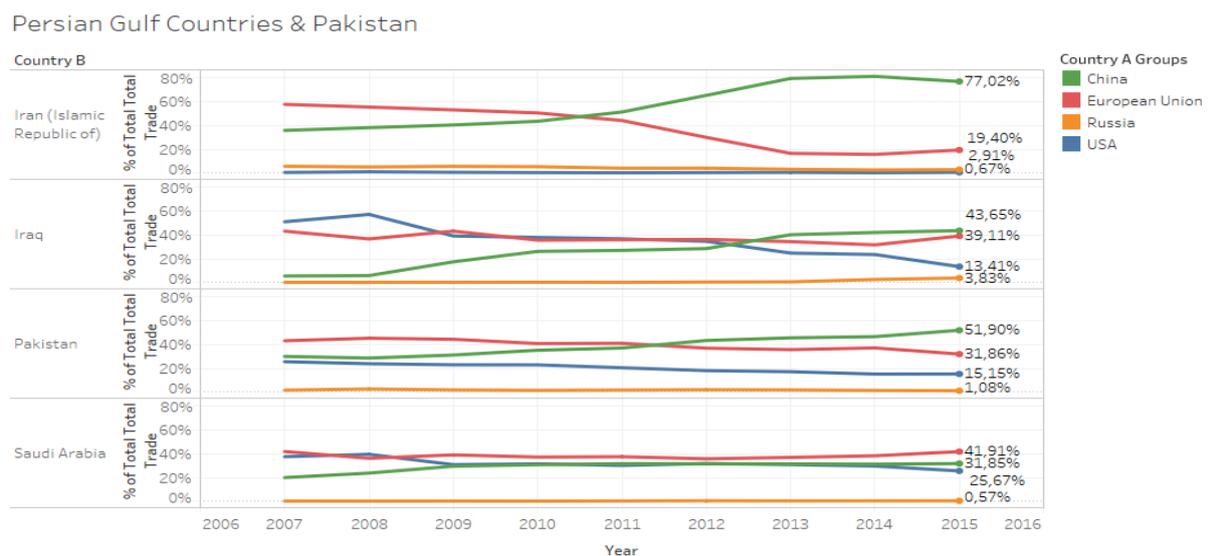
<sup>48</sup> The general downward slope after 2014 is largely if not entirely due to declining oil prices, and not indicative of diminishing mutual trade.

<sup>49</sup> The BRICS Post, "Algeria, China Ink \$3.3 Bn Mega Port Deal," 2016, <http://thebricspost.com/algeria-china-ink-3-3-bn-mega-port-deal/#.WNKsEHouOtF>.

<sup>50</sup> Middle East Monitor, "Israel and China to Cooperate on Technology," March 23, 2017, <https://www.middleeastmonitor.com/20170323-israel-and-china-to-cooperate-on-technology/>.

terms, a striking development in the Levant is that China has substantially improved its trade share with Jordan and (to an even greater degree) with Syria. This is chiefly due to the civil war raging there, as the absolute trade numbers with Syria have declined since 2011. In the Eastern Mediterranean, too, China has spearheaded some eye-catching projects, including a high-speed rail link between Istanbul and Ankara, and the Kumport container terminal near the Bosphorus.<sup>51</sup> In Israel, China sees potential to create a critical OBOR link by connecting the Red Sea with the Mediterranean, and also gained control over Spacecom, the Ramat Gan-based satellite technology company.<sup>52</sup>

The most significant segment of Chinese involvement is with various key fossil fuel providers between the Gulf and Central Asia (Figure 7).



The trend of % of Total Total Trade for Year broken down by Country B. Color shows details about Country A Groups. The view is filtered on Country B, Year and Country A Groups. The Country B filter keeps Iran (Islamic Republic of), Iraq, Pakistan and Saudi Arabia. The Year filter ranges from 2007 to 2015. The Country A Groups filter excludes Others.

Figure 7: trade share of China, EU, Russia and US with the Gulf countries and Pakistan. Data: IMF. Design: HCSS.

Unsurprisingly perhaps, the size of total trade is the largest with Saudi Arabia (\$52 billion (2015)). This is the largest bilateral trade relationship Beijing enjoys across the Middle East. The second largest in this sub-region is with the United Arab Emirates (UAE, \$48 billion), with Iran coming in only in third place (\$34 billion). Also, the relative share of China is distinctly different here in comparison to elsewhere in the Middle East (or, Western Asia, from the Chinese perspective). For instance, China is the top trading partner with Iran, Iraq, Pakistan and Yemen, among others, and strongly entrenched in Saudi Arabia and Qatar. These strong economic ties are also

<sup>51</sup> The Republic of Turkey Prime Ministry Investment Support and Promotion Agency (ISPAT), “Chinese Consortium Buys into Turkish Port with USD 940 Million Investment,” 2015, <http://www.invest.gov.tr/en-US/infocenter/news/Pages/280915-cosco-pacific-buys-turkish-kumport.aspx>.

<sup>52</sup> See reported at The American Enterprise Institute and The Heritage Foundation, “China Global Investment Tracker,” accessed January 23, 2017, <https://www.aei.org/china-global-investment-tracker/>.

reflected in some key infrastructure initiatives, including well-known projects such as the port of Gwadar in Pakistan. In Saudi Arabia, Chinese firms are involved in realizing plans to build 16 nuclear power plants worth USD 100bn.<sup>53</sup> This is significant in that China is also investing in nuclear plants in Iran, thus managing to have it both ways.<sup>54</sup> In general though, the strong bilateral trade figures achieved in this sub-region reflects the dependence that China has on these countries for procuring fossil fuel energy and to extend its OBOR project. At the same time, it demonstrates the biggest potential (or need) for China to also become politically active.

In conclusion, this overview shows not only that there are large differences in where China is invested in the greater Middle East, but also that its relative economic preponderance in countries such as Syria, Yemen and Libya could very well put Beijing in the drivers' seat when it comes to consolidating ties with these problem-riven nations once they re-enter the international community.

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<sup>53</sup> See "Saudi Arabia, China Sign Nuclear Cooperation Pact - Power Engineering International," January 17, 2012, <http://www.powerengineeringint.com/articles/2012/01/saudi-arabia-china-sign-nuclear-cooperation-pact.html>.

<sup>54</sup> Debalina Ghoshal, "China Pivots to the Middle East and Iran | YaleGlobal Online," July 7, 2016, <http://yaleglobal.yale.edu/content/china-pivots-middle-east-and-iran>.

## 6. Chinese security engagement

China's security engagement is related to what Beijing views as the primary external threat to its survival: economic stagnation. Such a trend is likely to present itself if risks to the uninterrupted supply of resources needed to ensure China's aspired economic development manifest. Because of this, a favorable security environment constitutes a necessary precondition for China's expanding external economic efforts.<sup>55</sup> To identify the effect of China's security engagement on regional security, we developed a specific framework (Figure 8).



Figure 8: China's Security Projection. Design: HCSS.

The extent to which China employs activities in the nine categories listed in Figure 8 indicates the extent to which each security capability is developed and deployed. Reading from left to right, these capabilities range from soft to hard military power. The deployments of these security capabilities are indicative of the security threats China perceives in the given area, country or region. The effect on regional security derives from the combination of China's foreign economic efforts, the security threats to its overseas assets and personnel, and China's actual security efforts on the ground. A first assessment of China's security projection is briefly explained below.

China's diplomatic network, including military attachés, is at the forefront of its security projection. It has contacts at all levels and with all major stakeholders in the

<sup>55</sup> The 13th five-year plan, for economic and social development of the People's Republic of China (2016-2020).

countries along the New Silk Road. Connected to its growing intelligence network, it assesses the security environment, the threats to China's facilities and people, the ability for local national governments to establish a favorable security situation, and the security effort required by China itself. Examples of the diplomatic network are China's increasing role in furthering peace negotiations between the Taliban and the Afghan government; Beijing's efforts—in collaboration with Russia and Pakistan—to get the Taliban off the UN sanction list to foster dialogue; and China's pressure on Pakistan to halt its support to the Taliban.<sup>56</sup>

Agreements on security matters between China and other nations are often ambiguously formulated and aimed at improving cooperation in the area of counterterrorism. The *Quadrilateral Cooperation and Coordination Mechanism* of August 2016—an agreement with China's neighbors bordering the Xinjiang (Uyghur) region, Afghanistan, Pakistan and Tajikistan—was set up with the purpose of furthering antiterrorism capabilities through (among others) intelligence sharing and joint exercises.<sup>57</sup> Similar aims have been presented for the twenty-five-year strategic cooperation agreement (January 2016) and a separate agreement on closer military cooperation (November 2016) between China and Iran.<sup>58</sup> China's regional security framework, the *Shanghai Cooperation Organization* (SCO), is slowly expanding its membership with observer member states such as Egypt. The SCO is primarily concerned with security threats stemming from terrorism, separatism and extremism, and has widened its scope through military exercises.<sup>59</sup>

Support to local national security forces are actions that aim to enable a favorable security environment for China's economic efforts. A wide range of actions can be identified in this context. Under the umbrella term of 'counterterrorism cooperation', Chinese special forces have engaged in several joint military training exercises with Pakistan, Saudi Arabia, Tajikistan and Yemen. Some bilateral and multilateral exercises revolved around disaster relief and border security, while the PLA also engaged in conventional (warfare) training with foreign militaries. China has conducted joint military exercises under these auspices with Russia, India and

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<sup>56</sup> Hamid Shalizi, "Afghans Arrested Chinese Uighurs to Aid Taliban Talks Bid: Officials," *Reuters*, February 20, 2015, <http://www.reuters.com/article/us-afghanistan-taliban-china-idUSKBN0LO18020150220>; An Baijie, "On Taliban's Reported Visit, China Says It's in Touch with All Afghan Sides," August 2, 2016, [http://www.chinadaily.com.cn/china/2016-08/02/content\\_26315227.htm](http://www.chinadaily.com.cn/china/2016-08/02/content_26315227.htm); Tahir Khan, "Afghan Taliban's Political Negotiators Visit China," *The Express Tribune*, March 7, 2017, <https://tribune.com.pk/story/1348055/afghan-talibans-political-negotiators-visit-china/>.

<sup>57</sup> Ministry of National Defense of The People's Republic of China, "Afghanistan, China, Pakistan, Tajikistan Issue Joint Statement on Anti-Terrorism," August 4, 2016, [http://eng.mod.gov.cn/DefenseNews/2016-08/04/content\\_4707451.htm](http://eng.mod.gov.cn/DefenseNews/2016-08/04/content_4707451.htm).

<sup>58</sup> Ting Shi, "How China Is Building Bridges With the Middle East," *Bloomberg.Com*, January 26, 2016, <https://www.bloomberg.com/news/articles/2016-01-25/what-xi-s-iran-trip-tells-us-about-china-s-middle-east-plans>.

<sup>59</sup> Eleanor Albert, "The Shanghai Cooperation Organization," *Council on Foreign Relations*, October 14, 2015, <http://www.cfr.org/china/shanghai-cooperation-organization/p10883>.

Mongolia.<sup>60</sup> In December 2015, the Standing Committee of the National People's Congress passed a new counterterrorism law allowing the PLA and People's Armed Police (PAP) to engage in counter-terrorist missions abroad. This new law indicates that China is following a process of learning-by-doing. Some Chinese experts see the PAP rather than the PLA as being at the forefront of China's future overseas operations because of the former's domestic expertise.<sup>61</sup> A different form of support is issued in the form of arms transfers. Whilst constituting an economic activity, such transfers are also a method of enhancing the capabilities of local national security forces. Here, Pakistan is of particular interest. Between 2011 and 2016, China was the largest supplier of arms to Pakistan, when compared with other major arms exporting countries. Between 2014 and 2016, the value of Chinese arms exported to Pakistan increased by 46%. Arguably, the most noteworthy purchase were eight new Type 041 submarines and Pakistan's plan to build two types of submarines with Chinese assistance. These submarines, Project S-26 and Project S-30, are to be built at the Submarine Rebuild Complex facility developed at Ormara, west of Karachi, at an estimated cost of \$4-5 billion.<sup>62</sup>

The rapid expansion of China's overseas activities coincides with a growing need for on-site security. Recognizing this need, China urges its corporations to invest in risk and crisis management capabilities.<sup>63</sup> Simultaneously, in 2010 China liberalized legislation allowing for a consolidation of the PSC market in China.<sup>64</sup> The industry focuses predominantly on the domestic market, but has recognized the potential of offering its services overseas. Shandong Huawei Security Group, a leading Chinese PSC, has set up an Overseas Service Center and now protects various Chinese interests in Sudan, Iraq and Afghanistan.<sup>65</sup> In Libya, China Kingdom International is responsible for the protection of a Chinese construction company, while Hua Xin Zhong An performs escort missions in the Gulf of Aden. In terms of expertise and market size however, Chinese PSCs lag behind their western competitors and are not able yet to fully match their offerings on the international market.

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<sup>60</sup> Office of the Secretary of Defense, "Military and Security Developments Involving the People's Republic of China 2016," Annual Report to Congress (Department of Defense, April 26, 2016), <https://www.defense.gov/Portals/1/Documents/pubs/2016%20China%20Military%20Power%20Report.pdf>.

<sup>61</sup> Mathieu Duchâtel, "Terror Overseas: Understanding China's Evolving Counter-Terror Strategy," October 26, 2016, [http://www.ecfr.eu/publications/summary/terror\\_overseas\\_understanding\\_chinas\\_evolution\\_counter\\_terror\\_strategy7160](http://www.ecfr.eu/publications/summary/terror_overseas_understanding_chinas_evolution_counter_terror_strategy7160).

<sup>62</sup> Gady Franz-Stefan, "Pakistan Will Buy Eight Chinese Subs," *The Diplomat*, April 2, 2015, <http://thediplomat.com/2015/04/confirmed-pakistan-will-buy-eight-chinese-subs/>; Benjamin David Baker, "Revealed: Why China Is Selling Submarines to Pakistan," *The Diplomat*, September 28, 2015, <http://thediplomat.com/2015/09/revealed-why-china-is-selling-submarines-to-pakistan/>.

<sup>63</sup> Mathieu Duchâtel, Oliver Bräuner, and Zhou Hang, "Protecting China's Overseas Interests. The Slow Shift Away from Non-Interference.," SIPRI Policy Paper (Sweden: Stockholm International Peace Research Institute, June 2014), <http://books.sipri.org/files/PP/SIPRIPP41.pdf>.

<sup>64</sup> State Council of the PRC, "Regulation on the Administration of Security and Guarding Services," October 13, 2009, <http://www.lawinfochina.com/display.aspx?lib=law&id=7779>.

<sup>65</sup> Sean McFate, *The Modern Mercenary: Private Armies and What They Mean for World Order* (Oxford University Press, 2017).

Support to non-official security actors is an alternative method of establishing a security environment that was applied by western countries in, for example, Afghanistan. According to unconfirmed sources, the Chinese have had contact with warlord militia in the security vacuum that emerged after the withdrawal of US forces in the areas surrounding Chinese companies.<sup>66</sup>

As of February 2017, China contributes to ten UN Peacekeeping Operations (PKO) through the provision of 186 police officers, 33 military experts and 2,348 troops. These numbers are substantially higher than those of its fellow five Permanent Members of the Security Council, with France and the US contributing a total of 995 and 68 PKO personnel respectively.<sup>67</sup> A majority of its troops are stationed with UNMISS (South Sudan) and MINUSMA (Mali). China is the second-largest financial contributor to the PKO budget for 2016, accounting for 10.29%.<sup>68</sup> This share will increase as of 2018 when the UN scale of assessment for PKO contributions will be re-determined, giving China additional leverage in the negotiations on PKO policy.

In sustaining the PLA's Navy operations, the establishment of a military support facility in Djibouti reflects China's first overseas military extension resulting in a permanent military presence. It has been utilized during Chinese anti-piracy efforts in the Gulf of Aden and off the coast of Somalia. The Djibouti base demonstrates China's increased need to protect its strategic interests overseas, thereby in effect extending its military reach. Rather than building full-fledged military bases, the Chinese will likely extend their overseas reach through the establishment of 'naval hubs'; exclusive or preferred access to foreign commercial ports through which civil and military operations could be carried out.<sup>69</sup>

Across the board, China has been developing high readiness expeditionary capabilities for the purpose of out of area power projection in order to protect its overseas economic interests. This capability consists of special forces, airmobile units, and these categories' required transportation means (both by air and sea). The many bilateral anti-terrorism exercises with special forces are an indication of this growing capability.

As of 2008 China has engaged in anti-piracy efforts in the Gulf of Aden and the waters off the Somali coast. Naval task forces carry out escorting activities for commercial vessels and patrol the waters. Beyond their anti-piracy activities, the task force's frigates in this area engaged in the evacuation of 35,860 Chinese nationals

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<sup>66</sup> Mingjiang Li and Kalyan M. Kemburi, eds., *China's Power and Asian Security* (New York: Routledge, 2015).

<sup>67</sup> UN, "Troop and Police Contributors," *United Nations Peacekeeping*, accessed April 25, 2017, <http://www.un.org/en/peacekeeping/resources/statistics/contributors.shtml>.

<sup>68</sup> UN, "Committee on Contributions," accessed April 25, 2017, <http://www.un.org/en/ga/contributions/assessments.shtml>. By way of comparison; the Netherlands pays 1.48% of the PKO budget for 2016.

<sup>69</sup> Office of the Secretary of Defense, "Annual Report to Congress: Military and Security Developments Involving the People's Republic of China 2016," April 26, 2016, <https://www.defense.gov/Portals/1/Documents/pubs/2016%20China%20Military%20Power%20Report.pdf>. p.6

from Libya in 2011 and over 570 Chinese nationals from Yemen through the Djibouti facility in 2015.<sup>70</sup> They have also been employed during the destruction process of Syrian chemical weapons and took part in a naval drill exercise in the Mediterranean with Russia in 2015,<sup>71</sup> and more recently with Iran.<sup>72</sup> But China's naval activity is not limited to the Middle East. In June of 2017, the Chinese teamed up with Russia for an exercise in the Baltic Sea, occurring one month before a G-20 summit in Hamburg, Germany.<sup>73</sup> In sum, these activities demonstrate the ability to rapidly deploy transportation means and security forces for overseas operations.

## 7. Political and security implications

In the Middle East, China seeks, as a principle, not to become politically involved. This despite that fact that it is likely aware that in the long run, this will be impossible. Indeed, when it comes to its ties with Saudi Arabia and Iran—potentially the most contentious diplomatic tightrope it may have to walk—Beijing's political stance is to insist (or hide behind?) the principle of non-interference. This is also a cornerstone of its Arab Policy paper, and one it hopes to uphold in years to come.

Another political issue is whether China might seek to carve out a 'sphere of influence' in the region, akin to how it claims exclusive rights to engage in the Asia-Pacific region. Given that the Russian entry into the Levant is a likely prelude to renewed great power confrontation leading the region's countries to line up behind one or the other power, and given that the region has a history of being carved up (think of Sykes-Picot, the Sevres treaty, the 1907 Anglo-Russian Entente etc.), China's considerable economic influence ought to be evaluated in light of how this relates to its security interests. As a pair of Chinese political scientists argue, it remains to be seen whether Chinese involvement could be "a means for China to build constructive great power relations".<sup>74</sup>

Still, China could arrive at a tacit agreement with the United States in terms of securing the Hormuz SLOC, which is partly patrolled by the US Fifth fleet based in

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<sup>70</sup> Information Office of the State Council of the PRC, "The Diversified Employment of China's Armed Forces," Defense White Paper, (April 2013), <http://eng.mod.gov.cn/Database/WhitePapers/2012.htm>.

<sup>71</sup> Oriana Skylar Mastro, "Hearing on Developments in China's Military Force Projection and Expeditionary Capabilities," § The U.S.-China Economic and Security Review Commission (2015).

<sup>72</sup> "China and Iran Carry out Naval Exercise near Strait of Hormuz as US Holds Drill with Qatar | South China Morning Post," accessed June 20, 2017, <http://www.scmp.com/news/china/diplomacy-defence/article/2098898/china-and-iran-carry-out-naval-exercise-near-strait>.

<sup>73</sup> "China, Russia To Hold Joint Military Drills In Baltic Sea After Trump Visit," accessed June 20, 2017, <https://www.rferl.org/a/chinese-naval-fleet-russia-hold-joint-military-exercises-baltic-sea-after-trump-visit-poland-germany/28565674.html>.

<sup>74</sup> Degang Sun and Shaoxiong He, "From A By-Stander to A Constructor: China and the Middle East Security Governance," *Journal of Middle Eastern and Islamic Studies (in Asia)* Vol 9, no. 3 (2015), [http://mideast.shisu.edu.cn/\\_upload/article/files/1d/4a/58baa2dc424a8ec35b7d8e1715c6/a5f2318d-2110-495c-8321-b1081c64a720.pdf](http://mideast.shisu.edu.cn/_upload/article/files/1d/4a/58baa2dc424a8ec35b7d8e1715c6/a5f2318d-2110-495c-8321-b1081c64a720.pdf). p. 70

Bahrain,<sup>75</sup> and build on cooperation relating to anti-piracy activity in the Arabian Sea.<sup>76</sup> It is simultaneously possible that, as the stakes increase, China will want to protect its key economic interests with its own military – for instance by concluding military cooperation agreements to protect port facilities and key sea lanes. It would then be up to the US and other powers to decide whether or not to accept such increasing Chinese preponderance.

The fact that China is likely to play a larger political role in the region has already been on display by involving itself in conflict resolution processes in Syria, Israel/Palestine, Yemen and Afghanistan, and of course as a negotiating party with the P5+1 agreement with Iran.<sup>77</sup> More in general though, China's approach is unlikely to include overtly interventionist approaches, having learned from western and Soviet experiences in the region. Stability and protection of sovereignty will therefore be hallmarks of Beijing's approach. Even if this could likely come at the expense of human rights on the domestic level, cooperation with China has recently been welcomed by EU foreign policy chief Federica Mogherini, who declared at the most recent EU-China summit that "[w]e are living clearly in times of growing tensions and geopolitical unpredictability, so our cooperation has never been so important. China and the European Union are global powers: we have a joint responsibility to work together towards a more cooperative, rules-based global order."<sup>78</sup> This is one indication that the EU is not powerless when it comes to dealing with China in the Middle East. What is more, China's interests in a prosperous OBOR zone also suggests that China has a bigger interest in maintaining good ties with Europe than one might think.

China's current security projection along the New Silk Road is limited, but growing. The areas in which most Chinese security capabilities are deployed are the greater Indian Ocean, Pakistan and the region spanning Tajikistan, Afghanistan, Pakistan and China (Figure 8, p.17). An ever expanding economic presence will go hand-in-hand with a greater need to protect Chinese personnel, facilities and strategic lines of communication. In doing so, China invests in its own security capabilities to provide a favorable security environment, rather than choosing to rely on others. This is a slow process, following a path of trial and error, in which legislation is adjusted and capabilities are developed along the way. According to China, the application of the security capabilities is pragmatic (what is required), restricted (not more than

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<sup>75</sup> See e.g. Parisa Hafezi, Myra MacDonald, and Humeysra Pamuk, "UPDATE 4-U.S. Fifth Fleet Says Won't Allow Hormuz Disruption," *Reuters*, December 28, 2011, <http://www.reuters.com/article/iran-hormuz-closure-idUSL6E7NSoP920111228>.

<sup>76</sup> Travis Alston and Eric Coffey, "US, China Conduct Anti-Piracy Exercise," *U.S. Navy News Service*, December 12, 2014, [http://www.navy.mil/submit/display.asp?story\\_id=84858](http://www.navy.mil/submit/display.asp?story_id=84858).

<sup>77</sup> Sun and He, "From A By-Stander to A Constructor." pp. 75-77

<sup>78</sup> "Remarks by the High Representative Mogherini Following the 7th EU-China Strategic Dialogue - European External Action Service," accessed April 20, 2017, [https://eeas.europa.eu/headquarters/headquarters-homepage\\_en/24821/Remarks%20by%20the%20High%20Representative%20Mogherini%20following%20the%207th%20EU-China%20Strategic%20Dialogue](https://eeas.europa.eu/headquarters/headquarters-homepage_en/24821/Remarks%20by%20the%20High%20Representative%20Mogherini%20following%20the%207th%20EU-China%20Strategic%20Dialogue).

necessary) and non-interventionist.<sup>79</sup> Tension between the principle of non-intervention and the need to protect overseas investments and Chinese nationals (in 2020 it is expected that 150 million Chinese nationals will travel and/or live abroad<sup>80</sup>) will however surely increase.

The potential for conflict between China and the countries in the greater MENA region is in itself small given that stability is an essential precondition for China's economic development and the latter is the prime reason for China's (security) presence. That said, and although threats to regional security are limited, they are nevertheless on the rise due to the growing scale of China's economic efforts and Beijing's China-centric approach in the region. The threats manifest themselves in an indirect manner. This is because China's security efforts are not directed against regional countries or foreign presence and because the threats the country presents are not as much a result of Beijing's security efforts themselves as much as they are the result of its economic *modus operandi*. The security threats are thus third or fourth order effects, starting with unemployment, combined with a growing population, resulting in unaccomplished basic requirements, and subsequently fueling social unrest and political instability, causing local and regional conflicts and migration to Europe.

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<sup>79</sup> Ministry of National Defense of China, "China's Defense Policy," *Eng.Mod.Gov.Cn*, February 2017, <http://eng.mod.gov.cn/Database/DefensePolicy/index.htm>.

<sup>80</sup> Keira Lu Huang, "'Not Enough' Consular Officers to Serve Chinese Nationals, Foreign Ministry Says," *South China Morning Post*, May 19, 2014, <http://www.scmp.com/news/china/article/1515554/consular-staff-struggling-cope-rising-number-foreign-trips>.

## **8. Conclusions**

Up front it should be made clear that what China does by way of rolling out its new Silk Road, and increasing its military/security presence along the route to protect its economic interests, does not radically differ from what western countries have done for centuries. The stationing of the US fifth fleet in Bahrain is a good example of how the overseas presence of a nation's armed forces safeguards crucial interests (in this case, the unhindered flow of oil and gas from the Persian Gulf).

It should however be noted that, in a contemporary setting, an important difference between the two derives from the underlying values that the countries wish to promote, protect or support. Whereas western liberal democracies seek to support rules and regulations that allow for the unhindered functioning of markets, strengthen the rule of law and support human rights, the model propelled by Beijing appears more focused on a narrow promotion of Chinese interests.

As noted above, the western model is about more than the narrow protection of economic interests alone. When faced with international crises, western powers have intervened in the past also in areas where there was not an immediate threat to core economic interests, but where the risk of prolonged instability was considered to be harmful in the long run. In its military posturing, and in the choice of participating in UN peacekeeping missions, Beijing appears to be much more motivated from a direct concern about Chinese economic interests.

### **Risky investments**

In the longer term, the loans issued for OBOR related investments should be viewed with concern. Since the investments frequently fail to live up to the both expectations and the needs of the host countries, and because they primarily serve to provide work and markets for Chinese enterprises, there is a genuine risk that countries will end up with substantial debts as well as with projects that will prove unable to generate enough revenue to repay the loans. Moreover, these outstanding debts give Beijing political influence. It should also be stressed that, in rolling out its new Silk Road, China does not always adequately take into account specific local circumstances. The heavy emphasis on Chinese companies and Chinese labor often deprives countries that lack a domestic industry from developing one. More worrisome is that it risks upsetting the delicate social fabric in countries that already suffer from a high degree of state fragility due to high (youth)unemployment, a rapidly growing population, an authoritarian political system and a high degree of social inequality. Moreover, in relative terms for some of the countries along the OBOR route, the investments make up a sizeable share of the total investments received. As noted in the section on debt, there is an ample number of precedents for the loans that are issued in this context to contribute to worsening a country's financial circumstances as illustrated by the cases of Venezuela and Pakistan.

### **Risks to cohesion and stability in Europe**

A different problem is that there is a suspicion that European rules on public tendering are not always respected. It remains to be seen what the investigation into the Belgrade-Budapest high-speed railway will uncover, but with looser rules in place for prospective EU member, the temptation to bend the rules is arguably higher in the Western Balkans than it is within the EU.<sup>81</sup> This risk is further aggravated in light of the decreasing attractiveness of the EU narrative in the region to the benefit of countries such as Russia and Turkey that seek to exploit historical and cultural ties to the region and undermine the process of European integration.<sup>82</sup> Taking into account that the economies of Serbia, Bosnia and Albania are vulnerable to economic shocks and have a negative trade balance with China, Europe is possibly facing an explosive cocktail of political (Russia, Turkey) and financial (China) meddling in its backyard.

### **Regional tensions with India and risk of sparking local civil unrest**

In the Greater Middle East we can see an increase in the tension between China and India as a result of the Chinese economic activities in Pakistan. India's refusal to take part in the OBOR Summit held in May 2017 spoke volumes about New Delhi's resentment. What is more, if Pakistan were to experience further financial difficulties as a result of the rollout of the China-Pakistan economic corridor, this could exacerbate the potential for civil unrest in the country. In other countries in the region, with the exception of the major oil exporting nations, we witness the impact of the large scale presence of Chinese companies and workers on the social fabric, leading to local tensions. In this regard, the EU should point Beijing to the damage that its China-centric approach can do to its own ambitions as it risks getting embroiled in regional tension and conflict. Meanwhile, China is also gradually becoming more involved militarily, an example being the recent naval drill with Iran.<sup>83</sup>

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<sup>81</sup> Kynge, Beesley, and Byrne, "EU Sets Collision Course with China over 'Silk Road' Rail Project."

<sup>82</sup> Andrew Rettman, "EU 'Perspective' for 'Fragile' Western Balkans," March 9, 2017, <https://euobserver.com/foreign/137161>; Robert Ledger, "Is Russia Winning a Battle of Hearts and Minds in the Western Balkans?," *New Eastern Europe*, March 15, 2016, <http://www.neweasterneurope.eu/articles-and-commentary/1923-is-russia-winning-a-battle-of-hearts-and-minds-in-the-western-balkans>.

<sup>83</sup> "China and Iran Carry out Naval Exercise near Strait of Hormuz as US Holds Drill with Qatar | South China Morning Post."

## 9. Recommendations

These conclusions give rise to a number of specific recommendations on how Europe can better deal with the effects of OBOR-related investments.

### **A need for increased resilience**

To safeguard cohesion in Europe, it is important that we hold firm to our values-based economic model and enforce European rules and regulations that contribute to establishing a level playing field for European and foreign companies. The analysis conducted in this paper makes clear that there is a need for Europe to increase its resilience. The news that the European Commission is looking to table a legislative proposal that will allow the screening of investments in Europe for their impact on national security is a welcome step in this context.<sup>84</sup> A previous piece of legislation that could serve as inspiration for how to deal with some of the negative effects associated with the OBOR project are the rules that oblige Member States to notify the European Commission on intergovernmental agreements in the field of oil and gas with non-EU countries before they are concluded.<sup>85</sup> Under the terms of the legislation, the Commission has the right to assess whether these agreements are in accordance with all relevant EU laws. It is likely that the new proposal will take a cue from this legislation.

On top of designing legislation, which is primarily aimed at ‘closing the ranks’ within the EU, it is also important to instigate a specific dialogue with China. Such a dialogue should be aimed at establishing a ‘code of conduct’ that would entail a visible commitment to the norms and values underpinning trade and investment within the EU. Although the nature of such a compact would be legally non-binding, having a dialogue about this issue in the first place would already be a welcome endeavor.

### **Re-evaluate policies towards EU neighborhood**

The rising threats to regional security, caused by China’s economic *modus operandi*, are a long-term threat to the EU. The EU therefore needs to increase its influence in its neighborhood by improving ties with these countries and providing both governing elites as well as the overall population with a more attractive alternative for the future. Given that China’s track record in the area of foreign investment is not perceived positively across the board, there is room for Europe to maneuver. The EU should stay firm in its commitment to upholding human rights and strengthening the rule of law, but should place a heavier emphasis on issues such as sustainability,

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<sup>84</sup> Jeroen Segenhout, “Europa Weert Zich Tegen Overnames Uit China,” *Fd.Nl*, June 19, 2017, <https://fd.nl/economie-politiek/1206511/europa-weert-zich-tegen-overnames-uit-china>; Jim Brunsten, “Brussels Seeks Tighter Vetting of Foreign Takeovers,” *Financial Times*, August 13, 2017, <https://www.ft.com/content/04fa752c-7dda-11e7-ab01-a13271d1ee9c>.

<sup>85</sup> Decision (EU) 2017/684 of the European Parliament and of the Council of 5 April 2017 on establishing an information exchange mechanism with regard to intergovernmental agreements and non-binding instruments between Member States and third countries in the field of energy, and repealing Decision No 994/2012/EU. OJ L 99-1 of 12 April 2017.

clean-tech, and demonstrate its long-term commitment and track record in providing legal certainty concerning investments.

### **Raise public awareness on the new Silk Road**

Within Europe itself it is important that the degree of public awareness concerning OBOR is greatly enhanced, especially concerning the conditions under which investments are made and loans issued, and which consequences these carry. The EU should take the lead in ensuring that there is a public information campaign on OBOR and that all relevant publications (research reports, academic articles, policy papers) that appear on this topic are distributed widely among EU member states and candidate countries and available in an online repository.

### **A better use of available analytical capacity**

Finally, the analysis provided in this paper is but an initial step into determining the geo-economics behind OBOR. We do not, for example, dispute the value of assessing China's military capabilities as such and keeping an eye on what it does in the South China Sea. We do contend, however, that – in the context of conflict prevention in countries around Europe – this type of analysis is perhaps less relevant. OBOR makes clear that China's political and security engagement in the 21<sup>st</sup> century is disguised in economic terms. It is therefore recommended for the intelligence services to use their networks to engage in the continuous monitoring of the extent to which the OBOR rollout affects a country's social fabric, creates potential financial vulnerabilities and raises the risk of civil unrest and conflict. Doing so will enhance our early phase of understanding the extent to which OBOR related investments heighten a country's susceptibility to societal unrest.

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*The Hague* Centre for Strategic Studies

Lange Voorhout 16  
2514 EE The Hague  
The Netherlands

info@hcss.nl  
HCSS.NL