

One Belt One Road: Building Asia on China's Strengths

Executive Summary

- OBOR is an ambitious development strategy that focuses on connectivity between China and Eurasia. It entails 6 land corridors and a maritime route (see **Figure 1**).
- OBOR has provoked two main strains of criticism: (1) *skepticism* about its commercial feasibility due to its massive scope, and (2) *unease* over OBOR's international ambition, which is taken as China's plan for global domination in the 21st century.
- In this paper, we attempt to answer both these criticisms, and conclude that OBOR is neither unfeasible, nor is it an attempt to establish Chinese hegemony.
- Skeptics claim that OBOR simply does not add up: its scope is far larger than available resources, and the project will not be able to solicit international funding. There is no credible master-plan.
- We argue that the skeptics miss three important points: (1) China has an enormous stake in making OBOR work, as its future growth strategy (and political stability) depends on its success; (2) OBOR is a long-term project, which will be implemented in a staggered manner; and (3) China's tried-and-tested (and unique) reform strategy rejects master-plans in favor of a more practical, heuristic approach. We show:
 - a) China must address its flagging growth momentum, as a severe economic downturn could threaten the Chinese establishment;
 - b) As the OECD weakens, China must look elsewhere for its growth engine (Asia); &
 - c) China must also develop its Western provinces, which have not prospered as much as coastal China.
- In our view, China will prioritize **Corridors 1 & 2**, namely CPEC and the route into Central Asia, Iran & Turkey. These have greater strategic value for China; are likely to face fewer impediments; and will directly impact the Western provinces. After showing results in these initial projects, China will more forcefully pursue the other corridors.
- Another insight that should deflect criticism, is the nature of China's own economic reforms since the 1980s. The scale and success of their *learning-by-doing* (or heuristic) approach to economic reforms, rejects blue-prints, relying instead on a gradual, piecemeal approach that seeks to balance the speed of reforms with social stability concerns.
- We then turn to those who view OBOR as an overture to global domination, with five points:
 1. China's recent history and global economic uncertainty, means it must prioritize pressing domestic concerns over global ambitions;
 2. Despite its international scope, OBOR is really about China itself. The rhetoric about reclaiming China's ancient past (Silk Road), is more a reflection of their preference for simple messages than an attempt to evoke a new "Chinese Empire" for the 21st century;
 3. OBOR's explicit focus on Asia undercuts its alleged desire for global influence;
 4. Given China's sheer size, any long-term plan will be construed as "global"; &
 5. China's strategy in the South China Sea is more an attempt to secure shipping lanes than to project its power.
- Finally, we turn to CPEC, which we believe is too important to be stalled by political squabbles and impediments. CPEC should also nudge Pakistan towards a *much-needed* industrial policy, which may be the solution to Pakistan's chronic economic under-performance.

Appendix 2 discusses how China, England and the US will fare in the next 25 years, in terms of projecting hard and soft-power on the global stage.

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Mushtaq Khan & Danish Hyder, August 12, 2016

*More than two millennia ago the diligent and courageous people of Eurasia explored and opened up several routes of trade and cultural exchanges...the Silk Road Spirit.... In the 21st century...it is all the more important for us to carry on the Silk Road Spirit in face of the weak recovery of the global economy, and complex international and regional situations.*¹

Observe calmly; secure our position; cope with affairs calmly; hide our capacities and bide our time; be good at maintaining a low profile; and never claim leadership. (Deng Xiaoping).

Given the scale and ambition of the One Belt One Road (OBOR) initiative, one cannot remain neutral in its assessment. This is especially true given China's economic transformation in the past three decades, and its very public commitment to OBOR. In our view, most of the global reaction to OBOR falls into one of two categories: those who think the project is simply not feasible (in terms of the resources needed and the timeline); and those who fear that OBOR is China's master-plan for global domination in the 21st century.

We disagree with both these views. In flushing out our argument, we will first address the skeptics by giving some context for OBOR as a solution to China's economic challenges, and some historical perspective to show that China is well-placed to undertake this ambitious project. We then address the concern that OBOR is China's plan for global domination. Finally, we touch upon what this discussion means for CPEC and Pakistan. **Appendix 2** is a slight digression, as it explains how dominant countries wield hard and soft-power, and how the global order could change in the next 25 years.

Introduction

The opening quote from the Chinese government captures much of what is compelling and initially confusing about the One Belt One Road (OBOR) initiative. The vision and scope are compelling: OBOR is a development strategy and framework that focuses on cooperation and connectivity between China and Eurasia, via an ambitious plan to re-establish the land and sea routes of the ancient Silk Road. This embodies the purpose of OBOR, which consists of the land-based *Silk Road Economic Belt* (SREB) and oceangoing *Maritime Silk Road* (MSR).

Focusing on the land-based routes, there are 6 proposed OBOR corridors (see **Figure 1**). In the grand scale of things, the plan involves more than 60 countries, representing a third of the world's total economy and over half the global population. In the short to medium run, OBOR aims to utilize China's economic capacity and accumulated capital for regional infrastructure development, to strengthen trade and people-to-people relations with ASEAN, Central Asia, the Sub-Continent and South East Asia. Most importantly, it aims at raising productivity in Western China to balance its economic development.

The Chinese government has synthesized the rationale for OBOR into 5 principles as shown in the table below.²

¹ "Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road", China's National Development & Reform Commission, March 2015.

² Ibid.

Policy coordination	Inter-governmental cooperation, macro-policy exchanges and communication channels to develop mutual political trust and cooperation.
Facilitate connectivity	Linking up unconnected road sections, and upgrading port infrastructure to deliver international transport facilitation. Priority will be given to the connectivity of energy infrastructure and the construction of cross-border optical cables and other communication networks.
Unimpeded trade	Improving investment and trade facilitation, enhancing customs cooperation, expanding trade areas, and developing modern cross-border e-commerce, will be the major thrust. Greater efforts would be made to eliminate investment barriers, expand mutual investment areas, & push cooperation within emerging industries.
Financial integration	Efforts will be made to build a currency stability system, establish the Asian Infrastructure Investment Bank (AIIB), and the BRICS New Development Bank. Financial integration is designed to strengthen the China-ASEAN Interbank Association and SCO Interbank Association, and encourage affiliated companies/financial institutions to issue RMB-denominated bonds in China.
People-to-people bonds	Students will be sent to each other's countries to promote jointly managed schools. The scale of tourism will be expanded by making it easier to apply for tourist visas in participating countries. The cooperation in science and technology will be increased, and think-tanks in <i>Belt and Road</i> countries will be encouraged to jointly conduct research and organize forums.

Slogans and condensed wisdom have been a popular way to communicate key political messages in recent Chinese history. In the case of OBOR, the Chinese President Xi Jinping stressed the goal of equality and shared economic growth, when he put forward the three *Nos*³:

1. No interference in the internal affairs of other nations;
2. [China] Does not seek to increase the so called “sphere of influence”; and
3. [China] Does not strive for hegemony or dominance.

It is instructive to note that the narrative of the new Silk Road does not focus on China's prominence in the ancient world, but rather the *material and cultural exchanges* between Eurasian civilizations. The authorities appear keen to market the potential prosperity fueled by cooperation on equal terms, rather than emphasizing China's past glory.

How OBOR is being perceived

A cursory reading of the OBOR plan, suggests towering ambition colored by historical references to the Silk Road. It outlines intent as well as some project details, but not enough to satisfy a reader who seeks to form a hard handle. Credible observers like McKinsey & Co., The Economist, and almost all global banks, have analyzed OBOR, with McKinsey comparing it to the post-WW2 Marshall Plan that rebuilt Japan and Western Europe. Most observers have also highlighted how this project targets countries that desperately need to upgrade their physical infrastructure. Having said this, foreign analysts list their broad concerns as follows:

1. The scale of the undertaking and the disconnect with available funding sources.⁴ There is a clear view that private sector funding will be required, which may be difficult to secure;

³ “Our Bulldozers Our Rules”, The Economist, July 2016.

⁴ In terms of funding required, various estimates exist. According to a report by PricewaterhouseCooper issued in 2015, Asia needs more than US\$ 5 trillion over the next five years for infrastructure development; more conservatively, the Asian Development Bank (ADB) estimates that infrastructure spending of US\$ 770 billion is required each year till 2020. McKinsey, on the other hand, estimates that OBOR will require \$ 2 or 3 trillion per year to bring Asian infrastructure to the levels that

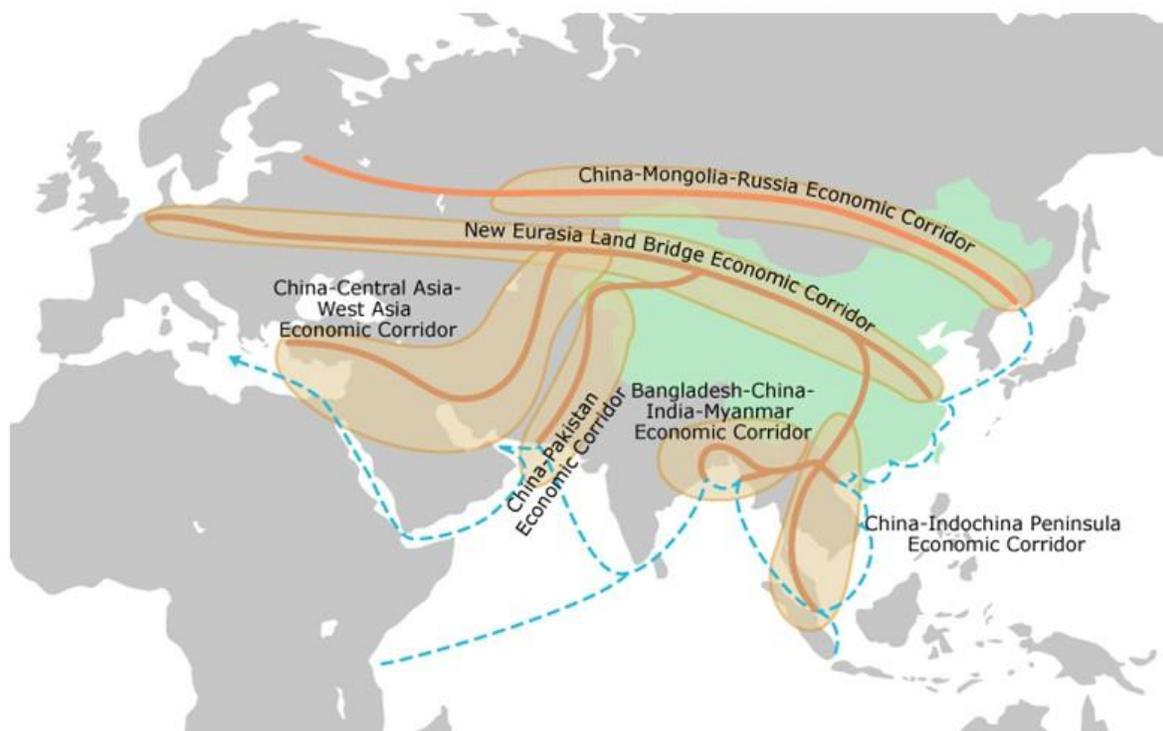
2. Issues of transparency and institutional credibility have been raised, which are required to attract global funding; and
3. The inherent risks in long-term infrastructure investments, especially when there are so many participating countries (some of which are not comfortable destinations for foreign capital). Specific concerns focus on financial/trade guarantees, regulatory reach and enforcement, and legal cover/recourse.

Hence, there is an overarching view that OBOR may not be commercially viable because of its scale and the sheer number of participating countries. Most analysts have used such concerns, colored by ancient Chinese values in its marketing, to conclude that OBOR is little more than foreign policy posturing by a newly empowered global player.

Looking specifically at CPEC, we find similar sentiments being aired by the press in Pakistan. For example, it is reported that GoP has not budgeted for its participation in CPEC; the stated timeline appears to be overly optimistic; there are growing concerns about the external debt sustainability of the project; there are provincial differences in terms of the precise routing of the various corridors of CPEC; and bureaucratic impediments are slowing progress. In effect, the stream of negative news has created some degree of pessimism about whether CPEC will ever materialize as envisaged.

Figure 1: OBOR's Reach in Asia and Europe

The Belt and Road Initiative: Six Economic Corridors Spanning Asia, Europe and Africa



We sympathize with these sentiments. Managing an interconnected web made up of heavy industry, energy, storage and transportation networks, which directly involves about 2 dozen countries, is an

currently exist in Eastern China. Having said this, China has stepped forward with funding commitments: \$ 890 billion for the China Development Bank; \$ 100 billion for the Asian Infrastructure Investment Bank (AIIB - Mckinsey); and \$ 40 billion for the Silk Route Fund. Though impressive, these amounts fall short of the required funding.

unprecedented international undertaking. For a project of this ambition, there can be no master-plan: accounting for an almost infinite number of variables in so many countries, till 2050, is simply impossible.

What China seeks to gain from OBOR

In trying to understand the policy motivation for OBOR, one should realize that China is desperate to maintain its growth momentum, especially given the uncertain global economic outlook. In our view, the challenges facing Chinese policymakers could be ranked according to the table shown below.

Goal	Explanation
1. Create new export markets	In view of slowing OECD growth and rising public sentiments against globalization/immigration, China perhaps realizes that the drivers of its past growth may no longer be in play. Hence, China seeks to cultivate new export markets that could substitute for traditional demand for Chinese goods. Africa and Central Asia represent frontier markets that have significant growth potential.
2. Use China's spare capacity	Building physical infrastructure like roads, railroads, ports, industrial cities, storage facilities and transport links, has been a key driver of China's economic growth in the past several decades. With the slowdown in these domestic investments (China has over-invested in infrastructure), its installed capacity to produce steel; cement; bulk chemicals and heavy machinery, is currently under-utilized. Building such infrastructure in neighbouring countries would be a convenient way to use its spare capacity.
3. Develop Western China	The Chinese government has often stressed the need for more balanced development, especially when it talks about the need to upgrade Western China. With the coastal areas largely saturated, three corridors that branch out of Western China should help balance out China's economic development. As shown in Figure 1 , Corridors 1, 2 and 3 are routed out of Western China.
4. Secure shipping lanes	As a major importer of oil and gas, China would want to secure transportation routes that are not vulnerable to the choke-point at the Malacca Straits. Hence, Corridors 1 and 2 have immense strategic value for China, not just for fuels and minerals, but also to access the Middle Eastern, Central Asian and African markets for Chinese exports.
5. Create goodwill with neighbouring countries	The project also entails establishing training institutes and schools, which should help create goodwill with neighbouring countries (this is an important avenue for a country to project soft-power – see Appendix 2).

The first 3 points focus on the need to maintain China's growth momentum, and also to ensure that Western China is developed. In some ways, China's development strategy is similar to Singapore's, where citizens are discouraged from becoming politically active in return for economic prosperity. In effect, if China's economic growth slows significantly, there are legitimate fears that this could spark social unrest, which could snowball into political instability (especially in the Western provinces).

While we would argue that China has little choice but to be ambitious (for its internal stability), we also make the case that the ambition can be overstated, unless one knows that OBOR is likely to be implemented in a staggered manner. Furthermore, we go so far as to argue that given China's own experience with economic reforms, it may not even *need* a detailed plan to start with.

In our view, China may not deliver all 6 corridors; it may not extend as far into the various directions as envisaged (see **Figure 1**); and it may not combine roads, railroads, and energy as currently planned. As we discuss later, we believe there may be a latent priority within the 6 OBOR corridors, with **Corridor 1 & 2** assigned top priority (see **Figure 1** and **Table 1** in **Appendix 1** for details). Taking a staggered approach makes sense, as it reduces the resources that have to be committed upfront, while the negotiations are likely to be less problematic (e.g. compared to **Corridors 5 & 6**). As shown in **Table 1**,

there are fewer participating countries in **Corridors 1 & 2** (Pakistan, Kazakhstan, Uzbekistan, Turkmenistan and Iran), which do not have particularly close ties with the US. Furthermore, **Corridors 1 & 2** have more direct strategic value for China compared to **Corridors 3 & 4** (see **Figure 1**).

This abridged version of OBOR, could be viewed as a medium-term effort to address economic underdevelopment in Western China, Central Asia, Pakistan and Iran. As **Corridors 1 & 2** specifically focus on industrial development, these countries could even adopt OBOR as a component of a more comprehensive Industrial Policy.⁵ This effort to create an industrial base with a trained labor force, should allow these countries to realize their economic potential by trading with each other. Once these have been realized, the Chinese are likely to use this experience, and the mutual gains for participating countries, to entice other countries to be more amenable towards OBOR. As discussed next, this heuristic approach to economic development is uniquely Chinese, and has been uniquely successful.⁶

China's approach to economic reforms

OBOR skeptics have unwittingly raised a more profound point about how China implements economic reforms. As touched upon earlier, the lack of a detailed master-plan is perhaps the very reason China has succeeded in becoming an economic superpower, while many other countries that were more developed than China in the 1970s, continue to struggle.

China's economic growth after the Tiananmen Square standoff in 1989, is an indication of how committed the Chinese government is to economic growth. To understand how China has diverged so significantly from the hardline ideology that was brutally imposed during the Cultural Revolution (1966-1976), one must consider the pivotal role of Deng Xiaoping (1904-1997) – see **Box 1**.

As the architect of China's economic clout, Deng Xiaoping embodies the Chinese commitment to economic reforms. In 1978, Deng challenged the Chinese to double the national economy by 2000, and make China a middle-income country by 2050. His practical approach to economic reforms defied all established models of economic development used by the international financial institutions (IFIs). It is ironic that the reform models promoted by the Washington Consensus, are far more ideologically-burdened, compared to the models adopted by Communist China.

In a paper about China's economic reforms⁷, Bo Qu summarizes three characteristics of economic reforms that China embarked on in 1978:

1. Economic reforms cannot be implemented according to a well-defined blueprint. The point is that reforms can never be minutely planned, as implementation challenges are often unpredictable and cannot be factored into a master-plan.⁸ Qu categorically states that experimentation is a fundamental part of Chinese reforms.
2. Reforms are primarily driven by specific problems encountered during the transition. This implies that implementation challenges will force planners to focus on solving these specific problems,

⁵ China's own experience transforming a backward communal agricultural economy into the world's manufacturing hub, and lifting an unprecedented number of people out of poverty (while creating a trained and disciplined labor force), should be invaluable guidance to these countries.

⁶ This customized approach to economic reforms (not for regular flows of subsidized debt, but for commercial returns on competitive global businesses), may be a more powerful incentive to adopt better business practices in participating countries.

⁷ Qu, Bo (2010), *Dynamic Engagement: China's Preference to the International Monetary Cooperation*, Woodrow Wilson School, Princeton University.

⁸ Quoting Barry Naughton, he states: "reform proceeds by a series of feedback loops – reforms begets further reform. A microeconomic reform (resulting in competition for state firms) creates a macroeconomic problem (a squeeze on government revenues), which impels further microeconomic reforms (more profit-oriented regulation of state firms)." *Growing out of the Plan: Chinese Economic reforms, 1978-1993, 1995*, Cambridge University Press.

instead of persisting with ideologically appealing, but ineffective, institutional arrangements. In effect, he states that Chinese policymakers keep tweaking their framework to create new interim targets, which are required for the end-goal to be realized. And

3. Chinese reforms are by design gradual and incremental. Hard timelines are unnecessary, and go against the spirit of reforms. Qu states that incremental reforms reduce adjustment costs, by keeping the balance between the speed of reforms and social stability.

In view of this approach, it is not surprising that despite starting as an under-developed agrarian economy in the late 1970s, China never approached the IFIs for policy advice or assistance with their economic reforms. They knew what had to be done, and figured out how to do it. The stark contrast between this approach to reforms, and Pakistan's IFI-sponsored structural reforms since the late 1980s, cannot go unnoticed. Pakistan has been working to fix its economy since the late 1980s, but many would argue that little has been achieved in this period.

Box 1: Deng Xiaoping

- Born in 1904 to a well-to-do landowning family;
- Joins the Chinese Communist Party in 1924, and studies in Moscow;
- Participates in the Long March (1934-35), a watershed moment for the CCP;
- CCP shifts away from Bolshevik influence and Mao takes charge;
- Deng Xiaoping rises in the ranks as the CCP battles the Japanese invasion in 1936, and endures WW2;
- Deng plays a pivotal role in the struggle against the Nationalists (Chiang Kai-Shek), and their eventual defeat in the mainland in 1949;
- Becomes the Mayor of Chongqing and continues to rise in the CCP; he is sent to Beijing in 1952. His focus on economic reforms raises eyebrows amongst hardline ideologues and Chairman Mao;
- Deng is purged in 1967 (as part of the Cultural Revolution), publicly humiliated and sent to work in a tractor factory job in Jiangxi Province;
- Brought back to Beijing in 1974 by Chou Enlai, but remains under a cloud;
- After Mao's death in 1976, Deng outmaneuvers Mao's chosen successor and consolidates power. Although Deng never holds the top job in the CCP, his influence is dominant during the period 1977-1989;
- Deng decentralizes economic power to provinces and initiates China's agrarian revolution (FRPS) in 1978;
- Is stripped of power in 1989 after the Tiananmen Square standoff between hardline ideologues and reformists;
- Undertakes the Southern Journey in 1992 as a retired *Elder*, by visiting the most dynamic coastal provinces of China. His speeches electrify the country and eventually gain support from the Politburo. Hardliners are replaced by reformists in the Politburo, and China embarks on 2 decades of focused economic growth;
- Deng Xiaoping dies in 1997. Known as the Paramount Leader, Deng has come to symbolize China's economic strength, and is emulated by the current Premier Xi Jinping.

Famous Quotes:

1. *No matter if it is a white cat or a black cat; as long as it can catch mice, it is a good cat.* On why appearances are less important than results.
2. How economic reforms are like: *crossing the river by groping stones.* This gradual, careful & adaptive path forward, is China's unique strategy of economic development that has been far more successful than other country efforts at structural reforms.
3. *Poverty is not socialism. To be rich is glorious. And Let some people get rich first.* From Deng's 1992 speeches to address public discontent that Coastal provinces were getting too prosperous.

The heuristic approach to economic reforms

The Family Production Responsibility System (FPRS), which was launched in 1978, is a good example of Chinese policy formulation and implementation. Before this, China only had communal farms with strict production quotas, where even meals were a group activity. The FPRS (which is still in force) allowed individual Chinese farmers to rent arable land from the government (there is no private property in China), in exchange for a specific quota of produce/crops, which was paid to the local government as rent. This simple idea where farmers were effectively permitted to sell *surplus* produce in village markets, was first tried in specific provinces (and with specific crops) in the 1970s. When positive results were realized, these experiments were replicated with different crops/produce, and then exported to other provinces of China till it became the FPRS in 1978. By 1984, 99 percent of total Chinese farm production had adopted this system. The scale of this change can only be appreciated when one realizes that China's rural population was about 800 to 850 million people at the time.

To implement this ambitious change, Deng Xiaoping had to overcome the resistance of Soviet-style central planners in order to give resource allocation powers to local governments. Naughton claims the agri experiments were initially conducted in secrecy to avoid complications with Beijing, and only after documented success, did Deng announce that these experiments should be replicated elsewhere⁹. By then, the proven success of this system was so well-known, that Beijing had little choice but to launch FPRS across the entire country. It is interesting to note, that Deng Xiaoping and the series of Chinese Premiers since, have had proven careers as provincial Governors in China (including Xi Jinping). This level of decentralization may surprise many who tend to view China's economy as being driven primarily by the central government.

Is OBOR an avenue for global domination?

There are significant foreign concerns about OBOR. China's territorial claims in the South China Sea, have soured relations with some Asian countries and the US, while India has formally stated its reservations about CPEC (specifically **Corridor 1**, claiming this corridor passes through Azad Kashmir, which India considers a disputed territory with Pakistan). More specifically, the ongoing tussle over the Paracel and Spratly Islands between China and Vietnam, Malaysia, Indonesia and the Philippines, implies that **Corridor 5** is also likely to be significantly delayed.¹⁰ **Corridor 6**, which ends in the Indian city of Kolkata (**Figure 1**), via Myanmar and Bangladesh, is also unlikely to be high priority as India is not too keen on the entire project.¹¹

If skeptics question the timeline and resources needed for all 6 corridors, while several corridors are actively being impeded, then why doesn't the Chinese government announce a more feasible subset (of OBOR) to gain international credibility? Perhaps the thinking behind not announcing a staggered

⁹ Ibid.

¹⁰ As the sole policeman of global shipping lanes, the US has sent military ships and supporting aircraft into the South China Sea, as part of its *freedom of navigation* operation, to show China that it has a say in the matter.

¹¹ Looking specifically at Pakistan, although the deep-sea port at Gwadar was first launched in 2007, it lay dormant for many years till it gained prominence (once more) as the anchor of CPEC. It is an unspoken, but widely shared view, that the US – in collaboration with India (and perhaps the UAE) – discouraged the launch of Gwadar as it would give China direct access to the Arabian Sea. As the US and India find common ground in containing China's influence in Asia, CPEC will not be welcomed, especially by India. This opposition was further reinforced when Gwadar's operations were leased to the China Overseas Port Holding Company in 2013, for a period of 50 years. The pace at which development at Gwadar is proceeding, strongly suggests that this component of CPEC is not as vulnerable to adverse foreign designs.

approach to OBOR, is to avoid awkwardness with lower priority countries, and to put forward a more *holistic* vision for continental Asia.¹²

Historical context

OBOR is not a direct challenge to US hegemony, although an element of political influence over participating countries is to be expected. More specifically, this project seeks to reclaim China's past, well before the Communist movement started. In this sense, it is important to put China's history into context: the nature of the upheaval by which Communist China came into existence, is unimaginable for most people. Modern China evolved from a large, scattered and subservient kingdom in the midst of a tense standoff between Imperialist Japan and the commercial interests of the British Empire in the 1920s – not soon after, China had to deal with the Second World War. It was only after the end of the War, that China achieved self-rule in 1949, but it was not recognized by the United Nations till 1971.

The fifty years it took the Chinese Communist Party (CCP) from forging an identity, to finally achieving international recognition, was largely done at the cost of rewriting China's own history. The *Great Leap Forward* that started in 1950, dismantled land-holdings (and landlords) and effectively set the clock back to zero, where social equality would cut across ethnic differences and socio-economic classes. The CCP effectively sought to erase China's history before the revolution, and its means of doing so were harsh. This was followed by the regressive and brutal *Cultural Revolution* in 1966, as a hardline response to the market-friendly policies that Deng and Premier Liu Shaoqi were experimenting with, which had started gaining traction with the people. Mao's *Red Book* was a very public symbol of the ideological purity he imposed, and was accompanied by state warnings to be suspicious of intellectuals and foreigners. This repression only ended with the death of Chairman Mao in 1976, and the Cultural Revolution was officially repudiated by the Chinese government when Deng replaced Mao. The subsequent focus on economic reform and growth during the 1980s, was instrumental in soothing the social turmoil created by the Cultural Revolution.

With China re-committing to economic reforms as recently as 1992 (after Deng's Southern Journey Tour), a series of subsequent events have shaken confidence in the global economy. We had the Great Recession of 2007/2008 (from which most of the OECD has barely recovered); the EU debt crisis in Greece and to a lesser extent, Portugal and Spain; the growing income inequality and dysfunctional monetary policies in the West; and the Brexit decision that could prove to be an existential threat to the European Union. As discussed earlier, in this period of uncertainty, China is trying to find its moorings to ensure that its economic momentum does not slow to levels that could be politically damaging. At a time like this, China is hardly in a position to launch a strategy of global domination.

Despite its name, OBOR is really about China

As discussed earlier, OBOR is primarily an economic policy for the 21st century. Although it does seek to integrate with countries to the west, the real motivation is to balance its own economic development and find an alternative engine of growth (beyond the OECD). This may appear to be a tall order, but as Deng stated *market socialism* is not a contradiction in terms. The tone that China has used to market OBOR, is driven by its own experience (simple slogans and goals) and has been crafted for a domestic audience (not global).

¹² Or, it could be a calculated move, whereby Chinese planners are pushing OBOR's towering ambitions to make it appear to be commercially unviable, so it is not taken as a *real* challenge to the global status quo. In our view, a more strategic and focused (and fully funded) plan for **Corridor 1 & 2**, would surely attract greater suspicion from the US and India, compared to the dismissive assessment that currently prevails.

If OBOR is global, then why the Asian focus?

If OBOR is China's muscular foreign policy for the 21st century, its specific focus on the Asian continent appears misplaced. We acknowledge that Central Asia has strong economic potential and is a source of energy security for China, but Latin America and Africa are also growth centers that could be cultivated into important trading partners for China. Since OBOR is likely to play out during this entire century, omitting such large continents certainly does not point towards creating a global presence.

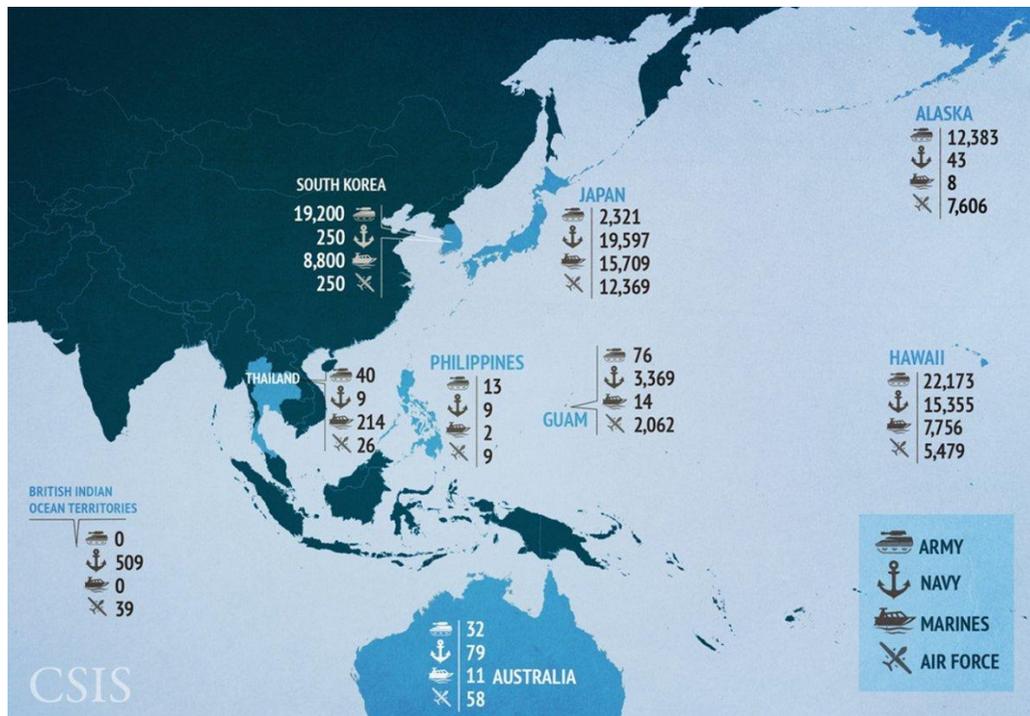
Size matters

A point that needs to be considered is China's size. As the most populous country on the planet, with the 3rd largest landmass after Russia and Antarctica, and the second largest economy in the world, any strategy it announces – especially a very long-term vision – is, by default, going to be on a “global” scale. Even if China's intentions are strictly regional, the scale of the undertaking will always trigger concerns that this is a global play. This simple fact is often overlooked.

Security also matters

In our view, China's posturing in the South China Sea, is perhaps the most obvious indication that China is taking on a more aggressive role in the global order. The building of new islands and the growing reach of its territorial claims, has been resisted by the US and a host of South East Asian countries. For a country trying to downplay the view that it seeks to challenge the US for global domination (and to avoid an accidental military exchange), China's strategy in Asia-Pacific is surprising.

Figure 2: US Military Presence in Asia-Pacific



China's ambition appears less threatening upon closer inspection. As shown in **Figure 2**¹³, the Asia-Pacific region has a significant US military presence, which China is viewing with growing concern. US military bases in Japan and South Korea, can be justified from the days of the Cold War, but the presence in the Philippines, Thailand and the Indian Ocean, could directly impact shipping lanes (especially the Malacca Straits). Since China's hard-power comes from its trade flows¹⁴, it is clearly concerned that a stand-off with the US could easily strangle its domestic economy. One must realize that China will confront the US in global issues more frequently, as it tries to protect its sphere of influence. Since China's ability to bargain with the US will be weakened if its trade flows remain vulnerable, its foreign policy in the South China Sea can be viewed as a defensive strategy to protect its own interests.¹⁵

What does this mean for CPEC and Pakistan?

In recent months, local media coverage of CPEC has become increasingly negative. Although most Pakistanis have already bought into the massive upside for the country and its economy, the news stream is now dominated by stories of delays; differences amongst the provincial governments; the priority attached to the various routes; and bureaucratic impediments to construction.¹⁶ In our view, these impediments will continue to hamper CPEC, but this should not dampen expectations that this project will become a reality.

In fact, we would list the following points to help Pakistanis manage their expectations about CPEC.

1. Given the complexity and scope of OBOR, and China's unique approach to project management, there is no master-plan that can be used to gauge whether this project (or a subset like CPEC) is on schedule. Having said this, China could not launch OBOR with only a vision. Hence, it needed a reasonably well-articulated plan broken down by stages; timelines; locational priorities; project specifics; financial details and participating companies. It's almost irrelevant whether this plan is credible. The point to make, is that CPEC's master-plan is only *suggestive*, and will change and evolve depending on a host of factors. As discussed before, CPEC will be implemented in a heuristic manner – participants from China and Pakistan will learn and adapt as they proceed.
2. Negotiations with the GoP and provincial governments are inherently complicated, as regional politics in Pakistan are divisive, and volatile. This will surely generate negative news.
3. The focus on Gwadar and Baluchistan will be opposed by foreign interests, and complicated by Baluchistan's past treatment by the federal government. This will also create negative news.
4. As suggested earlier, the Gwadar-Kashgar corridor along Pakistan's western border is of primary importance to China (see **Figure 3**). Gwadar Port has already been leased to a Chinese company, and significant construction activity is visible in the port city. In our view, this route will continue uninterrupted, in collaboration with the oversight and protection of the Pakistan Army, which has championed CPEC from the start. If politicians, regional power-players and government institutions continue to hinder CPEC, we could end up with *CPEC-lite*, which is a fully-functional Gwadar-

¹³ This map shows US military presence in terms of the US military, navy, marines and the USAF. Source: Center for Strategic & International Studies.

¹⁴ See Appendix 2.

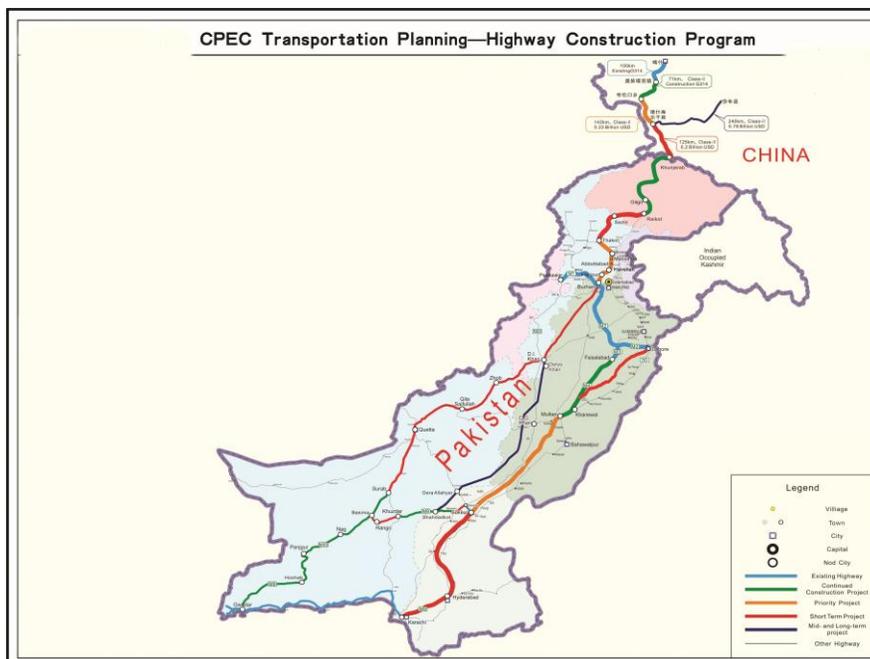
¹⁵ Such concerns are exacerbated by the political debate leading up to the US elections. Donald Trump has repeatedly criticized Chinese currency management and unfair trade practices, as a key source of US weakness. These issues will surely become more heated in the next few months, which implies that US trade relations with China will remain on the policy agenda even if Hillary Clinton does become the next US President.

¹⁶ In mid-July 2016, there was a front-page article that summarized the growing frustration of the Chinese government over bureaucratic delays in the implementation of CPEC. The article highlighted the Chinese suggestion that GoP should create a separate CPEC-Ministry that has the authority to handle all CPEC related issues in an expeditious manner.

Kashgar corridor, but with limited spillover to the rest of Pakistan's economy. In effect, China would gain, but Pakistan would only get a limited upside (e.g. transit charges). And

5. As stated earlier, CPEC's focus on physical infrastructure; energy; transportation networks; industrial cities and vocational training for local labor, could usher in a much-needed Industrial Policy into Pakistan. The structural reform programs that Pakistan has been involved with since the late 1980s, have intentionally excluded this policy option.¹⁷ However, for a country of Pakistan's size with significant unemployment; an uneducated and unskilled labor force; and poor and deteriorating social indicators,... industrial development has an economic *and* social dimension.¹⁸

Figure 3: CPEC Routes



Conclusion

The scope and ambition of OBOR cannot be denied. What is being questioned is whether this project will materialize as expected, and whether this is Chinese domination being rolled-out. Questions are being raised about OBOR's commercial viability; the potential indebtedness of participating countries; the timeline; and whether some participating countries are even interested. Then there is the political turmoil in Europe and the US, which is likely to focus attention on how China will react.

In our view, the developments in Western Europe and the US may inadvertently assist OBOR. With opinion-makers still grappling with the Brexit decision; the increasing frequency of ISIS attacks in Europe; and the tone of the debate that will shape the forthcoming US elections, Asian countries may

¹⁷ It is somewhat interesting to note, that only China actively implemented an Industrial Policy as it shifted away from a command-and-control economy. Unlike most other countries that transitioned away from Communism in the early 1990s, only China did not follow the policy advice of the World Bank or the International Monetary Fund. Some would argue, China's economic success compared to other developing countries, is an indictment of the role of these IFIs.

¹⁸ In our view, Pakistan desperately needs an Industrial Policy, even if this means the government must take an active role in shaping the country's industrial development.

decide that taking a bet on China makes more sense.¹⁹ If European political power shifts towards the right (as indications from France and Germany reveal), the EU faces an existential crisis. Even if Hillary Clinton wins the US elections, the issues that have surfaced in American politics will not be easy to contend with. Public sentiments in the US may not allow the country to maintain the same level of hard-power as it has been projecting since the end of WW2. The power dynamics between the US and China, could evolve as shown in **Figure 4** in **Appendix 2**.

With this backdrop, OBOR appears timely and sets the right direction for Asia.²⁰ As stated earlier, one should not evaluate this vision on project details – this time around, the devil is not in the details. The logic for OBOR is sound if one views the project as a means to develop the Western provinces of China, by integrating them with neighboring countries in Central Asia, Iran and Pakistan.

With hard and soft-power shifting towards Asia (see **Appendix 2**), Pakistan is likely to be a passive beneficiary. Although the divisive nature of Pakistani politics has not been able to put forward a credible partner for CPEC, the key components of this project are proceeding quite smoothly under the public radar. The Pakistan Army's outspoken support for CPEC is to be expected, given its long-standing ties with the People's Liberation Army.²¹ Given the strategic importance of the Gwadar-Kashgar corridor, this component of CPEC will surely be completed as planned.

The issue boils down to whether Pakistan's political leadership can overcome personal and provincial interests (and differences), to reach for the unique opportunity that CPEC provides. The creation of a commercially viable transportation network in under-developed parts of the country; the resolution of the stubborn energy deficiency; and the formulation of a comprehensive Industrial Policy, will surely overshadow the results achieved by decades of half-hearted structural reforms.

¹⁹ Making this decision easier for foreign stakeholders, is the blunt rhetoric coming from Donald Trump, who has openly questioned whether the US has the moral authority to police the world. Trump's obvious commitment to look inward (*America First*) and his acceptance of strong leaders who are willing to defy global treaties/sentiments (and his popularity with disenfranchised Americans), could be viewed as an indication that the US is no longer willing (or able) to take the lead in shaping global events. With Western Europe becoming more introverted, the resulting vacuum will surely embolden Russia and China.

²⁰ OBOR is relevant not just for China's economic growth, but also for Central Asia, Pakistan, Iran, and the less developed countries of South East Asia. The language used to market OBOR stands in stark contrast with the era of Anglo-Saxon colonialism that only ended in the mid-20th century. Furthermore, by targeting under-developed Asian countries with a softer (mutually beneficial) strategy of economic development, China may be on the right side of history.

²¹ In our view, the events in Abbottabad (May 2011) and Salala (November 2011) have further cemented this relationship.

Appendix 1: Details of the 6 Corridors in OBOR

Name of Route	Details	Status
Corridor 1 (China-Pakistan Economic Corridor)	<ul style="list-style-type: none"> • Linking Kashgar in Xinjiang province, with the deep-sea port of Gwadar. • This corridor will give China direct access to the Arabian Sea, bypassing the Straits of Malacca. • The CPEC agreement is worth approximately US\$ 46 billion, covering energy, industrial zones and transport/storage infrastructure. 	Partial
Corridor 2 (China-Central Asia-West Asia Economic Corridor)	<ul style="list-style-type: none"> • This will be a gateway for oil and gas, joining Xinjiang (China) to the Arabian Peninsula, Turkey and Iran. • The existing China-Central Asia gas pipeline is the world's longest, which starts at the border of Turkmenistan and Uzbekistan, runs through Uzbekistan and southern Kazakhstan, and ends at Horgos in Xinjiang. • From Horgos it will be connected to China's second West-East gas pipeline, which is under construction. • China has proposed a comprehensive cooperation strategy with Middle Eastern countries (known as the "1+2+3" strategy) of which energy, including nuclear energy and renewable energy, is a core element, alongside cooperation in infrastructure construction, aerospace technology and trade and investment. Participating countries aim to treble bilateral trade in the next decade and push forward the China-GCC Free Trade Agreement. 	Partial
Corridor 3 (New Eurasian Land Bridge)	<ul style="list-style-type: none"> • Runs from the port of Lianyungang in Jiangsu province, to Rotterdam in Western Europe. It is expected to become a major logistics passageway from China to Europe. • Faster than existing shipping lanes and cheaper than air routes, this corridor crosses seven provinces in China and operates on 3 existing railroads. • An international freight train from Lianyungang (in Jiangsu) to Kazakhstan (via Xinjiang) became operational in February 2015. 	Partial
Corridor 4 (China-Mongolia-Russia Economic Corridor)	<ul style="list-style-type: none"> • Involves high-speed rail and road links, and is divided into two lines: Beijing/Tianjin/Hebei to Russia (via Hohhot, Inner Mongolia) and Dalian to Chita in Russia (via Shenyang, Changchun, Harbin, and Inner Mongolia). International freight trains are already operating on this route. • This corridor fits not only with China's OBOR initiative, but also with Russia's Transcontinental Rail Plan. • In May 2015, President Xi Jinping signed a series of infrastructure agreements worth US\$25 billion with Belarus, Russia and Kazakhstan, on high-speed rail, energy infrastructure, aerospace, as well as industrial parks. 	Partial

<p>Corridor 5 (China-Indochina Peninsula Economic Corridor)</p>	<ul style="list-style-type: none"> • Will link the Pearl River Delta (near Guangzhou, Hong Kong and Shenzhen) with the South-East Asian countries of Cambodia, Laos, Myanmar, Thailand and Vietnam. • New high-speed railways and motorways will run from the Pearl River Delta in South China, to Singapore via Nanning in Guangxi Province and Hanoi in Vietnam (see Figure 1). 	<p>Planning Stage</p>
<p>Corridor 6 (Bangladesh-China-India-Myanmar Economic Corridor)</p>	<ul style="list-style-type: none"> • Will connect China with South Asia. China sees India as an important partner for integration with Western Asia and beyond. • A cooperative mechanism has been set up for the development of this corridor, and railway construction, industrial cooperation and professional training services are expected to be pursued. • During the visit to China by Indian Prime Minister Modi in May 2015, the two sides signed agreements worth more than US\$22 billion covering telecoms, steel, solar energy and film. It should be noted that most of this is for Chinese investment in India, not directly connected to the corridor's development. 	<p>Planning Stage</p>
<p>Maritime Silk Road</p>	<ul style="list-style-type: none"> • The Maritime Silk Road will link China's east Coast with the African coast, pushing up through the Suez Canal into the Mediterranean. 	<p>Enhance existing traffic</p>

Appendix 2: Soft & Hard-Power

China's rise in recent decades has raised concerns that it seeks to challenge the US in the global order. Such discussions inevitably focus on the hard and soft-power wielded by these countries beyond their borders; therefore OBOR should be analyzed within this context. To get a better handle on these concepts, some basic definitions are helpful.

Hard-power

Broadly speaking, hard-power comes from existing assets or the ability to deploy resources (by a country) to specifically influence other countries, with a *material* bottom-line.²² More simply, this could be viewed as foreign policy that relies on credible threats, to secure material concessions from another country. This is not limited to a bilateral interface: the acting country could use its economic clout with a coalition of like-minded countries, to isolate and/or impose economic sanctions against a target country to secure specific concessions.

One could therefore view hard-power as being either militaristic and/or economic in nature, where the latter is needed to create the former. From a historical perspective, we could also categorize economic power as internally and externally generated. More simply, economic power is internally generated on the basis of strong and consistent economic growth, which generates sufficient wealth to create military power, and global corporate reach. Externally generated economic power, on the other hand, is gained by exploiting resources (and manpower) from other countries. As examples, we could cite:

- Internally generated economic power:
 - US between 1940 to 1970, and during the internet age;
 - China between 1980 to 2015;
 - Japan between 1960 to 1980;
 - Singapore from 1990 to 2010.
- Externally generated economic power:
 - The use of African slaves by the US and European powers from the 15th to the 19th century;
 - US during the 19th and 20th century, when private companies like the United Fruit Company dominated a number of countries in Latin America;
 - England during the 18th and 19th century via the East India Company;
 - The Dutch during the 18th and 19th century via the Dutch East India Company in Indo-China;
 - The US, UK, and Dutch as they exploited the oil wealth of Iran, Middle East, Venezuela, & the East Indies till the 1960s/70s; &
 - Spain and Portugal during the 16th and 17th century via the New World.

Examples of using military (naval) power to extract economic concessions are far too many to list, but some insightful examples are as follows:

1. The US used its Black Ships in the mid-19th century, to intimidate Japan into ending its self-imposed isolation and begin trading with the US;
2. France used its Tonkin Flotilla (a group of Gunships) off the coast of Vietnam in 1883, to signal to China that this was its sphere of influence. This triggered the Sino-French War of 1886;
3. The First Opium War (1839-42) took place when China's Emperor refused to legalize and tax opium, and confiscated a shipment that was sent into China by the British East India Company.

²² Nye, Joseph, Bound to Lead: The Changing Nature of American Power (1990), Basic Books, New York.

Britain retaliated with its Gunships and achieved a quick victory; as compensation, China ceded the Island of Hong Kong to England till 1997;

4. The US organized a show of gunship strength when it sent the Great White Fleet around the world (from December 1907 to February 1909), as a brazen show of US naval strength; &
5. As recently as 1961, England sent its armed forces to the coast of Kuwait, as a sign of strength to deter Iraq, which had announced territorial claims on Kuwait after it was granted independence.

Soft-power

This is harder to get a handle on, but as shown by the absolute dominance of US soft-power in the 20th century, it is critical to appreciate this more modern form of global influence. We would categorize soft-power as either economic or social.

Economic soft-power refers to the lure that certain countries hold for the younger generation and/or those who are frustrated at home, to emigrate (say to the US, Canada or Australia) to avail opportunities and facilities not available in their countries. This lure has many dimensions: ambitious youngsters are attracted by the world's best universities; others crave an environment that allows for innovation and rewards merit; some are simply seeking a more tolerant society; etc. The end goal of soft *economic* power is that the world's best and brightest target these countries to enhance their own economic standing. Perhaps the best example of this is the pursuit of the *American Dream*.²³

Social soft-power is even harder to get a handle on. Hence, we will use examples (primarily from the US) to convey a sense of this kind of influence. The defining characteristic of soft social power is that it is *not* for material gain, and it is *not* coercive. When people are under the influence of such soft power (and this is relevant only for foreigners), this can be characterized as aspirational pull, involving emotional attachment and emulation.

In our view, the ingredients or avenues in which this soft-power plays out, could be listed as follows:

- Culture: which includes movies; television; music; iconic consumer products; top-rated universities; innovative spirit; literature, art and the lifestyle that focusses on sports & fitness.
- Socio-political values: which includes democracy; freedom of speech; unfettered Internet access; judicial recourse that is independent of economic means; Human Rights and Chapter 11. And
- Attitude towards the World: The soft-corner for the US could be captured by symbols like the Statue of Liberty; institutions like the Peace Corp; or the successful integration of diverse cultures (e.g. the Melting Pot of the World).²⁴

Figure 4 is a stylized representation of how dominant countries project soft and hard-power – it is done on a continuum from 0 to 1, with 0 representing no power and 1 representing maximum power in a global (but relative) scale. We start the assessment in the 1960s (a four or five year window around 1960), and extend to the 2040s. The point is to show how China's growing hard-power (especially economic

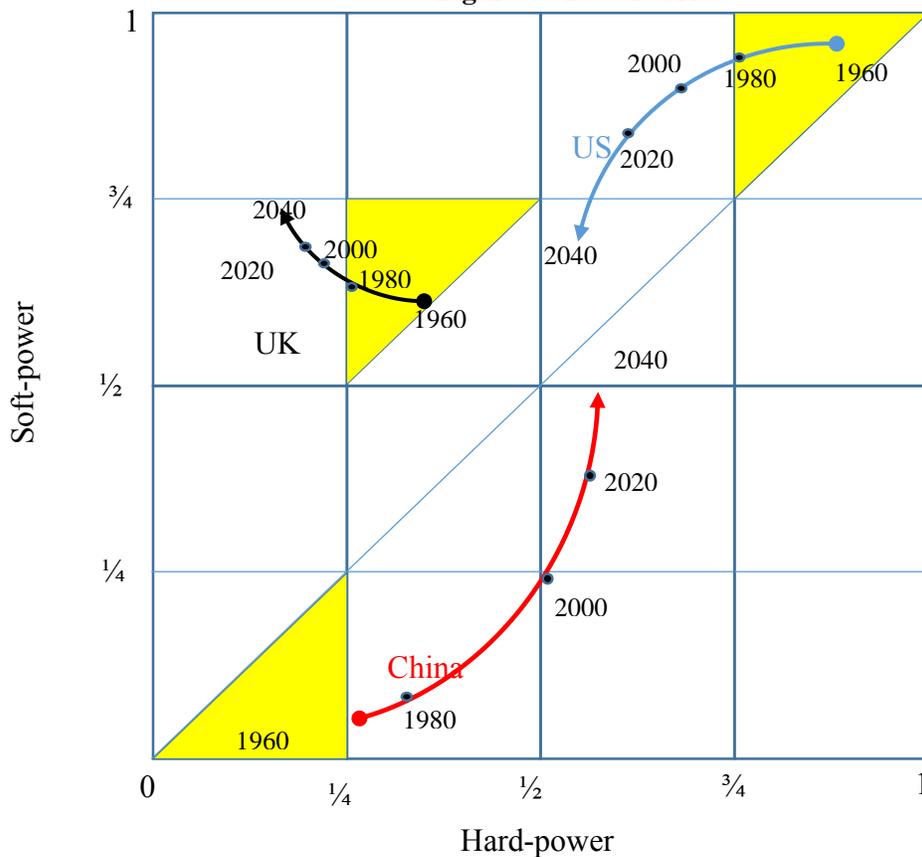
²³ By attracting the world's best minds, the US has gained significant economic power (both soft and hard). Born outside the US but now American citizens, Sergey Brin, Sundar Pichai (Google); Satya Nadella (Microsoft); Elon Musk (Tesla); Jan Koum (WhatsApp); Vinad Dham (Pentium processor); Andy Grove (Intel); and Jerry Yang (Yahoo), have effectively revolutionized the US and global economy in the 21st century.

²⁴ In our view, despite the immense value attached to cultural issues, most people are able to make a sharp distinction between their strong cultural attachment (to the US) and growing reservations about US foreign policy, or the dynamics of American society. This is especially topical nowadays, as the US struggles with racism, religion and immigration, which will play out in the forthcoming Presidential elections in November.

power), has also created a softer image, which means that China has gained soft-power, perhaps at the expense of the US.

- 1960s: The US is shown to have more soft power than hard, but dominates by being in the top quartile of both soft and hard-power. China in the 1960s is a closed economy struggling to transition to a hardline Communist state – it is largely inconsequential from the perspective of global power. However, one must realize that the People’s Liberation Army, was still a force to be reckoned with, as shown by the Korean War. We also show England in 1960s (**Figure 2**), where its soft power is more dominant than its economic /military might, which had been largely neutralized by WW2.
- 1980s: The US experiences a failed intervention in Vietnam, and also loses a key ally following the 1979 Iranian Revolution. Compared to the 1960s, the US loses some hard-power, and this dents its ability to project soft-power. China, on the other hand, shifts towards *market socialism*, and begins to generate hard economic power as it opens up to foreign investment. England continues to weaken in its ability to project hard-power (economic and military), but its soft-power gradually increases with its cultural sophistication.

Figure 4: Power-Grid



- 2000s: We include 9/11 and the period before the Iraq War in 2003. Although the spread of the Internet does boost US soft-power significantly, anti-Iraq War sentiment around the world undermines the US’s ability to project soft-power. On the other hand, China’s unprecedented economic growth attracts global attention and its growing external surpluses create significant wealth. With investors flocking to China, this improves how it is perceived by the global audience. In relative terms, England continues to lose hard power, but as London becomes the financial and cultural capital of the world, its soft-power increases.

- **2020s:** China's breakneck growth slows, but in relative terms, it is still gaining hard-power faster than any other country in the world. OBOR is launched; global brands target the Chinese (Asian) market, which further promotes China's global image gaining it more soft-power.²⁵ The US, on the other hand, is struggling with a disgruntled electorate that is divided on race, religion, immigrants; the haves and have-nots; and the dwindling number of people who have the keys to unlock the American Dream. We assume the US government becomes more focused on domestic challenges, at the direct expense of projecting its hard-power globally. Although the US remains the most powerful and influential country in the world, its lead in both hard and soft-power continues to wane. The UK (post-Brexit) retains its status as the global hub for finance, and seeks to become the global capital for film; culture and the arts. We also assume that the EU ceases to exist.
- **2040s:** We assume a degree of introversion has crept into US policies by this time, as domestic challenges with income distribution; race relations; cautious consumer spending; and a fragile fiscal position, create public pressure to force US leadership to reconsider its global presence (see **Figure 2**). China, on the other hand, successfully implements **Corridors 1 & 2**, which create deep economic and social ties with Pakistan, Iran and Central Asia – it also starts making headway with the other corridors. China's economic clout continues to soften its image, but its soft-power is still lower than the US, even though American soft-power (in 2040) is not what it used to be. London continues to build its status as the global capital of the world.

This far-reaching assessment based on current global dynamics, suggests that US dominance in soft-power is being lost, primarily because it is losing moral authority vis-à-vis its foreign policy and its socio-political challenges. US cultural exports remain strong, but as hard economic power keeps shifting to Asia, American cultural focus will also shift towards Asia. This will increase Asian soft-power at the direct expense of the US.²⁶ Having said this, China will not be able to enjoy its gradual ascendancy without effort: it will have to aggressively adapt to English (the undisputed global language); gear up its schools/universities accordingly, create more freedom for civil society; maintain its non-interventionist foreign policy; and soften the face of its political establishment.

To continue to build soft-power, China will also have to show that its foreign policy towards participating OBOR countries, remains above-board with no implicit agenda to unfairly advantage China. Perhaps this is already in play, as revealed by the three *Nos* that characterize the Chinese government's marketing of OBOR. Whether this is an intentional effort to show that China's overseas ambitions will not follow in the footsteps of colonial Europe, remains to be seen. In our view, OBOR's focus on two-way trade and person-to-person contact, suggests that China wants its neighboring countries to gain from this project, just as it hopes that Western China will integrate more fully with Eastern China.

If China is able to implement **Corridors 1 & 2** in the next several decades, and allow the benefits to filter down to residents in less developed towns and cities, it could define a new form of soft-power – a face-to-face relationship that creates mutual dependency and trust, at an individual level.

Image Sources: research.hktdc.com, amti.csis.org, www.mappk.com

²⁵ Business and news channels like CNN and BBC World specifically focus on Asia, and the resulting ads that focus on this region, have started shaping a narrative about Asian commercial success and its attractiveness to Western investors. In our view, this has created a soft and alluring image of Asia. In effect, by achieving a significant amount of economic hard-power, China has also cultivated media-based soft-power.

²⁶ More specifically, Hollywood and popular cable TV networks will either find themselves partially owned by Asian entities, or they will have to tailor their products to suit Asian tastes. This is already beginning to happen.