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Is Europe to Benefit from China's Belt and Road Initiative?

by Nicola Casarini

ABSTRACT

With the One Belt One Road (OBOR), arguably Beijing's major diplomatic outreach in decades, a process towards greater Sino-European connectivity has been put in place. The implementation of the OBOR in Europe has focused so far on financing infrastructure projects, in particular railways in Southeast Europe and ports in the Mediterranean Sea. This has been complemented by growing monetary linkages between the People's Bank of China and European central banks through the establishment of currency swap agreements and yuan bank clearing – so-called "offshore renminbi hubs" – with the aim of lowering transaction costs of Chinese investment and bolstering the use of the Chinese currency. While there are undoubtedly great economic opportunities, China's OBOR initiative also presents the EU with a major political challenge. There is the risk, in fact, that a scramble for Chinese money could further divide EU member states and make it difficult for Brussels to fashion a common position vis-à-vis Beijing. Furthermore, China's economic penetration into Europe may lead – if not properly managed – to a populist backlash as well as a strain in relations with Washington. All these elements should be taken into consideration by EU policymakers, as China's OBOR makes inroads into the Old Continent.

China | Central Asia | Balkans | Eastern Europe | Foreign direct investments (FDI) | Infrastructures | Transports | European Union | Renminbi

keywords

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by Nicola Casarini*

1. China's Belt and Road meets Juncker's Fund

The One Belt, One Road (OBOR) initiative – unveiled by President Xi Jinping in late 2013 – is China's major diplomatic outreach in decades. The project combines a land-based Silk Road Economic Belt and a sea-based 21st Century Maritime Silk Road which connects China to Europe through South East Asia, Central Asia and the Middle East, covering areas generating 55 percent of the world's GNP, 70 percent of the global population, and 75 percent of known energy reserves. The stated aim of this grandiose project is to boost connectivity and commerce between China and 65 countries traversed by the OBOR. China's total financial commitment to the project is expected to reach 1.4 trillion dollars. Beijing has already committed around 300 billion dollars for infrastructural loans and trade financing in the coming years, a sum which includes a 40 billion dollar contribution to the "Silk Road Fund" for infrastructural development and the 50 billion dollar initial capital (to be raised eventually to 100 billion dollars) allocated to the China-initiated Asian Infrastructure Investment Bank (AIIB).[1]

Sitting at the end-point of the OBOR, Europe stands to benefit greatly from these funds. At the last EU-China Summit on 29 June 2015, Jean-Claude Juncker, the European Commission President, called for the creation of synergies between his European Fund for Strategic Investments (EFSI) and China's Belt and Road initiative.[2] Premier Li Keqiang replied to Juncker by making a multibillion dollar

[1] For more details on the One Belt, One Road strategy, see François Godement and Agatha Kratz (eds.), "'One Belt, One Road': China's great leap outward", in *ECFR China Analysis*, June 2015, http://www.ecfr.eu/publications/summary/one_belt_one_road_chinas_great_leap_outward3055. See also Zhao Minghao, "China's New Silk Road Initiative", in *IAI Working Papers*, No. 15|37 (October 2015), http://www.iai.it/en/node/5495.

[2] EU-China summit joint statement, 29 June 2015, http://www.consilium.europa.eu/en/press/press-releases/2015/06/29-eu-china-statement.

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investment commitment to the EFSI, though no precise amount has been unveiled so far.[3]

Totalling 315 billion euros, Juncker's plan aims at relaunching Europe's growth and job creation in sectors ranging from innovation to research, education, and transport infrastructure. The Belt and Road initiative, on the other hand, serves the purpose of reviving the Chinese economy, now at a historical juncture transitioning from export-oriented growth to a new model based on consumption and outward investment. Loans for infrastructure projects abroad are expected to contribute to upgrading the Chinese economy at a time of domestic overcapacity and to the restructuring of various sectors, including heavy industries involved in the building and maintenance of transportation and energy infrastructure. Trade financing would serve to maintain existing – as well as find new – markets for Chinese products.

Policymakers in Brussels and Beijing are currently identifying appropriate cooperation mechanisms between Xi's Belt and Road and Juncker's Fund. Ideas presented so far include the establishment of a China-EU joint investment fund to support project shareholding, joint contracting and co-financing.[4] Infrastructure projects in Southeast Europe and the Mediterranean are likely to become the first concrete examples of this enhanced Sino-European connectivity.

2. Focus on Southeast Europe and the Mediterranean

Southeast Europe and the Mediterranean – in particular the Greek ports – have been the main beneficiaries of the Silk Road funds so far. The flagship infrastructural project in the area is a land-sea express route which will directly link the port of Piraeus – one of the largest container ports in Europe for which Chinese shipping giant COSCO has a 35-year concession – with at least six to eight Central and Eastern European countries, thus turning the Piraeus into a Chinese hub for trade with Europe. The 2.2 billion euro project is financed by soft loans from China's Export-Import Bank, and will be built by the state-owned China Railway and Construction Corporation. Work on the line is scheduled to begin by the end of 2015, and should be completed by 2017.[5]

[3] Translated keynote speech by H.E. Li Keqiang at the 10th EU-China Business Summit, 29 June 2015, http://www.eu-china-business-summit.eu/content/uploads/2015/07/CHN-BS-sp290615-Translated-speech-of-H.E.-Premier-Li-Keqiang.pdf. See also Robin Emmott and Paul Taylor, "Exclusive: China to extend economic diplomacy to EU infrastructure fund", in *Reuters*, 15 June 2015, http://reut.rs/1IX7LPK.

[4] Ministry of Foreign Affairs of the People's Republic of China, *Li Keqiang Meets with Vice President Jyrki Katainen of the European Commission*, 29 September 2015, http://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1304115.shtml.

[5] Dragan Pavlićević, "China's Railway Diplomacy in the Balkans", in *China Brief*, Vol. 14, No. 20 (October 2014), http://www.jamestown.org/single/?tx_ttnews[tt_news]=42992.

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The 370 km railway between Belgrade and Budapest will significantly improve transport of passengers and goods, cutting travel time between the two capitals from eight hours to less than three. China is also committed to upgrading Greece's railway system, focusing on the northern route to Macedonia through Thessaloniki and the Macedonian railway line that would connect Greek lines to the upgraded north-south route in Serbia and the Hungaro-Serbian High-Speed Railway.[6] Concurrent with these investments in the Greek and Macedonian portions of the line are Chinese plans to upgrade both railway and road infrastructure from Bar through Montenegro to the Serbian border. Once all the projects are completed, the high-speed rail connection will extend all the way from Piraeus to Budapest. A double track between the Mediterranean and the Danube will thus enable trains to reach a speed of up to 200 km per hour. By reducing shipping times, the new line will make Chinese products more competitive in the European market, helping to offset rising production costs at home.

Chinese goods are currently shipped through the Suez Canal, then in a wide loop through the Mediterranean, the Bay of Biscay and the English Channel to ports on Europe's north-western coast, including Rotterdam, Antwerp and Hamburg, from where they are dispatched by road and rail to inland cities. Once the Balkan projects are completed, Chinese products will go from the Suez Canal – which recently doubled its capacity – directly to Piraeus to be loaded onto trains, cutting transit times from roughly 30 to 20 days.

Piraeus is central in Beijing's strategy of linking China with Europe through the Mediterranean. The Greek port is, in fact, the gateway between the Middle East and the Balkans and European markets; from a Chinese perspective, it is a unique entry point into the EU. When Chinese Prime Minister Li Keqiang visited Piraeus in June 2014, he called it "the pearl port" of the Mediterranean Sea.[7]

Chinese companies are already well established in Piraeus. Huawei, an electronics conglomerate, opened a logistics centre in the port two years ago. This was followed by the June 2014 signing of a 2 billion euro deal between Greece and China to build new container ships and bulk carriers, financed by the China Development Bank, to serve the Greek port. However, the most important Chinese company operating in Piraeus is COSCO.[8]

[6] For more information on Chinese railways projects in the Balkans see: Dragan Pavlićević, "China, the EU and One Belt, One Road Strategy", in *China Brief*, Vol. 15, No. 15 (July 2015), http://www.jamestown.org/single/?tx_ttnews[tt_news]=44235.

[7] Xing Zhigang, "Li charms dock workers in Greece", in *China Daily*, 20 June 2015, http://www.chinadaily.com.cn/world/2014livisitbritaingreece/2014-06/21/content_17605748.htm.

[8] Frans-Paul van der Putten, "Chinese Investment in the Port of Piraeus, Greece: The Relevance for the EU and the Netherlands", in *Clingendael Reports*, 14 February 2014, http://www.clingendael.nl/node/5439.

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In 2009, COSCO – a state-owned, Hong Kong-listed company that is China's biggest dry bulk carrier and liner carrier – obtained a 35-year concession from the Greek government to operate two container terminals at the Piraeus Port. The deal, which carried a nominal value of 4.3 billion euros for the whole period, required COSCO to make substantial investments in Terminal II and to build a new section of Terminal III. In September 2013, COSCO agreed to invest an extra 230 million euros to increase capacity, prompting then Greek Prime Minister Antonis Samaras to call the Piraeus Container Terminal project the most important investment in Greece in the past decade.[9]

COSCO has upgraded the port's outdated crane system and built a new deep-water dock capable of accommodating today's giant container ships. This overhaul has made Piraeus one of the world's fastest growing ports, as it handled 3.7 million TEU (20-foot equivalent units, the standard measurement of container shipments) in 2014, more than nine times the 433,000 TEU received in 2008, before COSCO made its investment.

The Chinese carrier plans to double Piraeus's container traffic next year if it wins the privatisation tender to operate the rest of the port. COSCO is in pole position to snap up the 67.7 percent of the port that is still controlled by the Greek government, a stake that will soon be put up for sale according to the terms of Greece's latest 86 billion euro bailout agreement with the International Monetary Fund, the European Commission and the European Central Bank. If COSCO succeeds, Piraeus could become as big a container port as Hamburg, Rotterdam or Antwerp.

Chinese shipping companies also have a well-established presence in the Italian ports of Naples and Genoa, where both COSCO and the China Shipping Company have invested heavily. It is worthy of note that the port of Gioia Tauro in southern Italy also received some interest from Chinese investors before they decided to turn their focus on Piraeus.[10]

By focusing on infrastructure projects on land and sea, China seeks to build better connectivity as well as acquire political influence in the areas interested by the Belt and Road. The OBOR represents a great opportunity for the Old Continent – in particular for some cash-strapped governments of the periphery – to obtain financial capital from Beijing.

[9] COSCO, *The Inauguration of the Expansion of Pier III of PCT Successfully Convened*, 23 January 2015, http://en.cosco.com/art/2015/1/23/art_773_68531.html.

[10] Marco Sanfilippo, "Chinese Investments in Italy: Facing Risks and Grasping Opportunities", in *IAI Working Papers*, No. 14|19 (December 2014), p. 19-20, http://www.iai.it/en/node/2375.

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3. Taking Europe by investment

All European governments are eager to attract Chinese investment – and Beijing does not appear to be disappointing them. By Summer 2015, China had made purchases for about 65 billion dollars in listed companies on European stock markets,[11] ranking fourth for size of investment, surpassing Japan. In addition to Germany, which remains China's top destination, Beijing is now showing great interest in Eastern and Southern Europe.[12]

Since early 2014, the People's Bank of China (PBOC) – through its investment arm, the State Administration of Foreign Exchange (SAFE) – has invested more than 3.5 billion euros on stakes of about 2 percent each in ten of Italy's largest companies: these include Monte dei Paschi di Siena, Unicredit, Saipem, Mediobanca, Fiat Chrysler Automobiles, Telecom Italia, Prysmian, Assicurazioni Generali, ENEL and the state-controlled ENI (oil and gas operator). This has made the PBOC the 10th largest investor in Italy's stock exchange. Moreover, in May 2014 the Shanghai Electric Group bought a 40 percent stake in power engineering company Ansaldo Energia for 400 million euros. This was quickly followed by China's State Grid's acquisition of a 35 percent stake in energy grid holding company CDP Reti for 2.1 billion euros.[13] In March 2015, China National Chemical Corp (ChemChina) bought a majority stake (16.89 percent) in Pirelli, the world's fifth largest tire maker, in a deal worth 7 billion euros.[14] Beijing has, so far, invested more than 6.5 billion euros in listed companies on the Italian stock market, a sum which corresponds to around 10 percent of total Chinese investments in European stocks.

China has also increased its involvement in project financing. Here also, it is the countries of Eastern and Southern Europe that have received most of the funds so far. At the Third Meeting of Heads of State and Government of China and the 16 Central and Eastern European countries (CEECs) held in Belgrade in mid-December 2014, Chinese Premier Li Keqiang pledged to inject more funds to boost infrastructure

[11] This sum represents a conservative estimate, based on a number of reports published in the first part of the year and some recent investment announcements published in the specialised press in the last months. See, for instance, Baker & McKenzie, *Chinese investment into Europe hits record high in 2014*, 11 February 2015, http://www.bakermckenzie.com/news/Chinese-investment-into-Europe-hits-record-high-in-2014-02-11-2015; Thilo Hanemann and Mikko Huotari, *Chinese FDI in Europe and Germany: Preparing for a New Era of Chinese Capital*, A Report by the Mercator Institute for China Studies and Rhodium Group, June 2015, http://rhg.com/?p=8832.

[12] Nicola Casarini, "China's Rebalancing towards Europe", in *The International Spectator*, Vol. 50, No. 3 (September 2015), p. 122-129.

[13] For more details on Chinese deals in Italy and their value, see Marco Mutinelli, "The central bank is targeting listed companies", in *Il Sole 24ore*, 22 September 2015, http://24o.it/LKAcmz; KPMG, *Merger & Acquisitions 2014*, April 2015, http://www.kpmg.com/IT/it/IssuesAndInsights/ArticlesPublications/Pagine/RapportoMA.aspx.

[14] See Fausta Chiesa, "Alleanze: cinesi e italiani, parte la caccia alle buone occasioni", in *Il Corriere della Sera* (CorrierEconomia), 5 October 2015, p. 16, http://confindustria.toscana.waypress.eu/RassegnaStampa/LetturaNL.aspx?dest=info@assindustria.lu.it&cod=052015SIM148610001.

and sea and land connections between China and the region,[15] in addition to the 69 cooperation projects between China and the CEECs already pledged after the second meeting in Romania in November 2013.[16]

4. China's monetary inroads

In parallel with the surge in Chinese investment, the People's Bank of China (PBOC) has fostered closer monetary links with European central banks. This has occurred mainly through currency swap agreements and the establishment of yuan bank clearing – so-called "offshore renminbi hubs." In October 2013, for instance, the PBOC and the European Central Bank (ECB) signed a bilateral currency swap agreement for a sum of 45 billion euros (RMB 350 billion), the largest ever signed by Beijing outside the region.[17]

Most of Europe's central banks have added – or are considering adding – the Chinese currency to their portfolio, often at the expense of the dollar, as growing trade ties and a growing number of reforms by Beijing are leading reserve managers to view it as a viable reserve currency.[18] In October 2014, for instance, the United Kingdom raised 3 billion yuan via a landmark offshore sovereign yuan bond and kept the proceeds in its foreign exchange reserves rather than converting them into dollars. According to the specialised press, in November 2014 the ECB discussed whether to add the Chinese yuan to its foreign currency reserves.[19]

The purpose of this strategy is three-fold: (i) anchoring market confidence in Beijing's reform commitment; (ii) bolstering the international use of the renminbi; (iii) strengthening the chances of the renminbi to be included in the IMF Special Drawing Rights (SDR) basket in the near future. As the One Belt, One Road initiative moves forward, it is becoming increasingly urgent for Beijing to increase the renminbi's share in trade financing, monetary transactions and foreign exchange reserves in order to facilitate Chinese outbound investment and lower transaction

[15] See the website of the Secretariat for Cooperation between China and CEECs, http://www.china-ceec.org/eng/belgrade.htm.

[16] See "Opinion Piece by Prime Minister of China Li Keqiang", in *Belgrade Meeting Brochure*, 2014, p. 5, http://www.china-ceec-summit.gov.rs/doc/CHINA%20SEE%20SUMMIT%20Belgrade%20Meeting%20brochure%202014.pdf.

[17] Alex Domanski, "China signs second-biggest swap line with ECB", in *Reuters*, 10 October 2013, http://reut.rs/1fllvoe.

[18] For more details on Renminbi trading hubs and the Renminbi Internationalisation Index (RII) – a figure that describes the Renminbi's usage proportion in global trade – see the latest report by Standard Chartered Global Research authored by Kelvin Lau et al., *Offshore Renminbi – Anchoring Confidence*, 7 October 2015, https://www.sc.com/en/resources/global-en/pdf/Research/2015/RGI-Oct-2015.pdf.

[19] Stefan Riecher and Jeff Black, "ECB Said to Weigh First Step to Buying Yuan for Reserves", in *Bloomberg Business*, 10 October 2014, http://bloom.bg/1Lq4p7W. See also Nicola Casarini, "China's Financial Footprint in Europe", in *ISN-Security Watch*, 13 March 2015, http://www.isn.ethz.ch/Digital-Library/Articles/Detail/?lng=en&id=188943.

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costs.

Beijing also wants to make the yuan one of the main currencies for global trade, putting limits on the role of the dollar in the international monetary system. To this end, the PBOC has signed bilateral currency swap agreements worth more than 3 trillion yuan (500 billion dollars) with more than 35 central banks and monetary authorities in the last years. Today, the renminbi is the world's second most used trade finance currency and the fourth most used currency for global payments, though its share by value remains low – just 2.8 percent in August according to Swift and the *Financial Times*.[20] On 8 October 2015, Beijing launched a cross-border renminbi payments system in a further drive to boost the international use of its currency.[21]

The PBOC has designated a number of yuan clearing banks, known as RMB Qualified Foreign Institutional Investors (RQFII), the majority of which are in Europe, in places like London, Frankfurt, Paris, Luxemburg, Prague and Zurich. During the state visit of Xi Jinping to the United Kingdom in October 2015, China chose London to issue its first overseas renminbi sovereign debt.[22] It is very likely that other European financial capitals will issue Chinese treasury bonds in renminbi in the coming months, spurring a race among EU members to become an attractive place for renminbi trading and services.

Growing Sino-European monetary ties largely explain the decision by the UK followed promptly by Germany, France and Italy, to join as founding members the Asian Infrastructure Investment Bank (AIIB), a China-led regional bank seen as a potential rival to the World Bank, despite US pressure to stay out. By joining the Chinese-initiated bank, Europe's four largest economies have not only acknowledged Beijing's emerging financial power, but also laid the ground for closer monetary connectivity with the country that could soon become the world's largest economy. In an op-ed published by *The Guardian* in September 2015, George Osborne and Jim O'Neill, respectively the UK Chancellor of the Exchequer and the Commercial Secretary to the Treasury, made it clear that "the future prosperity of [the UK] depends on us strengthening our relationship with the world's next superpower."[23] Yet, opening up Europe's doors to the "next superpower" may also have some serious political implications.

[20] Gabriel Wildau, "China takes big step in push for renminbi to rival dollar", in *Financial Times*, 9 October 2015, p. 3 (online as "China launch of renminbi payments system reflects Swift spying concerns", 8 October 2015, http://on.ft.com/1ZeGa2t).

[21] Ibid.

[22] James Kynge and George Parker, "China set to choose London for its first overseas renminbi sovereign debt issue", in *Financial Times*, 14 October 2015, p. 1 (online as "China poised to issue sovereign debt in renminbi in London", 13 October 2015, http://on.ft.com/1ZzYWBI).

[23] George Osborne and Jim O'Neill, "It's in Britain's interest to bond with China now", in *The Guardian*, 19 September 2015, http://gu.com/p/4ch2d/stw. See also Liam Byrne, *Turning to Face the East. How Britain Can Prosper in the Asian Century*, London, Guardian Books, 2013.

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5. Implications for the EU

While there are undoubtedly great economic opportunities, China's Belt and Road initiative – and its corollary of growing Sino-European monetary ties – also presents the EU with a major political challenge. There is the risk, in fact, that a scramble for Chinese money could further divide EU member states and make it difficult for Brussels to fashion a common position vis-à-vis Beijing. Furthermore, China's economic penetration into Europe may lead to a populist backlash and the fate of the port of Piraeus could be the first of such cases.

Given the harsh conditions demanded by its creditors, Greece may have no alternative but to proceed with the Piraeus privatisation. The EU is keen to push the sale through while China is lobbying hard to win the tender. A kind of *entente cordiale* could emerge between Brussels and Beijing over the transaction, an understanding that could be replicated elsewhere in the cash-strapped periphery where the two sides share an interest in supporting infrastructure projects. Imagine, however, that if COSCO wins the Piraeus tender, the port will be entirely in Chinese hands. That prospect may sharpen the view of China as a political and commercial threat to EU member states, particularly in Belgium, Germany and the Netherlands, whose big container ports will face a tough new competitor.

Some European critics worry that the OBOR lacks transparency rules and that the opaque financing deals may threaten the competitiveness of European companies. China requires, in fact, that infrastructure works financed by its soft loans be carried out by Chinese companies, as in the case of the Hungaro-Serbian high-speed railway or Terminal II of Piraeus. This raises the question of reciprocity. While Chinese companies find an open-door environment in Europe, it is quite difficult – if not impossible – for a European company to succeed in winning a contract to build infrastructure projects in mainland China.

The question of reciprocity is closely linked to what may be the thorniest issue in Sino-European relations: the market economy status (MES). A provision in China's WTO accession agreement that allows other countries to treat it as a non-market economy will expire in December 2016,[24] potentially requiring the EU to begin drafting new trade legislation by the end of this year. Granting Beijing MES would make it easier for Chinese companies targeted in WTO anti-dumping cases to defend themselves. While Beijing argues that MES should be extended automatically in December 2016 under the terms of its WTO accession agreement, some EU member states maintain that the agreement instead requires Chinese exporters to prove first that they do not benefit from government subsidies and currency policy.

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[24] Roberto Bendini and Barbara Barone, *Trade and economic relations with China 2015*, Brussels, European Parliament, June 2015, http://www.europarl.europa.eu/thinktank/en/document.html?reference=EXPO_IDA%282015%29549062.

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There are growing concerns in Europe that through the Belt and Road initiative, China seeks to tackle industrial overcapacity at home by dumping or exporting goods priced below production costs, risking thus to bring entire industrial lines across Europe to their knees. If the EU were to designate China as a "market economy," it would then be impossible for Brussels to strike back against unfair export practices with countervailing tariffs. There is growing resistance in Europe from manufacturing industries that see themselves as vulnerable, and the EU – together with the US – may be tempted to resist granting China "market economy status."

Finally, closer Sino-European ties may strain relations with the US. Beijing has traditionally looked at the euro as the only serious counterbalance to the dollar and, consequently, has come to support the eurozone politically while divesting away from the dollar and into the euro in earnest. Today, euro-denominated assets represent more than one-third of China's total foreign currency reserves which are the world's largest. Europe – and the United Kingdom in particular, but not only – is playing an important role in the internationalisation of the Chinese currency, a move that directly challenges the global status of the dollar. US policymakers are, therefore, watching closely to see whether the EU is able to strike a balance between the historic transatlantic bond and China's pull on Europe.

Greater Sino-European connectivity will inevitably entail some economic and political costs for Europe – and the same could be said for China. Yet, the One Belt, One Road remains, ultimately, a great opportunity for a continent that is still struggling to recover from the crisis. Beijing has faith in Europe's recovery, as demonstrated by the multibillion euro investment commitment from China to Juncker's newly created European Fund.

What is urgently needed in Europe is a comprehensive response to the Belt and Road initiative. The focus should not be limited to economy and trade, but also include political and security issues. For instance, the OBOR plans to go through the same routes used by the refugees fleeing the Syrian conflict and other war-torn societies. Given the significant funds already committed to infrastructural projects in Southeast Europe and the Eastern Mediterranean, the stability of these regions should be a matter of priority for China as well. The OBOR should thus compel Brussels and Beijing to seek ways to join forces and contribute to bringing stability and prosperity to Europe's neighbourhood without relinquishing, however, those norms and practices that Europe has long fostered. Should the two succeed in creating effective mechanisms and ad hoc projects to address some of the root causes of the refugee crisis, this would help foster a positive image of China – and contribute to mitigating the costs of the Belt and Road initiative for some sectors of the European economy.

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