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China's New Economic and Foreign Policy Initiatives

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China's new leadership has launched a series of foreign policy and economic initiatives whose implications reach far beyond their own region. Washington disapproves of Beijing's plans, regarding the proposed financial institutions in particular as a challenge to their established Western-dominated counterparts. China's response is that these are sensible and important additions to the existing architecture. European states failed to fall in line with the US stance, and many became founding members of the Asian Infrastructure Investment Bank (AIIB). China's overarching vision of "new Silk Roads" integrating Asia and Europe by land and sea also demands a European response. In order to achieve better coordination than they managed over the AIIB question, the European Union and European states need to discuss and evaluate the economic and political dimensions of the Chinese initiatives in their overall context.

Under the new leadership that assumed office in 2012/13, China has displayed a striking degree of activism in foreign policy, including the economic sphere. Its initiatives possess the potential to cause lasting geoeconomic change affecting the economic centre/periphery structures of Asia, if not of the world.

China's New External Initiatives

At their sixth summit in July 2014 in Fortaleza, Brazil, the BRICS states (Brazil, Russia, India, China, South Africa) officially founded their New Development Bank (NDB), with an initial authorised capital of $100 billion. At the same meeting, the five states also launched a $100 billion Contingent Reserve Arrangement (CRA), a swap financing instrument designed to reduce their reliance on the International Monetary Fund (IMF) and the US dollar.

Almost a year earlier, in September 2013, Chinese head of state and Communist Party General Secretary Xi Jinping had presented his vision of a "new Silk Road" on his first foreign trip to Central Asia ("Silk Road economic belt"), adding the idea of a "twenty-first century maritime Silk Route" during a visit to Southeast Asia one month later. The objective is to connect China politically and commercially by land and sea to its neighbours in the region, to West Asia, and ultimately to Africa and Europe. Thus, this concept has much broader geographical implications than the earlier new Silk Road

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idea propagated by China back in the 1990s. Beijing has already set up a $40 billion "Silk Road Fund" for the land/sea initiative, known for short as "One Belt, One Road".

Lack of Russian support has thus far blocked Chinese efforts to create a development bank for the Shanghai Cooperation Organisation (SCO). However, the grouping may acquire its first new members this year, in the guise of India and Pakistan.

At the October 2013 meeting of the Asia-Pacific Economic Cooperation (APEC) in Bali, Indonesia, Xi Jinping announced the founding of yet another development bank: the Asian Infrastructure Investment Bank (AIIB), to be devoted exclusively to financing infrastructure projects. From the Chinese perspective it would complement the Asian Development Bank (ADB), which has been in existence since 1966. As in the case of the NDB, the authorised capital is to be $100 billion, of which China will contribute up to half.

In parallel to these two multilateral development bank initiatives, China has also extended considerable bilateral promises of financial support and infrastructure investment. Its engagement extends around the entire globe, with recipients including Africa ($5 billion), Latin America ($35 billion), Central and Eastern Europe ($10 billion), Venezuela ($20 billion) and China's western neighbour Pakistan ($46 billion). On his state visit to the latter in April 2015, Xi Jinping agreed the establishment of a transport corridor to the Indian Ocean, as well as numerous power generation projects.

Trade policy is already an established instrument of Chinese economic diplomacy. At the November 2014 APEC summit, which China hosted in Beijing, Xi revived the idea of a Free Trade Area of the Asia-Pacific (FTAAP). China concluded negotiations on bilateral free trade agreements with Australia and South Korea immediately before the summit, adding to similar agreements with, among others, the ASEAN states, Hong Kong, Taiwan, Pakistan, New Zealand, Chile, Peru, Costa Rica, Switzerland and Iceland. China's current trade policy priority, meanwhile, is the Regional Comprehensive Economic Partnership (RCEP), aiming at the harmonisation of existing bilateral free trade agreements between ASEAN and six of its partners.

China's new proactive diplomacy also manifests itself in a willingness to host international meetings, such as the May 2014 summit of the Conference on Interaction and Confidence-Building Measures in Asia (CICA). This organisation was initiated in the early 1990s by Kazakh President Nursultan Nazarbayev and comprises a very diverse spectrum of members. At the meeting, Xi Jinping argued that it was time for Asians to take charge of their own security (in other words, without the United States), which caused a stir in Western media. Beijing hopes that the 2014 upgrade of the Xiangshan Forum to an annual conference with official participation will become an equivalent to the more Western-dominated Shangri-La Dialogue in Singapore.

Altogether China's new leadership is pursuing a proactive foreign policy and seeking much more strongly to shape its own environment rather than simply reacting to events. Economic diplomacy plays a central role. Geographically the priorities lie in China's now more broadly defined "greater neighbourhood", where Xi Jinping speaks of a "community of shared interests, destiny and responsibility" or also a "community of common destiny".

Motives and Interests

Through the new visions, formats and instruments outlined above, China demonstrates its willingness to take on greater global and regional responsibility. As such, it is fulfilling a demand made by the industrialised West – but on its own terms and in selected areas aligned with its own interests.

The new financial institutions plainly also owe their existence to frustration over the failure to reform the World Bank, ADB and IMF to accommodate the interests of countries outside the OECD sphere. Resistance from the US Congress still prevents implementation of the 2010 decision to enhance the IMF voting rights of emerging economies (all the BRICS states together possess only 11 percent, China itself just 3.81 percent). In the ADB the United States and Japan are resisting overdue reforms of voting rights and quotas. And if the two major new free trade agreements – between the European Union and the United States (Transatlantic Trade and Investment Partnership, TTIP) and between twelve APEC members including the United States and Japan (Trans-Pacific Partnership, TPP) – actually come into being, China would find itself outside the two new major trading blocs, as would the other BRICS states. Beijing regards the TPP in particular as a US attempt to harm China economically through trade diversion and isolate it diplomatically in Asia. The AIIB and China's other initiatives can be interpreted as its response. Not only are they open to all countries to join without preconditions, but they could also become the motor of regional economic integration, because eliminating physical infrastructure deficits promises a much greater boost to Asian convergence and connection of regional supply chains than the lowering of tariffs and trade barriers proposed in the planned free trade agreement. Moreover, the AIIB involves the all ten ASEAN countries, whereas the TPP in its present composition splits ASEAN by including only Brunei, Singapore, Malaysia and Vietnam.

China's regional initiatives (AIIB and Silk Roads) also serve to polish its image in its own neighbourhood, which has become tarnished in recent years. While its territorial claims, which Beijing pursued considerably more forcefully after 2009/10 than in the early 2000s, have not vanished with the new engagement, China is seeking to bring itself into play again as an attractive partner.

China also hopes that embedding in a quasi-multilateral framework will lend greater legitimacy and acceptance to its infrastructure projects in partner countries. For example, in Myanmar, Kyrgyzstan and Sri Lanka there has been marked criticism of bilateral cooperation with China and the resulting dependencies.

The initiatives also possess a domestic economic dimension, where China hopes to boost its flattening domestic growth, the "new normal" of the Chinese economy with growth rates down to around 7 percent. Many provinces and cities are seeking to attract projects in the context of the two Silk Roads. AIIB-funded contracts are expected to fall overwhelmingly to Chinese businesses. The Chinese domestic infrastructure expansion has produced large, highly capable enterprises that are now in a position to compete abroad with low prices, acceptable quality and demonstrable project experience.

Beyond their benefits to the domestic economy, the external economic initiatives also possess geoeconomic significance. Thus it can be assumed that the planned investments will intensify China's regional pull and firmly establish the "Middle Kingdom" as Asia's economic centre of gravity. China is the natural heart of "Factory Asia" and its geopolitics promote an Asian spatial economic structuration centred on the country.

Finally, the outlined external economic initiatives effectively support China's autonomy-driven currency and finance policies. From the Chinese perspective, investing its own dollar reserves in foreign infrastructure projects represents a more politically and economically prudent use of foreign reserves than purchasing US treasury bonds. At the same time, the planned infrastructure investments directly promote the use of the Chinese national currency, the renminbi (RMB), as a means of payment in international trade in goods and services. In the medium term the renminbi is also likely to gain in attractiveness as an investment vehicle. For China the AIIB represents another step towards global financial and currency multipolarity, and greater independence from the US-dominated Bretton Woods institutions.

Overall Chinese foreign policy and economic diplomacy exhibit an integrated approach, where the AIIB initiative is about a great deal more than just a regional development bank.

The Test of Reality

While the five BRICS states are the sole founding members of the NDB, any country represented at the United Nations may join. The Bank is intended to promote investment in infrastructure and (less concretely) sustainable development – first and foremost in the BRICS states themselves, but also in other emerging economies and developing countries. Membership of and participation in the AIIB and the Silk Roads projects was, on the other hand, open from the outset.

In the case of the AIIB, China invited other states to join as founding members. But the rules under which it will operate have yet to be defined in detail. The Bank's charter is due to be finalised by 30 June 2015, which would allow it to be up and running by the end of the year. On present information participating Asian states will hold the majority of its capital stock, with the share held by non-Asian states to be capped at 25 percent (lower than in the ADB). Unless Japan decides to join, China may end up holding roughly 40 percent. The purpose of the Bank is to fund transport links (roads, rail), airports and seaports, telecommunications links, water management and affordable housing in Asian developing countries.

The Silk Road initiatives – "One Belt, One Road" – represent a comprehensive vision whose outlines were recently laid out in a paper by the National Development and Reform Commission (NDRC). The focus here is largely on expanding transport and energy corridors, connectivity, and new links between Asia and Europe. The concept also integrates projects already under way into its broader scope, such as the China–Pakistan and Bangladesh–China–India–Myanmar economic corridors. But the plan is largely for bilateral cooperations between China and the individual countries along the two major land and sea routes. Even after the official announcement of the Silk Road fund in November 2014 ($40 billion) it remains unclear what concrete form cooperation will in fact take.

The unstable security situation in certain countries earmarked for the concept represents a fundamental problem. For example, plans for the corridor through Pakistan had to be modified: instead of traversing Balochistan in western Pakistan the route will initially pass through Lahore and Islamabad to the port of Gwadar. But this bypasses exactly the areas in most urgent need of development. So while Xi Jinping postulates that development generates stability, this example demonstrates that development also presupposes a certain level of stability.

The various initiatives are interwoven. For example, both the NDB and the AIIB could be tapped for funding infrastructure projects in India. And while the Silk Road fund represents a dedicated resource for projects coming under the grand vision of the "One Belt, One Road", the AIIB will also play a central role. The Silk Road fund will be the more flexible instrument, because China administers it alone and it requires no statutes. China also already possesses its own national institutions for funding development aid and foreign trade, the two most central being the China Development Bank and the Export-Import Bank of China. But there are also numerous special funds, for example for funding energy and resource projects abroad. Every year since 2010 China has granted more development loans than the World Bank.

But the new financial institutions initiated by China and its Silk Roads vision have yet to pass the test of reality. Many questions, for example concerning transparency, labour and environmental standards, conditionality and tendering, remain unanswered. As the mixed experiences of Western development aid have shown, a lack of investment capital is not the most problematic bottleneck. The failure of numerous large-scale projects that looked good on paper should serve as a warning that without good governance and capable administrative institutions in the receiving countries it is almost impossible to adhere to budgets and timetables or to keep newly acquired modern infrastructure properly maintained. China has already repeatedly learned the hard way that its own development experience cannot simply be transplanted elsewhere.

Lessons from the AIIB

Responses to the AIIB Initiative

The memorandum of understanding on founding the AIIB was signed on 24 October 2014 by twenty-one Asian states: Bangladesh, Brunei, Cambodia, China, India, Kazakhstan, Kuwait, Laos, Malaysia, Mongolia, Myanmar, Nepal, Oman, Pakistan, the Philippines, Qatar, Singapore, Sri Lanka, Thailand, Uzbekistan and Vietnam. The only ASEAN nation missing from the list was Indonesia, citing its very recent change of government.

Washington eyes the AIIB and China's other initiatives with great scepticism. In essence they are regarded as competition for Western-dominated institutions and a challenge to America's traditional supremacy. While this stance brought no negative consequences for the BRICS bank or the Silk Road initiatives, the United States not only refused to participate in the AIIB, but reportedly even exerted diplomatic pressure on "allies and friends" to refrain from supporting it. The US Administration says it doubts that the new bank will adopt high environmental, tendering and human rights standards.

At first Washington was listened to: Influential nations in the region such as Japan, South Korea and Australia were negative or at least hesitant. But in the subsequent months other states – including a number of US allies – decided to join the list of prospective founding members before the deadline expired (31 March 2015). Japan is now the only major Asian nation not to join. Countries like Australia and South Korea justified their change of heart largely with the argument that it made more sense to influence the AIIB's structure and procedures from within than to criticise from outside.

Taiwan also sought to join. Alongside other questions, clarification of its designation will be needed, since China does not recognise Taiwan as a sovereign state. As "Taipei, China", it is already a member of the ADB and APEC. While Beijing has rejected Taiwan joining as a founding member, it has not excluded later membership.

After initial hesitation, the World Bank, IMF and ADB welcomed the founding of a new regional development bank. Following a meeting with Liqun Jin, secretary general of AIIB's Interim Secretariat, the Japanese president of the ADB, Takehiko Nakao, even announced that the ADB would fund projects jointly with the AIIB.

China also invited European states to join. While the US and Japanese positions made any common G7 stance an unrealistic proposition, discussions did take place between EU member states. These did not, however, lead to an agreed and coordinated course of action.

The United Kingdom was the first country in the EU to declare its willingness to join the AIIB as a founding member, on 13 March 2015. France, Italy and Germany followed a few days later, with a joint declaration attributing the new bank a positive role for the region's economic and social development and for global growth. London's decision was surprising in light of Washington's negative stance, and the Obama Administration criticised Britain's "constant accommodation" of China.

Other European states followed the UK example. The AIIB's website lists Denmark, Finland, Luxembourg, Malta, the Netherlands, Portugal, Poland, Spain and Sweden as prospective founding members from the European Union, alongside non-EU-members Iceland, Norway and Switzerland.

Undermining or Complementing Established Institutions?

Opinions diverge over whether China is seeking to undermine the still Western-dominated financial institutions established following the Second World War and replace them with its own alternative system, or whether these are in fact sensible or even vital additions where China is acting as the "responsible stakeholder" the West has long been calling for. The associated question of whether these Chinese moves mark the beginning of the end of Western domination is equally contested. Even within the United States several think tanks have criticised the US stance as a missed opportunity and interpreted China's agenda as more of a modest reform than a frontal attack on the established institutions.

The notion that the NDB and AIIB could play complementary roles is supported by predictions of infrastructure needs of developing countries and emerging economies published by the established multilateral development banks themselves. The ADB estimates the capital required for infrastructure investment between 2010 and 2020 at $8.29 trillion for Asia alone. The World Bank assumes that developing countries and emerging economies globally will require about 7 percent of GDP, which is equivalent to an annual investment volume of about $2 trillion. These numbers exceed the capacity of the established institutions, providing a gap for the new development banks to fill. With authorised capital exceeding $160 billion and a triple-A rating, the ADB will remain the most important lender for infrastructure and other development cooperation in Asia for the foreseeable future. But the AIIB, the NDB and China's other bilateral funding facilities possess sufficient reserves to fill future infrastructure funding gaps in Asia – and elsewhere too.

In general there is much to suggest that China's intentions are not revisionist. Instead, the country is seeking to play a political role within the existing global economic system commensurate to its economic weight. Ultimately China owes most of its economic advances of recent years to its ever closer integration into the global economy. The United States and Europe are the main markets for China's exports and its most essential sources of investment, know-how and technology. Moreover, China is in no sense taking leave of the existing formats, but is in fact demonstrating greater willingness to participate more actively there too. In the guise of Justin Lin, China provided the World Bank's chief economist from 2008 the 2012, while Zhu Min has been deputy managing director of the IMF since 2011. With industrial policy and the principle of capital controls, China has made its mark at the World Bank and the IMF. In 2016 China will chair the G20 for the first time, and host a summit on Chinese soil. Beijing is demonstrably pursuing its own goals and interests both within the established multilateral system and by setting up its own structures. So it is conceivable that the new development banks created by China and other countries might in fact spur the reform process in the Bretton Woods institutions. The World Bank and the G20 also placed infrastructure investment on their agendas at the end of 2014.

There is no sign that China and the other emerging economies are seeking to reinvent the wheel, in the sense of introducing completely new rules, standards and procedures under which the new financial institutions will function. All those involved must be aware that relaxing conditions would mean greater default risks. And like any bank, the AIIB will have to insist on repayment of principal and interest. Instead of a revision, it would be more accurate to speak of an adaptive evolution of the Bretton Woods system. The new BRICS reserve fund (CRA), for example, is already tied to the IMF by its statutes: Just like the Asian currency fund of the Chiang Mai Initiative, 70 percent of its pool can be tapped only under observance of IMF conditionalities. In the case of the AIIB there were consultations with the World Bank from the outset, and for its charter Beijing hired a lawyer who had worked for the World Bank for three decades. Personnel is recruited globally.

One important task of the European and Asian member states will be to ensure, as founding members and prospective supervisory board members, that the AIIB sets and observes high standards in the fields of human rights, social and environmental protections, compliance and governance.

In view of the great infrastructure needs, a constructive stance is appropriate. To brand the new Chinese initiatives from the outset as anti-Western attempts to dismantle the existing system will only feed into the widely held Chinese belief that the US and the West are trying to keep the country down and imposing a policy of containment.

In the meantime, the United States and Japan have also modified their rejection of the AIIB. At a joint press conference at the White House during a visit by Japanese Prime Minister Shinzo Abe in early May 2015, President Obama declared that the Bank could play a positive role if it adhered to high lending standards. Abe stressed the importance of "fair governance". But this shift will do nothing to blunt widespread criticism, even within the United States, that Washington handled this issue in a clumsy and counterproductive way.

Lessons for Europe

Thirteen EU member states successively accepted the invitation to join the AIIB. The uncoordinated nature of the European response is unfortunate. For present and upcoming positioning, a better-coordinated political discussion within the European Union would be desirable. The diverse Chinese initiatives must be discussed together, with the two Silk Roads forming the backbone holding them all together. The new development banks, the investment funds and the state banks are all intended to serve as financing instruments for projects under the "One Belt, One Road" vision.

Reform of voting rights in the established financial institutions is not to be expected, since it requires approval by the US Congress. But at the regular five-yearly review, the IMF's members will soon have to decide whether to include the renminbi in the currency basket that determines the value and composition of its special drawing rights. The currencies currently represented are the US dollar (41.9 percent), the euro (37.4 percent), the yen (9.4 percent) and the British pound (11.3 percent). The criteria for acceptance are the country's share of world exports and whether the currency is freely usable. China may have made considerable progress on the latter point, but restrictions on movement of capital persist and the domestic bond market remains underdeveloped. Nonetheless, a political decision should be made to include the renminbi in the basket, in a sense as a statement of confidence. But this step should be tied to conditions concerning liberalisation and opening of capital markets.

With respect to the Silk Roads, the European states and the European Union need to act in unison and not allow themselves to be divided by exclusive agreements between China and individual member states. The ongoing talks on a European-Chinese investment agreement should also pay heed to China's interest in physical connectivity to Europe. In its Silk Roads vision Beijing has already included the "16+1" format, a regular meeting with sixteen central and eastern European states including five non-EU members. A number of Chinese infrastructure projects in that region have been agreed, such as the modernisation of the Budapest–Belgrade rail line.

From the European perspective the Asia-Europe Meeting (ASEM) offers a broader platform for the two Silk Road initiatives. Because of its composition and size – fifty-one European and Asian members plus the European Commission and the ASEAN Secretariat – it could form an appropriate framework. Possible forms of cooperation and the necessary conditions could be best raised here, supported by sectoral meetings, for example of the transport ministers.

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