The Development of China's Maritime Silk Road Initiative in South Asia & Its Implications for Business & Government

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An Overview of China's Maritime Silk Road Initiative (MSRI)

China's MSRI was proposed by Chinese President Xi Jinping in 2013 in Indonesia. At that time, China provided very few details about which countries would be involved in the scheme, which was a sister to its Silk Road Economic Belt project and part of its larger Belt and Road Initiative (BRI) *(Map 1)*, and which projects would be included in it. Even today we have no official list of MSRI participants or projects. Wild sums of money, often without any reasonable basis in fact, were attributed to the scheme with some analysts, firms, and journalists speculating that China would provide several trillion US dollars in funding to support the BRI. The initial reaction to the MSRI and larger BRI entailed quite a bit of hyperbole with commentators forecasting it would produce dramatic political and economic sectoral (e.g. resources), regional, and global consequences.

As I noted in single-authored and co-authored publications in *Geopolitics* in 2017, it is clear, despite the vagueness of official Memorandums of Understanding (MoUs), reports, and statements that China envisions it to include massive amounts of hard infrastructure. Hard infrastructure means airports, bridges, port infrastructure, railways, roads, and warehouses. It also entails dams, electrical transmission lines, pipelines, mines, and power plants. Furthermore, it encompasses industrial parks and special economic zones (SEZs). Also relevant is soft infrastructure such as customs clearance and phytosanitary accords, bilateral investment treaties (BITs), MoUs for educational exchange and training, dispute resolution courts, and trade agreements to facilitate greater flows of goods, peoples, moneys, and services.

The economic goals motivating China to support the scheme include enhancing its export channels (critical at a time when China has excess capacity in many areas), creating new foreign direct investment (FDI) and contracting opportunities for its multinational corporations, bolstering its access to oil and minerals, advancing the internationalization of the renminbi, and accelerating the development of subnational actors like Chinese provinces. There is much debate, laudatory as well as critical, about the political objectives behind China's MSRI. Posited goals include a Chinese quest for regional hegemony, an effort to promote peaceful relations within and between MSRI participants, a move to boost China's soft power, a desire to fill, as economist Long Ke has argued, a global leadership vacuum, and a wish to limit local government parochialism in China.

MAP 1
Map showing China's BRI

Source: American Chamber of Commerce Shanghai

Economic Limits to the MSRI — the South Asia Setting

South Asia is a vital MSRI region because of the volume of trade and energy shipments passing through the Indian Ocean and the fact that the world's sixth-largest economy in nominal GDP terms (India) is situated there. According to Alice G. Wells, US acting assistant secretary for South and Central Asian affairs and acting special representative for Afghanistan and Pakistan, who was speaking at the Indian Ocean Conference in Colombo in September 2017, the Indian Ocean "is the fulcrum of global trade and commerce with nearly half the world's 90,000 commercial vessels and two-thirds of the global oil traveling through its sea lanes." Moreover, a quick look at the Eastern Hemisphere map *(Map 2)* shows

MAP 2
Map of Eastern Hemisphere

Source: Mapswire

quite clearly that the Indian Ocean is an essential passageway for any plans that connect China to Europe and Africa because, at some point, the goods on existing and planned railways from Pakistan, Myanmar, and Thailand, ships coming via the Malacca Strait, and planes from various starting points have to transit the Indian Ocean Region (IOR).

It remains unclear, though, if South Asia offers fertile economic soil for the MSRI to take root and blossom, an issue that was brought into stark relief when, in 2017, Sri Lanka had to turn over a majority equity stake in its massive Hambantota port development project to a Chinese company because of its inability to repay its loans from China. Separate essays by Xinmin Sui, Jabin T. Jacob, David J. Karl, and Srikanth Kondapalli in the edited book *China's Maritime Silk Road Initiative and South Asia* (2017) already showed at that time that key South Asia MSRI participants like the Maldives, Pakistan, and Sri Lanka faced numerous daunting economic challenges such as their ability to repay the debts they incurred to build MSRI-related infrastructure, challenges in boosting exports, weak rule of law, problematic civil institutions, and slow economic growth. On top of this, a number of South Asian MSRI participants have corruption problems, fiscal deficits, balance of payment problems, poor educational systems, and excessive government bureaucracy and red tape.

There also are economic issues at the regional level that may impede the full achievement of the MSRI. To illustrate, Amitendu Palit's chapter in the aforementioned book shows that South Asia is not well integrated economically. The poor state of integration is due to political factors, national customs and trade policies, poor logistics facilities, insufficient transportation systems (e.g. roads and rails) within MSRI countries, and a lack of connectivity among countries. Certainly, MSRI-related infrastructure aims to rectify some of these problems, but its contribution will be less dramatic than if it was already building upon an established base of railways, roads, and power systems.

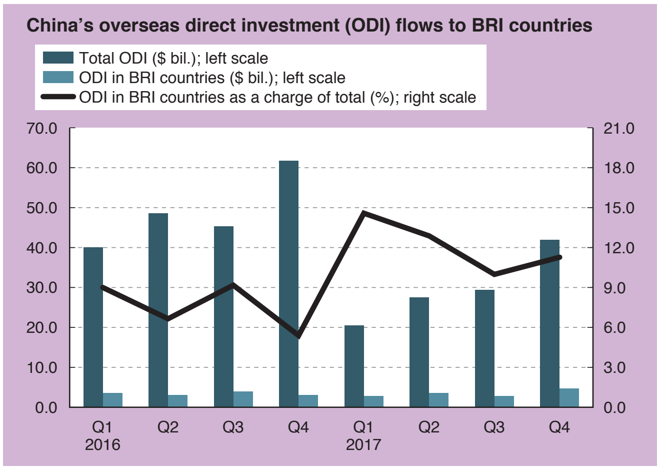
Economic Limits to the MSRI — China

China has numerous financial institutions that can marshal hundreds of billions of dollars in trade financing (letters of credit), investment, loans, purchasing credits, and political risk insurance to support MSRI trade, investment, and infrastructure even though this may not be their main mission. These institutions include the China Development Bank (CDB), the Export-Import Bank of China (Ex-Im Bank China), the Asian Infrastructure Investment Bank (AIIB), the BRICS New Development Bank, the China Investment Corporation, the Silk Road Fund, and Sinosure. Chinese financial institutions such as the Industrial and Commercial Bank of China, Chinese state-owned enterprises (SOEs) such as China Three Georges, and Chinese private firms represent additional sources of moneys to back MSRI activities and projects.

It has long been unclear exactly how much of the MSRI's capital Beijing intended to provide itself, though it was known that it did not plan to provide all of the moneys itself and also intended for private capital, multilateral institutions such as the Asian Development Bank, and other governments to partner with the AIIB, CDB, and Ex-Im Bank of China. Of late, though, there have been increasing doubts about China's willingness to open the taps to fund MSRI projects. One cause is the restraints, whose impact is shown in the *Chart*, that China puts on outward capital flows, starting in 2016, in order to protect its then plummeting currency reserves. A second cause is China's increasing caution about extending loans in the face of trouble or rising debt loads encountered in African, Latin American, and South Asian countries such as Kenya, Venezuela, and Sri Lanka.

CHART

Chinese limits on capital outflows restrain outward FDI



Source: Economic Intelligence Unit

A third is China's slowing growth.

While the MSRI is a major Chinese foreign policy endeavor and one of Xi's signature initiatives, there are many issues inside China that compete for time and money which will limit the amount of resources that Beijing can devote to the MSRI. These include the problem of resolving overindebted and zombie SOEs, the need to restructure China's growth model to one placing less emphasis on infrastructure and real estate, and the ongoing campaign to eradicate poverty.

Political Challenges Facing the MSRI — the South Asia Setting

Not only are there many questions about the international and domestic (in MSRI participants and China) economic context surrounding the development of the MSRI, there also are many political ones. A huge political issue is the stance of India towards the MSRI, an issue highlighted frequently in the aforementioned edited book. For diverse reasons, India's relationship with China has improved of late as shown by, for instance, interactions between Indian Prime Minister Narendra Modi and Xi in April 2018 *(Photo)*.

However, for reasons of history, identity, prestige, status, and domestic politics, India is anxious about Chinese inroads into the IOR and thus the MSRI which, if fully realized, incontrovertibly would broaden and deepen China's presence in India's neighborhood and in the IOR. On top of this, India fears Chinese economic competition, has a long-standing and contentious territorial dispute with China, and is quite concerned about China's much strengthened relations with neighboring countries like Bangladesh, Pakistan (India's arch enemy), the Maldives, Sri Lanka, and so on — all of which, with the exception of Pakistan, used to be only in India's orbit. These factors not only have prevented India from participating in China's scheme, but also have spurred New Delhi to use diplomacy, economic deals, and military and security cooperation to try to counter it.

Domestic politics presents another challenge to the MSRI's progress in South Asia. In Sri Lanka, the MSRI has become politicized domestically because of its environmental and social impact and indeed China's surging presence in Sri Lanka was one of the factors that led to the ouster of the Mahinda Rajapksa regime in 2015. Moreover, elites and local citizens are worried about the sovereignty implications of the equity-for-debt swaps that the government embraced to reduce the country's crushing debt burdens. In the Maldives, the MSRI also is a hot-button political issue as we have seen in the recent election where the victory of the opposition was attributed partly to voter concerns about the larger implications of the country's participation in China's program. The MSRI has even become a political issue in Pakistan, a long-time Chinese ally, for various economic and political reasons.

Political Challenges Facing the MSRI — the Broader Context

Due to the importance of the IOR, the progress of the MSRI in South Asia has drawn attention in Canberra, Tokyo, and Washington.

Photo: Prime Minister of India Narendra Modi Twitter Page

Indian Prime Minister Narendra Modi and Chinese President Xi Jinping at their informal summit in Wuhan, China

Indeed, Japan, which has not signed on to Beijing's program or become a member of the AIIB, has been using diplomacy, aid, lending, FDI, and trade programs to structure alternatives to the MSRI. Specific examples include infrastructure projects in India and Sri Lanka, cooperation with India on the launch of an Asian connectivity vision dubbed the Asia-Africa Growth Corridor, intensified economic cooperation with Vietnam, increases in official development assistance for Japan's "Free and Open Indo-Pacific Strategy", and Japan's $110 billion Partnership for Quality Infrastructure Initiative. Germane, too, is increased collaboration between India and Japanese businesses in places like Bangladesh and Sri Lanka.

It is important not to exaggerate the intensity of Japanese initiatives even though they are a reality that can affect the shape of the MSRI and the reactions of MSRI participants. Moreover, since summer last year, Prime Minister Shinzo Abe, potentially because of a desire to profit from the economic opportunities offered by the BRI, Japanese business lobbying, and hopes that China will reciprocate politically, has been voicing a willingness to consider Japanese participation in the BRI and AIIB. Indeed, this fall, Chinese and Japanese representatives are expected to discuss joint Japanese-Sino private sector MSRI projects. Yet, here too, one must be careful not to exaggerate Japan's "embrace" because Abe has stressed it is conditional:

> First of all, it is critical for infrastructure to be open to use by all, and to be developed through procurement that is transparent and fair. I furthermore consider it essential for projects to be economically viable and to be financed by debt that can be repaid, and not to harm the soundness of the debtor nation's finances. I would expect that the "One Belt, One Road" initiative will fully incorporate such a common frame of thinking, and come into harmony with the free and fair Trans-Pacific economic zone, and contribute to the peace and prosperity of the region and the world.

These conditions certainly are not easy for China to fulfill!

For its part, the United States has been following two tracks to deal with the rise of the MSRI in South Asia as well as the rise of China more generally. First, it has been working to strengthen relations with India. This has included more leader meetings, the creation of a 2+2 dialogue involving US and Indian defense and foreign ministry officials, raising the status of India and the region in US security planning, enhanced military and intelligence cooperation, and support for a "Free and Open Indo-Pacific".

Second, it has been working to incorporate India into multilateral initiatives such as the Quadrilateral Dialogue, a soft military grouping involving Australia, India, Japan, and the US that conducts joint military exercises. A recent multilateral initiative of note is a joint investment and project development initiative involving the US Overseas Private Investment Corporation (OPIC) which has struck partnership deals with Australia and Japan. Regardless, it remains open to debate how closely New Delhi will follow the US lead in responding to the MSRI even though it, too, has concerns about the MSRI as discussed. This is because it has political and economic reasons to work with China, disagreements with Washington about Iran and its military and political relations with other BRICS countries like Russia, and does not necessarily want to be caught up in the harder elements of US hedging against China.

The multinational South China Sea territorial and maritime dispute, which involves, in different ways and extents, Brunei, Indonesia, the Philippines, Malaysia, Taiwan, and Vietnam, is another extra-regional issue with potential ramifications for the development of the MSRI in South Asia. If the dispute escalated dramatically, then it would disrupt commerce and investment from South Asia to Southeast Asia and vice versa. In addition, India maintains close ties with a number of countries in Southeast Asia pursuant to its Act East policy. Given this, a blow-up of the South China Sea controversy could affect relations between India and China with subsequent spillover into the way that India perceives and responds to the MSRI.

Risks for Business & Governments

A successful MSRI has a number of potential adverse implications for non-Chinese businesses. To date, China has used the lure of aid, FDI, and loans (sometimes offering preferential terms such as lower interest rates or longer repayment terms) to win deals to build and/or operate power generation and distribution facilities, transportation infrastructure such as high-speed rail, and industrial parks (studies have shown that China rarely gives foreign firms opportunities to participate in such projects), to secure supply arrangements that favor Chinese companies, and to improve China's position in setting the technical standards that structure economic interactions. Moreover, the connectivity, business networks, and relationships resulting from China's MSRI have the potential to create a better future situation for Chinese business, to reconfigure natural resource flows, and to improve China's soft power which, in turn, can improve the receptivity of local decision-makers and the local populace to Chinese investment and contractors.

The MSRI's risks for governments are noteworthy, as well.

Obviously, if the MSRI substantially deepens participant country economic bonds with China, then these countries become susceptible to Chinese influence, though their actual pliability will depend upon a multitude of variables such as their domestic political situation, their economic condition, and the availability of regional and global alternatives to China and Chinese moneys. Furthermore, countries such as the US and Japan could experience waning power and status in the IOR if China's scheme is fully realized. Beyond this, to the extent that the MSRI ensconces networks favoring China, countries that rely on IOR ports, transportation systems, or natural resource flows could experience a loss of independence and become more subject to Chinese control and sanction.

The issues above deserve serious consideration, but there is much hyperbole about them, too. The political and economic factors discussed earlier, which relate to MSRI participants, China, and the actions of extra-regional players, will block, slow, or modify the implementation of the MSRI and thus the risks that it might raise for business and governments inside and outside the region. Moreover, it is conceivable that China or other relevant Chinese actors such as SOEs may create problems for the realization of that MSRI in South Asia because of their poor corporate social responsibility practices, a possibility suggested by previous episodes in Ethiopia, Peru, and Myanmar where environmental externalities, the mistreatment of workers, or insufficient attention to local communities produced a backlash against Chinese projects.

Opportunities for Business & Governments

The implementation of the MSRI in South Asia may pose certain downsides for non-Chinese businesses, but it offers a number of potential gains, too. For instance, if it boosts economic growth in participant countries then it will expand opportunities for companies to sell goods and services. Furthermore, the exploitation of MSRI-participant natural resources, the building of industrial parks and SEZs, the expansion of transportation systems, the development of power systems, and reduction of barriers to commerce should facilitate existing operations, increase the return on investment, generate new trade opportunities, open new opportunities to provide financial services, and provide a base for greater tourism. Of course, many of these benefits depend upon China accomplishing the MSRI and it is not clear that it will be accomplished in full given the challenges enumerated previously.

Intriguingly, the clouds facing the MSRI in South Asia generally and in the Maldives, Pakistan, and Sri Lanka specifically may have a silver lining for foreign businesses. To elaborate, MSRI-participant countries now seemed focused on diversifying their sources of financing and investment which is leading them to seek to work with a wider range of banks, firms, and multilateral investors. It also seems to have served as a spur for China to welcome wider foreign participation in the MSRI as a way to diversify risk as well as deflect criticism.

While many governments seem to be focused on the negative political aspects of the MSRI, it is wrong to assume the MSRI only will produce negative political externalities. Although the linkage is far from guaranteed, economic growth has the potential to enhance the political stability of MSRI participants. It further can diminish the potential for terrorism by, in theory, reducing the crushing poverty that provides a breeding ground for recruits. As for the aforementioned economic interdependencies, which many fear will fuel Chinese dominance, it is important to point out that they will not just bond countries to China, but also link countries to one another and thus produce more pacific relations. Finally, Chinese analysts have argued that the MSRI shifts China's foreign policy direction westward and therefore should minimize the potential for conflict between it and others like the US.

Conclusion

This article has put the spotlight on China's MSRI with a focus on South Asia, a region that will play a critical role in the evolution of the MSRI. I have highlighted a number of features of the scheme as well as its objectives, but also identified a number of political and economic challenges that will affect its full realization. These challenges include economic problems in host countries, anxieties in India, and counterbalancing activities, albeit to different degrees, by Australia, Japan, and the US. As I have shown, the MSRI has potential upsides and downsides for businesses and governments, some more likely if the MSRI succeeds and others more likely if the MSRI is troubled. Given the contingent nature of the MSRI's success and its impact, it is wise neither to be a blind optimist nor a blind pessimist about the initiative. Instead, businesses and governments need to contemplate multiple possible scenarios as well as to reflect dispassionately about the ways they can shape the costs and benefits of these various scenarios. JS

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